Corporate Market Responsibility for Orderly Financial Markets

Systemic Risk and Regulation following Citigroup, Sovereign Funds, and the Credit Crunch

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Abstract

How are companies responsible for helping to ensure orderly financial markets? In economic theory, the question is redundant, because orderly markets result from normal business activity, with support from regulators. Within the last few years, however, several episodes have suggested differently. Citigroup investment bank was fined for destabilising bond markets, despite being absolved of criminal conduct. Sovereign wealth funds were compelled to sign a code-of-conduct, to safeguard "free and open markets", despite having brought economic benefits globally. The US and UK governments described the most profitable financial decade in generations as an "age of irresponsibility", after it led to a crisis. These three episodes are the empirical focus of this thesis.

The thesis develops a grounded theory of corporate market responsibility (CMR) – an expectation by regulators and other actors that firms will help to regulate systemic risk in financial markets through discretionary activities that supplement regulatory requirements. This expectation explains the controversies, and may help us to anticipate and understand similar episodes in future. Further, it is argued that observing CMR conduct – which relates to risk management, investment policy, and proactive improvement – decreases regulatory risk for financial firms, while not observing it increases regulatory risk. The primary reason for this is that CMR conduct is perceived to reduce systemic risk, and state actors regard market governance as a shared responsibility with firms.

In addition to framing these controversies, CMR theory contributes to our understanding of several concepts in decentralised governance and regulatory capitalism. It illustrates a substantive model of meta-regulation – that is, the regulation of corporate self-regulation. As such, it illustrates substantive limits for private authority and its legitimacy. The observation of CMR also reveals new dimensions of sociological processes in financial governance, particularly markets' social embeddedness, and actors' reliance on performative market models. Finally, CMR illustrates a governance model combining incentives with ethics, as regulators seek to de-legitimise regulatory arbitrage by firms. The analysis concludes by arguing that CMR is increasingly relevant for other substantive contexts such as the hedge funds industry and private markets like 'dark pools'.

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My daughter Maia played not a small part. Her preference for pragmatism over reverie was a frequent inspiration.

A note of distinction is reserved for my parents, to whom this thesis is dedicated. My mother gave me many options and encouragement throughout my education, and her practical support was extensive. My father nurtured my lucidity and empathy, and gave me existential guidelines that I use daily and spontaneously. He also turned me, as it happens, to the critique of markets many years ago.

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List of Abbreviations

BaFin	Bundesanstalt Finanzdienstleistungsaufsicht
BIS	Bank for International Settlements
BOE	Bank of England
CMR	Corporate market responsibility
CMVM	Comissão do Mercado de Valores Mobiliários
Consob	Commissione Nazionale per le Società e la Borsa
DT	*The Daily Telegraph*
EC	European Commission
FCIC	Financial Crisis Inquiry Commission
FED	US Federal Reserve
FSA	Financial Services Authority
FT	*Financial Times*
GAPP	Generally Accepted Principles and Practices
GU	*The Guardian* / Guardian Unlimited
IMF	International Monetary Fund
MTS	Mercato dei Titolo di Stati
NYT	*The New York Times*
SEC	Securities and Exchange Commission
SWF	Sovereign wealth fund
TE	*The Economist*
TT	*The Times*
UKP	UK Parliament
UKT	UK Treasury
USC	US Congress
UST	US Treasury
WP	*The Washington Post*
WSJ	*The Wall Street Journal*

"What I'm saying to you is, yes, I've found a flaw. I don't know how significant or permanent it is. But I've been very distressed by that fact.

"Waxman: You found a flaw in the reality --

"Greenspan: Flaw in the model that I perceived as the critical functioning structure that defines how the world works, so to speak."

Alan Greenspan, former Chairman of the Federal Reserve (1987-2006), testifying to the US Congress in 2008

Chapter 1: Discovering 'corporate market responsibility'

1.1. Research question

Since the 1980s, we have frequently heard the message "greed is good", with the rationale that greed drives efficient markets, which drive economic growth.[1] This particular message has, in recent years, lost its ironic charm. Since the onset of the financial crisis in 2007, it has become more common to hear that greed is "irresponsible". The British Prime Minister told the United Nations in September 2008 that the world had lived through an "age of irresponsibility" in financial markets (Brown 2008), and five months later, the American President heralded a "new era of responsibility", writing:

> "This crisis is neither the result of a normal turn of the business cycle nor an accident of history. We arrived at this point as a result of an era of profound irresponsibility that engulfed both private and public institutions from some of our largest companies' executive suites to the seats of power in Washington, D.C. For decades, too many on Wall Street threw caution to the wind, chased profits with blind optimism and little regard for serious risks—and with even less regard for the public good. [...]
>
> The time has come to usher in a new era — a new era of responsibility in which we act not only to save and create new jobs, but also to lay a new foundation of growth upon which we can renew the promise of America" (Obama 2009, p. 1).

This thesis engages with the latter messages. It builds a theory about companies' responsibilities in the governance of financial market stability. It is the product of research begun before the crisis, analysing the reaction to a Citigroup bond trade that resulted in the bank being fined for improper conduct, despite not having broken the law. The case suggested that operating efficiently and within the boundaries of compliance had not sufficed to satisfy other market actors and regulators. It suggested that additional behaviours were tacitly expected of the bank.

Similar messages emerged in other contexts, to the effect that certain principles of good market conduct were widely expected. Following a significant political controversy, codes of conduct were drafted for sovereign wealth funds (SWFs) in 2007-08, under threat of regulatory sanctions, alongside concerns that, even if the funds obeyed the law, they could compromise the effectiveness

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[1] Celebrated quotation from the character Gordon Gekko in the film *Wall Street* (1987), see: www.youtube.com/watch?v=JaKkuJVy2YA.

of markets due to their large size and opaque corporate governance. Then, in 2008, as the global financial crisis unravelled, market expectations became characterised by uncertainty.[2] Trust in market signals broke down, major banks were nationalised or collapsed, regulation tightened, government policies sent mixed signals, and, for the first time outside of this doctorate, ***banks' responsibilities to markets*** became a topic of widespread discussion.

This thesis develops a substantive, integrative theory of financial firms' responsibility for regulating systemic risk – 'corporate market responsibility' – a contribution to this wider debate. The CMR concept, and the propositions that comprise a CMR theory, provide an explanation for these three controversies, whose analysis forms the bulk of the thesis: Citigroup's Eurobond trade, sovereign wealth funds' rise to prominence, and the post-Credit Crunch regulatory debate. In each episode, regulators and other actors showed significant concern about firms' impact on financial stability, despite the firms ostensibly behaving as they should, profitably and legally. These actors sought to influence firms to adopt certain internal management systems that they perceived would reduce risks to the wider financial system.

Conceptually, this dynamic cuts across several forms of financial market governance. On one hand, it illustrates 'simple' regulator-led inducements for firms to carry out business in certain ways. It also illustrates how other non-market actors participate in financial governance, by bringing reputational and political pressure to bear on the target companies. Concerns over poor market conduct were also voiced by market participants themselves. These various actors sought to influence firms' management decisions, while simultaneously reinforcing their discretion to take those decisions. In this respect, firms were compelled to adopt certain self-regulatory internal controls – self-regulation was itself increasingly regulated. The firms were held responsible for meeting regulators' objectives of systemic stability. Markets were not assumed to self-correct. This represented a shift in normative responsibility for market governance. Firms were held accountable for more than their traditional economic mandate – which is to be profitable and compliant (Friedman 1970).

My research question related to the normative underpinnings of this dynamic. The first episode, Citigroup's trade, which I read about shortly after the event, jarred with my understanding of

[2] For a detailed narrative account of this process, centring on Lehman Brothers' bankruptcy, see Sorkin (2009).

economic behaviour and perceptions. On 2 August 2004, Citigroup traders sold a large amount of bonds, watched the price fall as a result of their sale, and bought back the same bonds minutes later at a lower price, making a substantial profit. For an economics graduate, the operation did not fit how profit-making theoretically happens. It did not seem to be about clever arbitrage, spotting mispriced assets and trading them for a profit, but rather about manipulating the signals of supply and demand that define those prices.[3] Although Citigroup was absolved of market manipulation, or any other criminal conduct, the market was unable to accommodate the operation. Other banks on the Milan-based MTS Eurobond exchange suspended their trading. MTS administrators convened to assess whether to condone or condemn Citigroup, despite stating that it had not breached regulations. Regulators such as the UK's Financial Services Authority (FSA) launched investigations. Citigroup's clients protested. The bank was eventually fined by the FSA, on the grounds that it had not helped to ensure "the efficient and orderly functioning of the market" (FSA 2005).

If the original event had jarred with my theoretical understanding of profit-making, the FSA's judgement raised a bigger question. It implied that financial markets were not even perceived to be self-correcting, but to require special commercial conduct from firms. If this was the case, then the question was worth pursuing: <u>how are companies responsible for ensuring orderly financial markets?</u>

This research question resonates with problematic issues in several disciplines. I sought to answer it, first, by building propositions from data; to account for the three controversies as well as the wider theme they all share. Only then would I integrate these propositions with existing theoretical explanations. This grounded theory approach (Glaser 1978, Strauss and Corbin 1998, Charmaz 2006) would help me to stay sensitive to the empirical data, and not preclude certain types of information or theoretical insights that might fall outside a pre-determined hypothetical framework. The theory was built by comparing empirical data, deriving concepts and propositions that explain those data, and sampling for new empirical contexts that demonstrate variations in the emerging concepts. As a result, in this thesis, knowledge accrues cumulatively. Each of the three controversies – Citigroup's transaction, sovereign funds' rise to prominence, and the post-Credit Crunch debate – has a

[3] It emerged in the FSA's (2005) ruling that Citigroup had sought to arbitrage two different markets. For a sociological account, see Beunza, Hardie, and MacKenzie (2006).

dedicated chapter, and each chapter contributes, first, an explanation for the specific controversy and, second, concepts that build up to a wider answer to the research question. The objective of the thesis is to build a theory that explains each of the controversies and is tentatively generalisable to new situations in financial governance.

The research began by exploring sensitising concepts (Strauss 1987) and theoretical questions that I could use as heuristics during the data analysis. It looked initially to theories of corporate social responsibility (CSR), economics, and political economy. Although these analyses suggested that the question was relevant, it was also important, given my epistemological and methodological position, to stay open to what the data itself revealed, and not force it unduly into the extant concepts. As the research progressed, the theorisation departed from these sensitising concepts. The final substantive theory resonates with slightly different themes. I present the following analysis to sensitise the reader to the concepts that first motivated this work. Then, I explain the structure of the thesis and its argument.

1.2. Sensitising concepts

For an economist interested in corporate responsibility, the question of companies' responsibilities towards their markets is problematic. In liberal economics, the question is redundant. Economics regards the market as self-regulating, through endogenous incentives. External planning, sanction or distribution are considered to reduce its efficiency. Orderly markets, with few exceptions, are considered simply a by-product of legal profit maximisation – normal business activity. In corporate social responsibility (CSR) literature, the key focus is the role of firms in social governance, rather than market governance. Firms' responsibilities to the market environment are not neglected, but they are understudied. Corporations are said in the CSR literature to be 'economically responsible' whenever they produce goods or services efficiently and legally (Carroll 1979, 1991; Mitchell 1998; Schwartz and Carroll 2003; Wartich and Cochran 1985; Wood 1991). The implicit dichotomy in the CSR discourse is that corporations have social responsibilities to society, or the "non-market environment" (Baron 2001), and economic responsibilities to themselves (i.e., shareholders, managers, etc). CSR theory does not develop the concept of 'economic responsibilities' because it devolves them to self-regulating market forces, as conventional economic theory would have it. Political economy theory has addressed some of these issues, exploring the role of private regulatory regimes (Cutler, Haufler and Porter 1999), informal industry norms (Haufler 2000, Porter 1993), corporate political activity (Baron 2003, Vogel 1996), and other features of private authority, which often lacks legitimacy and normative underpinnings (Underhill and Zhang 2003b, 2008).

1.2.1. CSR: modes and purpose of corporate responsibility

Several CSR researchers have defined what they call "corporate economic responsibility" (CER) as economists would have it – a responsibility to maximise shareholder value efficiently and legally (e.g. Carroll 1991). The traditional concept of CER has important limitations: it is incompatible with key definitional features of corporate *social* responsibility, and incompatible with CSR's approach to market failure.

The definitional inconsistency between corporate economic, and corporate social responsibility is found in the two necessary conditions for CER: efficiency and legality. Both fall short of standards of CSR. Prioritising efficiency precludes managerial discretion to increase costs and decline business opportunities that management perceive might destabilise other market stakeholders. Yet these expectations exist. For example, the FSA (2005) argued that Citigroup should have invested more into risk management resources and abstained from their transaction in order to safeguard market stability. Citigroup itself apologised for failing "to fully consider [the transaction's] impact on our clients, other market participants, and our regulators" (*Financial Times* 2004). Similarly, many innovative products and business strategies were condemned after the Credit Crunch, like structured derivatives and short-selling, due to their effect on market stability (FSA 2009b). The firms were expected to incur risk management costs and opportunity costs on behalf of the market, even if this was not the most efficient management scheme. Efficiency's status as a threshold of CER implies that managers do not need discretion to depart from the most efficient scheme in order to be responsible. Yet such discretion is a pre-requisite of CSR, which is predicated on adapting managerial choices, and increasing costs if necessary, to meet pre-defined social objectives outside the firm (Frederick 1998, Ackerman 1973; c.f., Schwartz and Carroll 2003).

The second element of CER, not to break the law, is, again, not what corporate responsibility is strictly about. From the earliest conceptions of CSR (Bowen 1953, McGuire 1963) to present-day instrumental (Wood 1991) or ethical approaches (Crane and Matten 2003), it is clear that socially responsible companies *exceed* legal requirements. They engage with social problems even in the absence of legal compulsion to do so. There is little reason à priori why corporate responsibility theorists should not say the same of the market environment: it does not take inefficient or illegal practices to create significant market problems, as witnessed in the 1997-8 global financial crisis (Radelet and Sachs 1998), and in the Credit Crunch, the topic of this thesis's fifth chapter.

The inconsistency between CER and CSR is widened when we consider the different approaches to responsibility itself. Consider Dubbink's (2003) two models of responsibility: indirect and direct. The indirect responsibility model "holds that the responsibility of actors in the market ends with their republican duty, abiding laws and the rules of common decency" (op cit: 3). Proponents of liberalised markets champion this view because they do not consider actors in the market responsible for public problems in society, and prefer to limit markets with system-wide rules such as taxation. Pro-market theorists have also derided the concept of CSR on the grounds that controlling the market is the (democratic) state's responsibility, rather than firms' (ibid). On the other hand, there is a direct responsibility model, favoured by CSR theorists, whereby "actors are called upon to personally acknowledge their responsibility, [to assume] some public responsibility at actor level, [and] to use at least some of their freedom (discretionary space) to solve public problems" (op cit: 2-3). CSR models that rely on CER to postulate a complete understanding of corporate responsibilities conflate the direct and indirect responsibility models. CSR claims that firms operate within a broader society, and have *direct* responsibilities to public problems in the nonmarket domain, but only *indirect* responsibilities to public problems in the market domain.

The incompatibility between CSR and CER is further evident in light of what proponents of CSR and economists expect of governance in the economy. Take the concept of market failure, which has been central to the development and implementation of CSR, particularly with practitioners who subscribe to the triple-bottom-line approach (financial, social, and environmental; Mitchell 1998). Accepting the existence of market failure presents us with two options to prevent and correct those failures: either advocate state intervention in the economy, or advocate pro-active industry self-regulation. Both options appear incompatible with how CER has been defined. If markets' broader impact should be governed by political and legal entities, then the concept of corporate responsibility loses resonance because governments will look after society. If, on the other hand, companies are encouraged to regulate their activities voluntarily and redistribute utility, then their economic responsibilities must go beyond legal competition because they must correct market failures, some of which are market-bounded, as I argue below. Market failures are *prima facie* conceptual evidence that the traditional definition of CER is incomplete.

There are a number of factors that may explain why the gap in our understanding of CER and CSR is still open. Accepting that the main audience for CSR theorisation are practitioners (Edlund 1996), it is possible that CSR theorists have chosen not to challenge the foundations of basic competitive operations, with a view to persuading more business practitioners to address social issues. It may also be because political economy is not the main research interest or specialisation of CSR theorists. Jones (1996) cites a survey of business ethics, CSR, and corporate social performance studies which found that "only 9% (6 out of 67) of projects were in any way related to issues of political economy, whereas 36% (24 out of 67) of projects were ethics oriented" (Jones 1996: 32). It is also possible that the gap exists because the concept of CER problematises the corporate social responsibility construct in its entirety.

1.2.2. Economic theory: Market failure and self-correction

Market failure is the main indicator or test in economics of whether the market requires political intervention. It is central to the question of how corporate conduct may relate to the well-functioning of markets. Welfare economics postulates four major causes for market failure: imperfect information; abuse of market position through monopoly; external, unaccounted benefits or costs of market activity (externalities); and underprovided public goods with societal benefits.

This concept is being challenged with growing momentum by eminent economists such as Rogoff (2002) and Wolf (2002) among others, who argue that the concept is unhelpful because *government failure* – the analogy made with respect to inefficient government planning – is worse. In this argument, theorists often conflate the problem with the proposed solution. That is, they downplay the problem of market failure because they appear to dislike the solution of government intervention. Often, the debate on market failure is reduced to the relative desirability of market versus socialist economics (see Sirico 1998). More sophisticated arguments against market failure have emerged (Zerby Jr and McCurdy 2000), but they do not resolve the following problem.

Considerable disagreement remains over how market failures may be resolved if government is too inefficient or lacks capacity to correct it. Many have argued that incentives are unavailable for corporations to address market failures, especially due to transaction costs (Zerby Jr and McCurdy 2000). Instrumentalist theories in CSR have provided partial exceptions to this rule, by arguing that corporations may improve financial performance and maintain economic sustainability if they correct or prevent negative social externalities. This analytical gap is important because the responsibility of corporations in the face of market failures is higher if governments are unable to correct them. CSR is a partial but incomplete response to this problem. It concentrates predominantly on market failures with nonmarket (social) impacts. However, some classes of market failure impact strongly on market actors and only tangentially on nonmarket actors. This is particularly true in wholesale financial markets, where a large share of trading bears little relation to the real economy – market activity that Adair Turner, FSA Chairman, called socially useless (FSA 2009b). In other words, some market failures are market-bounded.

Another type of market failure, 'positive' barriers to entry (Hindmoor 1999), occurs when able entrepreneurs are prevented from accessing credit and contributing to markets because they do not have enough financial resources. This constitutes an opportunity cost for the market. Such barriers to entry are exacerbated when the number of firms in a market decreases rapidly through mergers and acquisitions. If a market is tending towards monopoly, economic theory suggests the incentives are in place for the market's efficiency eventually to fall (fail). In each of these situations, governments have policy options to intervene in markets, but politically diverse research suggests that in a globalising environment they are increasingly difficult, and unfashionable, as I outline below. A gap remains. What should firms do to ensure that markets function effectively when governments are unable to intervene, and where current CSR prescriptions do not capture the problem because the failure is bounded within the market?

1.2.3. Political economy: Private regulatory regimes

Political economists have addressed this problem more specifically. Much of this literature, writes Walter (2000: 51), argues that capital markets, like other factors, have "eroded the ability of governments to make policies that constrain the activities of transnational corporations (TNCs) within their jurisdictions. This view is widespread amongst both critics and supporters of globalisation...". The threat to regulatory capacity is often caused by an inability of government institutions to develop technologies (hardware, knowledge and approaches; Ness and Brechin 1998) to monitor fast-paced innovation and fluid corporate assets effectively (Strange 1996). In addition, government-led stabilisation of the economy has been "unfashionable" (*The Economist* 2005), despite a recent revival of more interventionist, Keynesian ideas (Skidelski 2009). A decrease in state regulatory capacity, or willingness, would strengthen the proposition that *de facto* corporate responsibility for the market governance is emerging (in a descriptive sense). Corporations are acquiring autonomy over markets without interstate institutions assuming an effective governance role.

Literature in the political economy of private sector regulatory regimes (e.g. Cutler, Haufler and Porter 1999) has pursued that theme. Haufler (2000: 122) writes that in response to "a mismatch between markets and politics in terms of governance, [private regimes arise within industries, to coordinate] self-regulation or rule-setting in the absence of an overarching global political regime." Other theorists also emphasise, like Kroszner (1999: 335), that companies have adopted private regulation, "spurred by the avoidance of traditional government regulation" (see Maitland 1985, Getz 1997, Haufler 2000). In reference to the financial sector, which contains the most globalised and complex set of markets, Porter (1993) writes that this "suggests the absence of a strong hierarchical regulatory body for finance does not mean there are no significant institutions for regulating global finance. It means rather that we must take informal arrangements into account in searching for such institutions" (ibid). Further, Haufler writes, "These private sector regimes address the problems of international efficiency, the security or stability of markets, the power and autonomy of firms, and the social embeddedness of economic actors" (op cit).

The Citigroup episode resonates with Haufler's, Porter's, and Kroszner's arguments. Citigroup's competitors claimed that the bank had broken a gentlemen's agreement between traders on the MTS market, implying that the market relied on implicit norms in order to secure its stability.[4] In addition, sovereign wealth funds were compelled to adopt a self-regulatory code-of-conduct in order to ensure the efficiency of international markets and avoid traditional protectionist regulation. However, non-private dimensions were also significant. The FSA and other regulators investigation did not cite norms in their censures of Citigroup, for example. In the post-Credit Crunch episode, the narrative of the "age of irresponsibility" cut across all financial markets, beyond the reach of discrete regimes and institutions. Perhaps this narrative reflected generalised expectations about market conduct to stabilise financial markets. This thesis suggests that such expectations exist. As political economy literature searches for normative underpinnings of private authority (Underhill and Zhang 2003b, 2008), the thesis advances a tentative response.

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[4] I find that the evidence of a gentlemen's agreement is tenuous, as I discuss in Chapter 2, but that the social embeddedness of the actors was significant.

1.3. Thesis structure and argument

The argument in the thesis accumulates in the three empirical analyses – on Citigroup, sovereign funds, and the Credit Crunch. The first contribution of these chapters is to present empirical data and a theoretical explanation of the episode itself. The second is to develop, simultaneously, concepts with broader relevance for the other episodes. Take the concept of *proactive improvement* by firms. When this concept first emerged in the data, it had few processes associated with it, one of which was *cooperating with regulators*. Both Citigroup and SWFs had faced a lower regulatory risk on the grounds that they had begun cooperating with regulators even when they were not obliged to do so. The Credit Crunch episode added a new process to this theme, which evolved into *responsible compliance* – not only *cooperating with regulators* but also *interpreting regulation as it was intended*. So by incorporating various processes from the different episodes, the concept of *responsible compliance* came to represent processes observed in all of the episodes. This theory-building method is explained in detail in the following chapter. Figure 1-1, below, illustrates how each chapter contributed to the accumulation of knowledge in the thesis.

Figure 1-1. Chapter contributions and accumulation of knowledge

Chapter	Empirical contribution	Theoretical contribution (broader thesis)
2. Postpositivist grounded theory	(Details the selection of each empirical episode and data sources)	Specifies research objectives, theory's generalisability, and criteria for assessment
3. Citigroup's Eurobond controversy	Presents empirical data and develops a theoretical account of the Citigroup controversy	Presents initial concepts (such as *judging market conduct*) and tentative conceptual relationships for further sampling
4. Sovereign funds' rise to prominence	Presents empirical data and develops a theoretical account of the SWF controversy	Develops concepts' properties and dimensions; advances first CMR propositions explaining both episodes; defines CMR
5. The post-Credit Crunch regulatory debate	Presents empirical data and develops a theoretical account of the regulatory debate	Theoretically saturates concepts; presents new concepts with broader scope (such as *systemic risk*)
6. Theorising Corporate Market Responsibility	Interprets empirical data as new variations of existing concepts in the literature, like meta-regulation and market embeddedness	Integrates propositions and concepts into a theory of CMR; presents its implications for political economy and economic sociology literature

Chapter 2, which follows this introduction, explains the epistemological objectives of the research and its methodology. It proposes combining standards of rigour commonly associated with positivists, like objectivity and deductive transparency, with the benefits (and inevitability) of subjective experience and interpretation, associated with constructivists. This postpositivist approach (Morçol 2002) is shown to be very closely associated with Strauss and Corbin's (1998) grounded theory methodology, which I outline in detail. The objective of the thesis is to build a substantive theory that explains the empirical episodes in full and is tentatively generalisable to new situations. Quality criteria for assessing this claim are set out in Chapter 2, and the claim is finally assessed in Chapter 6, where I present the theory. The methodological discussion also explains why the empirical episodes were selected, and which data sources were most suitable for the investigation. The thesis is based on documentary evidence from news reports and regulatory and policy papers.

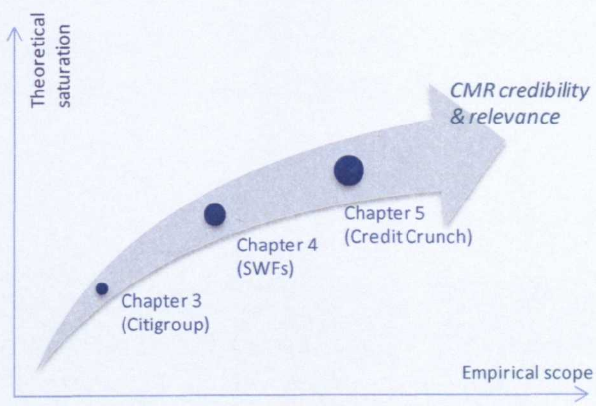
Chapter 3 presents and conceptualises Citigroup's Eurobond controversy. The problematique in this episode is that Citigroup was penalised for its transaction despite having been absolved of criminal conduct. Numerous market actors were cited in the press saying that Citigroup had broken a *gentlemen's agreement*, and news reports focused extensively on this. However, no one clearly articulated what the agreement had been, and some evidence suggests that it did not exist. The conceptual argument, based on citations in the press and regulatory documents, is that the bank had been expected to promote market stability by adopting, among other things, a risk management system that anticipated the trade's impact on market risk. A *gentlemen's agreement* seems to have been invoked to justify the notion that even in such a "cut-throat" market, as the *Financial Times* put it (FT28), norms of good market conduct were nevertheless expected.

Chapter 4 extends this analysis to the controversy surrounding sovereign wealth funds' rise to prominence. The problematique in this chapter is a similar one: that SWFs were held accountable for ensuring that they would not threaten efficient and orderly markets. Whereas the Citigroup episode was a reaction to perceived misconduct, this controversy anticipated misconduct. The funds were compelled, under threat of regulatory sanctions, to develop a voluntary global code-of-conduct to mitigate systemic risk. It is notable that the first blueprint for the global code provides a fair summary of the principles that *Citigroup* was said to have violated. This supports the notion that similar principles applied across the substantive contexts. The provisions of the IMF, US, and European codes-of-conduct for sovereign funds are coded to reveal which generic processes the funds were expected to adopt. It is argued that the SWFs and Citigroup controversies were owed to the expectation that the firms would implement management systems (responsible market conduct), in the areas of risk management, investment policy, and proactive improvement specifically. Chapter 4 thus presents tentative propositions defining CMR.

Chapter 5 extends the analysis to the post-Credit Crunch regulatory debate, where it was argued that firms had behaved "irresponsibly" in the lead-up to the crisis (Brown 2008, Obama 2009). The problematique in this episode is, similarly, that financial firms were judged to have neglected their "responsibilities" to the financial system, despite having been profit-maximising and compliant. However, this is a much broader episode that raised questions of the very foundations of capitalism, as Greenspan's quote in the opening of this thesis suggested. Analysis of the regulatory debate and its reporting in the press held that, among other issues, *responsible compliance* was a central concept in the debate. For example, the Securities and Exchange Commission, which describes itself as a "law enforcement agency", said in a statement that "We need to encourage a tone and culture ... that mere compliance with the law, narrowly viewed, is not the highest goal to which we aspire, but the base from which we start" (SEC 2009b). Significant questions were also raised about moral hazard in key investment banks, and 'bad' innovations. The findings from this chapter are integrated with the propositions from Chapters 3 and 4.

The episodes in Chapters 3-5 are of progressively broader scope. Chapter 3 focuses on a controversy surrounding a single actor in a well-defined Eurobond market with specific rules. Chapter 4 focuses on a *set* of actors that operate across several markets, including bonds, equities, real estate, etc, globally. Chapter 5 covers a broader range of "banks and other financial institutions" (UK Treasury 2009), and other "systemically important" firms (*Financial Times* 2009b). This means that as concepts develop throughout the chapters, they become more abstract and represent a broader set of empirical phenomena, while, simultaneously becoming "theoretically saturated" – that is new data does not show new variations in the concept (Glaser 1978, Strauss and Corbin 1998, Charmaz 2006). Thus, concepts gain, both, more breadth and density in the data underpinning them. As a result, the theory becomes more *credible* because it fits a broader set of data, and becomes more *relevant* because it addresses issues that are problematic for more actors. These are two of the four criteria of a good grounded theory, as the methodological discussion in Chapter 2 explains.[5] Figure 1-2 illustrates.

Figure 1-2. Theory gaining credibility and relevance cumulatively throughout the thesis



Chapter 6 integrates the findings from the empirical chapters and sets out a theory of corporate market responsibility (CMR). The term 'CMR' refers both to a theoretical concept and to a corporate practice. As a concept, CMR is an expectation by regulators and other actors that firms help to regulate systemic risk by adopting certain discretionary management protocols. This expectation exists because CMR protocols are perceived to improve firms' impact on the financial system. As a corporate practice, CMR refers to the management protocols themselves.

The theory of CMR is presented in three sets of propositions (summarised in the figure below). The first set is a single proposition affirming the existence of corporate market responsibility, the regulatory expectation. It defines what CMR is, how it is implemented, by whom, when, and with what consequences. The second set of propositions looks specifically inside the firm. These propositions hold that CMR conduct comprises three management protocols: operating a *risk management* system that anticipates the firm's systemic impact; operating a transparent *investment policy*; and *proactive improvement* in respect of CMR. Each of these protocols in turn entails specific corporate processes (like *stress-testing*, or *responsible compliance*).

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[5] The other two criteria are that the theory should be useful and original. Chapter 2 details the technical aspects of the four criteria and Chapter 6 assesses my findings in light of them.

Finally, the third set of propositions looks outside the firm. It relates CMR conduct to two other dynamics in wider market governance, both of which emerged from the empirical analysis: regulatory risk and systemic risk. Firms are argued to face a higher risk of regulatory changes or punishment (regulatory risk) when they lack CMR protocols, because in that state they are perceived to increase systemic risk. Conversely, when firms adopt CMR protocols, they face less regulatory risk, **partly because they are taking on some of the regulators' responsibilities for systemic risk regulation.** The CMR protocols relate to *internal* controls, and in this way, CMR is a regulation of discretionary conduct.

Figure 1-3. Summary of CMR propositions

Propositions on Corporate Market Responsiblity	
CMR	Financial companies are expected to help regulate systemic risk in financial markets, through...
CMR protocols (conduct)	Operating a sound risk management system that anticipates the systemic impact of business operations
	Operating a transparent investment policy that defines parameters for commercial transactions
	Correcting shortcomings proactively even if they are not in literal breach of regulation.
CMR and market governance	Less CMR conduct leads to more regulatory risk.
	More CMR conduct leads to less regulatory risk.
	Less CMR conduct leads to more systemic risk.

These are substantive propositions, and several empirical boundaries de-limit their explanatory power, as I will discuss. Nevertheless, it is argued that they are also useful frames of reference to interpret and explain emerging issues. I note that the increasing regulatory scrutiny of private markets like dark pools, and of market conduct like high-frequency trading, may find useful interpretations in this CMR theory because they fulfil similar conditions. The extent to which these propositions are generalisable is explored in Chapters 2 (method) and 6 (theory).

Chapter 6 also positions CMR within a broader theoretical context, drawing on the literature about decentralised governance and private regulation (e.g. Cutler, Haufler and Porter 1999; Braithwaite and Drahos 2000). The dynamics of CMR are consistent with Levy-**Faur's (2005: 15) notion of "regulatory capitalism", where states adopt a supervisory role and compel firms to adopt self-**regulatory manage**ment systems "in the shadow of the state"**. A central regulatory mechanism of regulatory capitalism is meta-regulation (Grabosky 1995, Parker 2002, Braithwaite 2003). Meta-regulation focuses on firms' internal protocols (rather than their incorporation or specific types of transactions, for example) (Chiu 2009), and aims to ensure that firms' self-regulation is such that it meets regulators' own strategic objectives (Black 2006), often defined "through the prism of risk" (Gray and Hamilton 2006: 227). CMR, regulators' expectation that firms adopt management protocols to help reduce systemic risk, appears to be a substantive form of meta-regulation. Under meta-regulation, like under CMR, the required protocols cannot be excessively prescriptive, "as regulators are not in a position to micro-manage firms, and hence, these represent a meta-regulatory approach where regulators expect certain internal measures to be in place in firms, and the regulators' role is to monitor the performance of such measures," writes Chiu (2009: 29). CMR also shares characteristics with models of enforced self-regulation (Ayres and Braithwaite 1992), and ethical self-regulation (Shamir 2008).

These comparisons help CMR, an empirically developed concept, to find resonance with established concepts and thus gain further definition. Inversely, CMR's empirical weight enhances our understanding of these models. For example, the generic meta-regulation model has been criticised for lacking insight into its broader impact, including systemic risk (Chiu 2009). The CMR form of meta-regulation attends specifically to that risk and therefore contributes to our understanding of meta-regulation in practice.

Having thus positioned CMR within a broader theoretical tradition, Chapter 6 explores CMR's implications for other current theoretical problems, in political economy and economic sociology. One problem is the search for normative underpinnings for global financial governance, particularly to increase its legitimacy, and therefore effectiveness (Underhill and Zhang 2008). CMR is a substantive normative ethic and a partial response to this search. It enhances the three phases of Underhill and Zhang's (2008) model of legitimacy: providing *input* for regulatory agendas (CMR protocols) that aims for an *outcome* in the public interest (systemic stability), along with an ethic of *accountability* (regulatory risk). The empirical observation of CMR further suggests that the transfer of authority to private interests may slow when it leads to systemic risk. The thesis is argued to contribute both theoretical and empirical knowledge to this debate.

CMR is also argued to enhance our understanding of key concepts in the sociology of financial markets, which addresses the problems of social norms and networks that are also problematic in political economy. Each of the empirical episodes shows new dimensions of markets' social embeddedness (e.g. Granovetter 1985) and the performativity of economic theory and models (e.g.

MacKenzie 2006). Citigroup's transaction occurred in a highly embedded market that showed the state-market condominium (Underhill 2000) as a profitable business model for states and firms. One social norm in the market, the putative ***gentlemen's agreement*** between banks, appeared to be a *post hoc* construction that allowed market actors to rationalise the failure of economic theory to explain why a legal and profitable transaction should be controversial. The sovereign funds episode illustrated what I call performativity-plus. The funds were given "users' manuals" for capitalism (disembedding them from traditional and historical forms of decision-making) to help them perform economic theory, but in addition, to perform it *responsibly* (re-embedding them in the CMR ethic). In the Credit Crunch episode, some CMR protocols were used to de-legitimise the practice of regulatory arbitrage – firms' search for minimum regulatory requirements – both through incentives like regulatory risk (see Goodhart et al 1998) and through ethical compulsion (see Shamir 2008).

Thus it is also argued that CMR is an integrative concept that helps to explain problematic patterns of interaction both in political economy and economic sociology. The theory proposed in this thesis does not attempt to resolve extant theoretical debates, but rather is an integrative concept that may be used to enhance understandings of a range of current governance problems. A multidisciplinary discussion supports this claim.

The theory's limitations and other contributions are captured in the concluding chapter.

Chapter 2: Building self-aware social science – Postpositivist grounded theory

It is not until researchers are able to let go and put trust in their abilities to generate knowledge that they finally are able to make discoveries of their own.

Anselm Strauss and Juliet Corbin[1]

2.1. Introduction

A self-aware social scientist seeks to abide by conventional benchmarks of rigour, like objectivity, but also acknowledges that his results are not necessarily the whole truth. He takes the middle ground in a polarised epistemological landscape, where positivists stand to one side advocating 'rigour', to uncover objective reality, and constructivists stand to the other advocating 'authenticity', interpreting the necessarily subjective context of their research. Positivist scientists argue that they are aware of their subjectivity, and that is why they design research controls and double-blind experiments. Constructivists hold that the very choice of research design is influenced by the broader environment, and that claims to objectivity undermine scientists' own understanding and subjugate others'.

In arguing that both objective rigour and subjective authenticity are required in social science, a postpositivist – which I call a self-aware social scientist – may carry the highest burden of persuasion, disputed by either polar camp. Either side may argue that the postpositivist deploys shortcuts to avoid the hard work of justifying a conventional approach in full. To me, it is the conventional polar positions that feel incomplete. Constructivists often aim to understand the broader context in which phenomena are embedded, such as social classes, in order to induce social change (Denzin and Lincoln 2005: 195). However, by their own measure they speak a different language from those that hold power (positivists, predominantly), and remain epistemologically incommensurate with those whom they seek to influence. I would respond to them by paraphrasing the political economist Susan Strange (1997b): those who depart too far from the underlying language of power cease to be taken seriously by those who possess such power.[2] Positivism's so-called 'disinterested scientists', by contrast, claim an untenable scholarly objectivity. At the extreme, this leads to the kind of situation where a Harvard economist, having accepted an invitation to speak at an IMF conference on poverty reduction, refused to derive any practical policy implications from his research, on the grounds that

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[1] Strauss and Corbin (1998: 49).

[2] Strange was referring to the distribution of structural power rather than the 'language of power'.

doing so is not part of academic work.[3] This, to my mind, is also an incomplete epistemological position.

In this chapter, I argue for a middle-ground, postpositivist position, which recognises the merits of replicable analytical techniques and the inevitability of subjective judgement. To do so, I draw primarily on Denzin and Lincoln's (2000, 2005) comparisons of research paradigms, and while they argue that postpositivism is similar to positivism, I argue that it is also similar to constructivism. This epistemological positioning foreshadows my choice of methodology and the claims I make for the generalisability of my research. The methodology is grounded theory, which seeks to build abstract theory from data, rather than use data to verify pre-conceived hypotheses. This methodology deploys formal concepts and techniques (Glaser and Holton 2004, Strauss and Corbin 1998) that tend towards objectivism. However, it acknowledges and harnesses researches' subjective knowledge – their "theoretical sensitivity" (Glaser 1978) – because it helps researchers better identify problematic issues in a substantive area and adjust the research design in order better to explain and interpret them. As the product of, both, good technique and good temperament, a postpositivist grounded theory advances "limited, tentative generalisations, not universal statements" (Charmaz and Bryant 2007: 52). It is on this basis that a grounded theory achieves credibility, relevance, usefulness, and originality, its four key quality criteria.

2.1.1. Purpose and contribution of this chapter

The purpose of this chapter is to explain my postpositivist position, and the methodological, analytical, and sampling decisions that I made while researching the thesis. It details the objective of the thesis – to build a substantive grounded theory about how firms are expected to contribute to orderly financial markets – and the methodological criteria with which I assess my findings at the end of the work. It also establishes my claims for the resulting substantive theory: that it should account for the central problematiques in each of the empirical episodes and, in addition, be tentatively generalisable to new situations in financial markets.

[3] Michael Kremer, presenting the paper *Odious Debt*, declined on these grounds to answer my question regarding practical implications, at the IMF Conference on Macroeconomic Policies and Poverty Reduction in Washington, 14-15 March 2002.

2.1.2. Chapter outline

The argument begins in Section 2.2 with epistemological positioning, showing a natural conceptual overlap between positivism and constructivism, and a corresponding research tradition. Extending this argument to the methodological domain in Section 2.3, I argue that the most fitting methodology for a postpositivist approach is grounded theory, because it combines specific analytical techniques, in a nod to positivism, with guidelines for subjective interpretation. The section details those techniques and goes on to argue that tentative generalisability is desirable in social science. I state my objective of building a representative, tentatively generalisable theory based on three empirical settings: Citigroup's Eurobond controversy, the rise to prominence of sovereign wealth funds, and the regulatory debate after the Credit Crunch. In Section 2.4 I explain how these episodes and the data behind them – news reporting and regulatory documents – were selected. Section 2.5 outlines epistemological implications from this research design and its empirical boundaries. I conclude by reiterating my epistemological claim: to present limited, tentative generalisations that account for the analysed empirical episodes in full and can be used as interpretive frames to research other phenomena.

2.2. Epistemology: Postpositivism as self-aware social science

Corresponding to a critical realist ontology, my analysis is positioned in an epistemological space that Guba and Lincoln (1998, 2000, 2005), Denzin and Lincoln (2000, 2005), Charmaz (2000, 2006), and Morçöl (2002) describe as postpositivist. The table below reproduces a comparison of research paradigms that appeared in Guba and Lincoln (1998, 2000, 2005), and in it I have highlighted the core features of the postpositivist approach. This approach has its roots in positivism, and it is often used by researchers who collaborate with constructivists and are motivated by inducing practical change (on this tradition, see especially *Epilogue* in Denzin and Lincoln 2005), thus bridging the gap between the two epistemologies. Postpositivism is at the centre of epistemological pluralism (Guba and Lincoln 1998, Morçöl 2002).

Morçöl (2002: 94-5), citing Giddens (1995) and Fischer (1995), traces the roots of postpositivism to Thomas Kuhn and Karl Popper, who, respectively, demonstrated that "it was not possible to maintain the fact-value dichotomy and the principle of ethical neutrality in science", and "proposed another concept for the goal of science: 'verisimilitude' (getting closer to or approximating the truth rather than obtaining the full truth)". This was a first criticism of realist ontology and its pursuit of absolute objective truth. The argument evolved when, according to Morçöl, "in the 1980s, the critique shifted toward epistemological and methodological issues and it was then that critics [of realist ontology and positivism] began using the term *postpositivism*" (2002: 104). As such, postpositivist research corresponds to a critical realist ontology: a neutral reality exists but attempts to apprehend it are mediated by analysts' inevitable subjectivity and context.

Morçöl states that the philosophical umbrella for all postpositivist theories is the following dichotomy between methodology and epistemology: "the theory and practice of [...] analysis are predominantly positivistic [whereas ...] analytic knowledge is presupposed (i.e. it is mediated by analysts' preconceived notions, pre-acquired beliefs, and values) and formed in historical, cultural, and political contexts" (p. 105). In other words, postpositivists are aware of their subjective rendering of knowledge and, in contrast to positivists, do not take their research to represent an objective reality. However, postpositivists also seek to approximate reality through well substantiated statements, rather than dismiss objectivism outright. Charmaz and Bryant (2007) describe a postpositivist grounded theory as offering "limited, tentative generalisations" (p. 52). This is a reconciliation of the traditional positivist/constructivist dichotomy, which I also adopt.

Campbell (1982, 1984) defended the postpositivist ontology of critical realism against constructivist's relativism, calling such relativism, "ontological nihilism". In this critique of constructivists, Campbell argued that "conceptualizing truth entirely as a social construction [...] undermines our effective motivation for criticising and changing the existing global order" (Morçöl 2002: 111). Contrary to popular depictions of postpositivism (e.g. Guba and Lincoln 1998, 2000, 2005; Denzin and Lincoln 2000, 2005), Campbell thus suggests that postpositivists are also motivated by inducing social change. I identify entirely with these articulations of postpositivism by Morçöl and Campbell, and this explains why, in the figure below, I have highlighted some features of both positivism and of constructivism as reflecting my own position. Next, I elaborate my position.

Figure 2-1. Comparison of research paradigms (Cited and adapted from Guba and Lincoln 2005: 193, 195)

Basic Beliefs (Metaphysics) of Alternative Inquiry Paradigms

Item	Positivism	Postposivitism	Critical Theory et al	Constructivism
Ontology	Naive realism – 'real' reality but apprehendible	Critical realism – 'real' reality but only imperfectly and probabilistically apprehendible	Historical realism – virtual reality shaped by social, political, cultural, economic, ethnic, and gender values; crystallised over time.	Relativism – local and specific constructed and co-constructed realities
Epistemology	Dualist/objectivist; findings true	Modified dualist/objectivist; critical tradition/community; findings probably true	Transactional/subjectivist; value-mediated findings	Transactional/subjectivist; created findings
Methodology	Experimental/manipulative; verification of hypotheses; chiefly quantitative methods	Modified experimental/ manipulative; critical multiplism; falsification of hypotheses; may include qualitative methods	Dialogic/dialectical	Hermeneutical/dialectical
Inquiry aim	Explanation: prediction and control		Critique and transformation; restitution and emancipation	Understanding; reconstruction
Nature of knowledge	Verified hypotheses established as laws or facts	Nonfalsified hypotheses that are probable facts or laws	Structural/historical insights	Individual reconstructions coalescing around consensus
Knowledge accumulation	Accretion – 'building blocks' adding to 'edifice of knowledge'; generalisations and cause-effect linkages		Historical revisionism; generalisation by similarity	More informed and sophisticated reconstructions; vicarious experience
Goodness or quality criteria	Conventional benchmarks of 'rigour': internal and external validity, reliability, and objectivity		Historical situatedness; erosion of ignorance and misapprehension; action stimulus	Trustworthiness and authenticity, including catalyst for action
Voice	'Disinterested scientist' as informer of decision makers, policy makers, and change agents		'Transformative intellectual' as advocate and activist	'Passionate participant' as facilitator of multivoice reconstruction
Training	Technical and quantitative; substantive theories	Technical; quantitative and qualitative; substantive theories	Resocialisation; qualitative and quantitative; history; values of altruism, empowerment, and liberation	

2.2.1. (Re)defining postpositivism: reconciling positivism and constructivism

As is evident in the table above, Guba and Lincoln (2005) characterise postpositivism as being much closer to positivism than constructivism – more about "explanation", than a "catalyst for change". When describing analysts' voice and goodness or quality criteria, Guba and Lincoln go so far as to draw no distinction between positivism and postpositivism. I contend that postpositivists' voice and goodness or quality criteria needn't be characterised so differently from constructivists'. This kind of methodological reconciliation is inherent in the postpositivist approach, as noted by Morçöl (2002), Campbell (1982, 1984), and Guba and Lincoln themselves in an earlier work (1998). In that study, Guba and Lincoln write that postpositivists "take the position that all paradigms can be accommodated – that is, that there exists, or will be found to exist some common rational structure to which all questions of difference can be referred for resolution" (p. 216-7). Indeed some theorists (e.g. Jurgen Habermas) have been closely aligned with critical theory despite being postpositivists (Morçöl 2002), an affiliation that Guba and Lincoln (2000, 2005; cf. 1998) would appear not to recognise in their later work.

Revisiting Guba and Lincoln's (2005) representation, I would argue that the postpositivist and constructivist renderings of voice and goodness or quality criteria are not, on close examination, so different. According to Guba and Lincoln, the postpositivist argues with the voice of a "'disinterested scientist', as informer of decision makers, policy makers, and change agents", using goodness or quality criteria that require "conventional benchmarks of rigour: internal and external validity, reliability, and objectivity" (op cit: 193). The constructivist, in turn, speaks with the voice of a "passionate participant, as facilitator of multivoice reconstruction", and holds as goodness or quality criteria "trustworthiness and authenticity" (ibid). The constructivist uses this voice and criteria to engage in "Advocacy and activism [which] are also key concepts in this [constructivist] view" (Guba and Lincoln 1998: 211).

And yet, the constructivists' advocacy and activism target a similar audience as the postpositivists' "decision makers, policy makers, and change agents" (ibid). Why does the postpositivist adopt a "disinterested" voice, if not to build "trustworthiness" (the goodness or quality criteria of the constructivist) among those "decision makers, policy makers, and change agents"?[4] The

[4] Charmaz (2006) makes a similar point: "... [positivist] theories present arguments about the world and relationships within it, despite sometimes being cleansed of context and reduced to seemingly neutral statements. For those who espouse positive notions of objectivity, such cleansing and neutrality only adds to their persuasiveness" (p. 128).

postpositivist and the constructivist arguably set out (1) to be trusted by (2) the same audience, but using different voices and criteria as routes. The implication is that voice and goodness or quality criteria are options that researchers have in order to build what postpositivists would call "a strategically crafted argument" (Morçöl 2002: 105).

Guba and Lincoln's (1998) earlier work, in contrast with their later work, specifies the parallels between different voices and criteria quite explicitly:

> "*Constructivism*. Two sets of criteria have been proposed: the *trustworthiness* criteria of credibility (paralleling internal validity), transferability (paralleling external validity), dependability (paralleling reliability), and confirmability (paralleling objectivity) (Guba 1981; Lincoln & Guba 1985); and the authenticity criteria [...]" (p. 213).

What is important therefore is to adopt a methodological scheme that is consistent with the researcher's epistemological position. A researcher is free to mix voice and quality criteria from the positivist and constructivist camps *provided that* the analysis methodology is consistent with, and disciplines, this pluralism.

On the paramount issue of goodness or quality criteria, Guba and Lincoln (2005) again draw no distinction between positivist and postpositivist approaches, arguing that both seek "conventional benchmarks of 'rigour': internal and external validity, reliability, and objectivity", whereas as constructivists aim for "trustworthiness and authenticity, including catalyst for action" (p. 193). Grounded theory methodology, which I detail in the next section, has both positivist and constructivist variants (Charmaz 2006), as well as a postpositivist variant that incorporates elements of both camps, so-called "repositioned grounded theory" (Charmaz and Bryant 2007, ch 1). I outline those quality criteria at the end of the next section.

Ultimately the postpositivist reconciliation is based both on personal beliefs and on epistemological objectives. Researchers have their own views about the existence of an objective, apprehendable reality and these are embedded in their contributions to knowledge. By acknowledging their own contextual environment and aiming, nonetheless, to be methodologically rigorous, postpositivists' work is stricter than qualitative research, it is self-aware social science.

2.3. Methodology: Grounded theory, its temperament and techniques

Postpositivist grounded theory "produces limited, tentative generalisations, not universal statements". It is objectivist to an extent and interpretivist to an extent.

Charmaz and Bryant 2007[5]

In this thesis I operationalise the postpositivist approach through grounded theory methodology (GTM), a formal "family of methods" for qualitative analysis (Bryant and Charmaz 2007: 11). GTM holds that theoretical discovery should emerge from, be grounded in, data. This approach differs from the dominant model of research, where data is collected and analysed based on pre-determined theoretical frameworks. In GTM, data collection and analysis precedes and accompanies the building of hypotheses or propositions. This is, as I will argue, a fundamentally postpositivist methodology that includes, both, specific techniques, in a nod to objectivism, and guidelines for good subjective interpretation. It is this unique mix that makes it a best-fit for the epistemological perspective that I have outlined. In giving primacy to data, GTM also provides good leverage for developing new theoretical constructs that might otherwise fit awkwardly with extant hypotheses, particularly if the extant hypotheses would span across disciplines. As such, it is especially well-suited for research on original or less established concepts. This section outlines the methodology's roots, temperament, techniques, and finally its epistemological claims and criteria.

GTM began as a positivist research programme with Glaser and Strauss's (1967) *Discovery of Grounded Theory*, its first manual. It was originally conceived to "emancipate" qualitative analysis by challenging:

- "Beliefs that qualitative methods were impressionistic and unsystematic
- "Separation of the data collection and analysis phases of research
- "Prevailing views of qualitative research as a precursor to more 'rigorous' quantitative methods
- "The arbitrary division between theory and research[6]
- "Assumptions that qualitative research could not generate theory" because it was necessarily situational and interpretivist (Charmaz 2006: 6).

[5] Charmaz and Bryant (2007: 52).
[6] Glaser (1978) clarifies the division thus: "traditional methods of theory development rely on standard methods of social research that are not directly formulated, controlled by or related to how the theory will be developed" (p. 2). That is, methodological schemes are not developed to fit specific empirical contexts.

Since its inception, GTM's objective has been "to generate a theory that accounts for a pattern of behaviour which is relevant and problematic for those involved[; t]he goal is not voluminous description, nor clever verification" (Glaser 1978: 93). Yet, approaches to grounded theory have developed formalist (Glaser), postpositivist (Strauss and Corbin) and constructivist (Charmaz) variants. In the formalist camp, Glaser sharply criticises what he calls "erosion", "lacing" and "remodelling" of grounded theory by other qualitative data analysis, which he groups into a single, interpretivist family. Glaser and Holton (2004) argue at length against:

> "the mixing of QDA [qualitative data analysis] and grounded theory methodologies [because this] has the effect of downgrading and eroding the grounded theory goal of conceptual theory... Grounded theory becomes considered, wrongly, as an interpretative method, a symbolic interaction method, a constructionist method, a qualitative method, a describing method, a producer of worrisome facts, a memoing method, a method of field interview and so forth".

Crystallising this distinction between grounded theory and other qualitative analysis, he writes positivistically that "the goal of grounded theory is conceptual theory abstract of time, place, and people. The goal of grounded theory is NOT the QDA quest for accurate description" (ibid, original emphasis). Finally, confirming his formalism, Glaser argues that "grounded theory requires following its rigorous procedures to generate a theory that fits, works, is relevant and readily modifiable.[7] When it is adopted, co-opted, and corrupted by QDA research, a close look at the work often shows that the QDA researcher is <u>tinkering with the grounded theory method</u>" (ibid, underlining added).

Glaser's formalism stands in sharp contrast with the approach pursued by Anselm Strauss, the co-originator of grounded theory. This excerpt from Strauss and Corbin's (1998) seminal *Basics of Qualitative Research: Techniques and Procedures for Developing Grounded Theory* is representative of the broader postpositivist tradition in grounded theory:

> "We emphasise strongly that techniques and procedures, however necessary, are only a means to an end. They are not meant to be used rigidly in a step-by-step fashion. Rather, their intent is to provide researchers with a set of tools that enable them to approach analysis with confidence and to enhance [their] creativity [...]. It is the vision of new understandings and the building of useful grounded theory that is the driving force behind this methodology" (p. 14).

Charmaz (2006) and Charmaz and Bryant (2007) have argued that the line between formalism and interpretivism is increasingly blurred among grounded theorists. "Grounded theory as *theory* contains both positivist and interpretivist inclinations", writes Charmaz (2006):

> "Strauss and Corbin's (1998) view of theory has some positivist leanings but emphasises relationships among concepts. For them, theory means a 'set of well-developed concepts related through

[7] I describe these quality criteria below.

> statements of relationship, which together constitute an integrated framework that can be used to explain or predict phenomena' (p. 15). Their stance towards constructing theories, however, also acknowledges interpretivist views. Corbin (1998) recognises that analysis means that researchers interpret data but implies that such interpretation in an unavoidable limitation." (p. 127).

In practice, the distinction between positivist and grounded theory is predominantly one of nuance, as the following table shows.

Figure 2-2. Epistemologies of grounded theory (Adapted from Charmaz 2006: 130-1)

1.Objectivist grounded theory	2. Constructivist grounded theory	3. Judgement and boundaries
"Objectivist grounded theory resides in the positivist tradition and thus attends to data as real in and of themselves and does not attend to the processes of their production."	"A constructivist approach places priority on the phenomena of study and sees both data and analysis as created from shared experiences and relationships with participants."	"I juxtapose constructivist and objectivist forms of grounded theory here for clarity; however, whether you judge a specific study to be constructivist or objectivist depends on the *extent* to which its key characteristics conform to one of the other."

Postpositivist grounded theory as self-aware social science

"Any research method makes epistemological claims," write Bryant and Charmaz (2007: 23). I understand that Strauss (1987), Strauss and Corbin (1998), Charmaz (2006) and Charmaz and Bryant (2007, ch. 1) increasingly identify grounded theory with postpositivist epistemology. Departing from formalist underpinnings, Strauss and Corbin's call for critical flexibility and openness to methodological innovation mirrors the postpositivist tradition of Habermas's multi-method research and Campbell's positivistic activism, but also the idea that "in order to break out of normal science, researchers must constantly strive for innovative insights and fresh conceptualisations" (Charmaz and Bryant 2007: 51), a principle grounded in Kuhn's (1962) *Structure of Scientific Revolutions*. In their exposition of GTM's history, Charmaz and Bryant call this postpositivist approach a 'repositioned GTM':

> "It is realist to the extent that the researcher strives to represent the studied phenomena as faithfully as possible, representing the 'realities' of those in the studied situation in all their diversity and complexity. A repositioned GTM assumes that any rendering is just that: a *representation* of experience, not a replication of it. It is interpretivist in acknowledging that to have a view at all means conceptualising it. [...] It produces limited, tentative generalisations, not universal statements" (p. 51-2).

The principle of striving both for (hard) objectivity and (soft) faithfulness is at the core of grounded theory through what grounded theorists call theoretical sensitivity. To understand this, one much go back to the key tenet in the methodology: that theory should be grounded in data. In GTM, data gathering and analysis lead to theoretical propositions, whereas in traditional 'scientific' research methods researchers often do the opposite: deduce hypotheses from extant theories, and then collect data to verify, refute, or extend them.[8] The grounded theorist begins the research, writes Glaser:

> "with as few predetermined ideas as possible – especially logically deducted, a priori hypotheses. In this posture, the analyst is able to remain sensitive to the data by being able to record events and detect happenings without first having them filtered through and squared with pre-existing hypotheses and biases. His mandate is to remain open to what is actually happening" (Glaser 1978: 2-3, underlining added).

Without a priori theoretical positioning, the choice of research topic and the theory-building rely heavily on a researcher's theoretical sensitivity (Glaser 1978: ch. 1). Entering the field with as few pre-conceived arguments as possible does not of course mean entering it with an empty head. Sensitivity means "having insight into, and give meaning to, the events and happenings in the data," write Strauss and Corbin (1998: 46-7), adding, "that enables us to recognise incidents as being conceptually similar or dissimilar and to give them conceptual names". While sensitivity accrues from earlier knowledge and experience, it is also, writes Glaser (1978) "necessarily increased by being steeped in the literature that deals with both the kinds of variables and their associated general ideas that will be used. ... This theoretical grasp of problems and processes within data is – in our perspective – a very useful way to understand what is going on in a substantive area and how to explain and interpret it" (p. 3). I have outlined how, observing my first piece of data in a newspaper, I was drawn to how the reported event challenged my notions of economic theory. In that respect, this thesis was conceived as a result of theoretical sensitivity.

Glaser turns the issue of theoretical predispositions and biases on its head with an interesting argument. Can the use of theoretical sensitivity discipline a researcher's "proclivities and premises", rather than encourage them?

> "Most generally," he writes, "the background experiences of one's education and training is used to *sensitise* the researcher to address certain kinds of broad questions. Thus, one's methodological orientation is broadly, rather than narrowly, based in one's scholarly discipline. Its sensitising nature lacks specification of attributes, but forms guidelines and reference points which the researcher uses to deductively formulate questions which may then elicit data that leads to inductive concepts being formulated later. But, most importantly, the sensitising concept is not simply verified through the research process. Instead it is used to uncover *data* that otherwise might be overlooked" (op cit: 39).

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[8] Many doctoral research programmes are structured to accommodate this traditional model, with the first year dedicated to a theoretical literature review and development of hypotheses. This constraint helps to explain why grounded theory remains unconventional. Grounded theory has also been severely mischaracterised as an inductive method (Glaser and Holton 2004). That view neglects the processes of constant comparison, theoretical sampling, and theoretical saturation, which are all essential for deduction and verification in the method.

In this way, theoretical sensitivity helps direct the analyst to useful new *data* for sampling that he might have overlooked.[9] By contrast, the traditional research model, argues Glaser, can close off valuable research trajectories:

> "[Traditionally,] hypotheses are created before the researcher has initiated the investigation. The investigator may then feel compelled to find the information that is presupposed by the hypotheses that were logically derived. [...] Commitment to pre-conceived hypotheses may limit the kinds of observations, information and insights that the researcher makes [...]. He finds himself subject to a non-strategic, fixed and immovable research design. His theoretical sensitivity is thwarted" (op cit: 38).

Theoretical sensitivity is harnessed by a number of specific guidelines, which I now turn to.

2.3.1. Temperament

To make grounded theory a "careful method of idea manufacturing" (Glaser 1978: 7) several guidelines exist, with an associated technical toolkit. They rely first and foremost on the following personal characteristics of grounded theorists:

- "The ability to step back and critically analyse situations
- "The ability to recognise the tendency towards bias
- "The ability to think abstractly
- "The ability to be flexible and open to helpful criticism
- "Sensitivity to the words and actions [in the data]
- "A sense of absorption and devotion to the work process" (Strauss and Corbin 1998: 7).

With this mindset, the following guidelines are recommended: abduction through constant comparison, memoing, deriving a core concept, sampling theoretically, and achieving theoretical saturation.

Guideline 1: Abduction through constant comparison

"Conceptual specification is at the focus of grounded theory", and the method for it has three functions: induction, deduction, and verification (Strauss 1987: 11). The method is based on "a concept-indicator model," which holds that empirical indicators can be abstracted to represent a concept (op cit: 25). These indicators are found in data: events, processes, hierarchies, stated perceptions, etc. Observed phenomena are *constantly compared* until the researcher "constructs concepts that account for relationships defined in the empirical data, and each concept rests on

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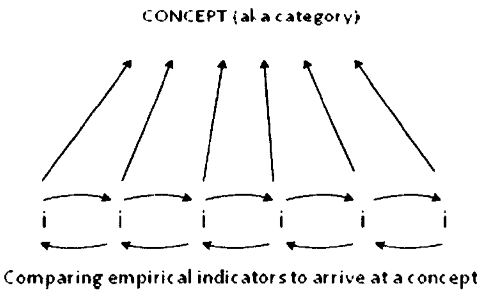
[9] If an analyst has positivistic training, this sensitivity may mitigate biases – it led me to choose grounded theory over a purely interpretivist approach, for example.

empirical data," writes Charmaz (2006: 187): "Thus, the concept is 'grounded' in data". The diagram below illustrates.

Figure 2-3. The concept-indicator model (adapted from Strauss and Corbin 1998: 25)



In comparing empirical indicators, researchers are asking questions. The ubiquitous, persistent question is "What is this data a study of?" (Charmaz 2006: 138; Glaser 1978). The answers may be temporal (e.g. frequency, duration, rate, and timing of phenomena), spatial (location, size, boundedness, visibility), technological (requisite equipments, ease of use, sourcing), and informational (who knows which information, where and how is it sourced), and include values, rules and standards (Strauss and Corbin 1998: 91-2). The analyst draws on several heuristics to keep bias in check; using 'counterfactuals', which turn concepts upside-down to assess alternative outcomes (paralleling a falsification test), and looking out for words such as 'always', 'never', 'fortunately', and 'obviously' in their reasoning. These heuristics identify when personal experiences may be obscuring the data or "intruding into the analysis" (op cit: 97).

Detailed conceptualisation should integrate all of the data into the emerging concepts. Contradictory phenomena may signal higher-order processes. The analyst specifies the contingent nature of the concept its constituent *properties*, and their *dimensions* (see table of definitions below). Thus, conceptualisation as a process can also be referred to as conceptual ordering, or the "organisation of data into discrete categories (and sometimes ratings) according to their properties and dimensions and then using description to elucidate those categories" (Strauss and Corbin 1998: 19).

Figure 2-4. Conceptual ordering (adapted from Strauss and Corbin 1998: 101, 124)

Terms	Definitions	Examples
Categories	Concepts that represent phenomena such as events, problems, or processes	'Market behaviour'
Properties	Characteristics of a category	'Competition' (or 'Investing')
Dimensions	Ranges along which properties vary	'Monopoly', 'Oligopoly'
Codes	Labels attached to words in the data, which represent conceptual categories, properties, and dimensions.	All of the above

Guideline 2: Memoing (analytic momentum)

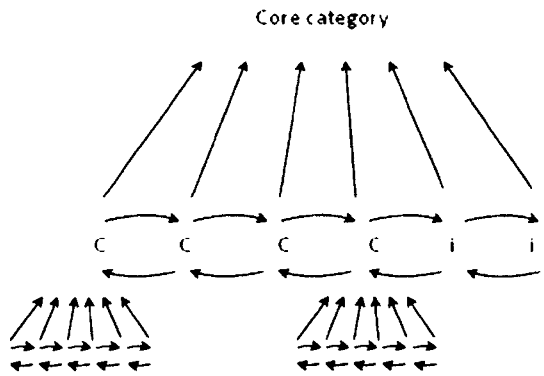
The purpose of developing theory is to find an explanatory or unifying theme for the ordered concepts and their relationships. As Strauss and Corbin (1998) define it, "*theory denotes a set of well-developed categories (eg, themes, concepts) that are systematically inter-related through statements of relationship to form a theoretical framework that explains some relevant social, psychological, educational, [...] or other phenomenon. The statements of relationship* explain who, what, when, where, why, how, and with what consequences an event occurs" (p. 22, original italics). As the analyst codes and conceptualises data, ideas about their relationships emerge. "When the analyst generates a good idea in thought, he must decontain himself immediately by writing a memo on it," writes Glaser (1978: 8).

Memos include records of codes, questions, propositions, and other forms of conceptual development, discussing conceptual relationships and processes (Charmaz 2000: 517). They constitute the "pivotal intermediate step between data collection and writing drafts of papers ... a crucial method in grounded theory [prompting] you to analyse your data and codes early in the research process" (Charmaz 2006: 73). Writing memos frequently and throughout the research ensures analytic momentum and thus helps to "extend theoretical reach further" than a sequence that simply "identif[ies] a process, outline[s] its phases, and then describe[s] them" (op cit: 137). "One hazard of grounded theory approaches is constructing a list of connected but under-analysed processes," writes Charmaz, and analytic momentum reduces this risk (ibid). Refined memos are ultimately sorted and integrated to form the core of the grounded theory (op cit: 94).

Guideline 3: Core category

A grounded theory revolves around a core category that "accounts for most of the variation in a pattern of behaviour" (Glaser 1978: 93). This central concept is related to all the other categories logically and consistently; it is sufficiently abstract to allow its study in new substantive areas; it appears frequently in the data, explains variation in the main pattern studied, and its central idea is also related to alternative cases (Strauss and Corbin 1998: 147; Glaser 1978: 95-6). The diagram below shows that the core category has a similar relationship structure to other categories as the other categories have to their empirical indicators (cf. diagram above; *c* signifies a category, *i* signifies an empirical indicator).

Figure 2-5. Core category accounts for the conceptual variation in the data (author developing Strauss and Corbin 1998)



Ensuring that the core category accounts for as many of the concepts as possible "has the prime function of *integrating* the theory and rendering the theory *dense* and *saturated* as the relationships increase" (Glaser 1978: 93). Thus, the analyst achieves "theoretical *completeness* – accounting for as much variation in a pattern of behaviour with as few concepts as possible thereby maximising parsimony and scope," writes Glaser (ibid): "Clearly integrating a theory around a core variable *delimits* it and thereby research project". "Another delimiting function of the core category occurs in its necessary relation to *resolving the problematic* nature of the pattern of behaviour to be accounted for," he adds (ibid), "Without a focus on how the core resolves, solves or processes the problem, the analysis can drift to accounting for irrelevancies in the pattern, instead of being forced to integrate around the problematic".

Guideline 4: Theoretical sampling

Sampling in grounded theory is fundamentally different from traditional sampling, and this difference is at the core of the methodology. Traditionally, the function of sampling is to capture a representative sample of a population 'out there' that will verify or refute pre-determined hypotheses. In grounded theory, the purpose of sampling is "to go to places, people, or events that will maximise opportunities to discover variations among concepts and to densify categories in terms of their properties and dimensions", write Strauss and Corbin 1998 (p. 201). Charmaz (2000) specifies:

> "[...W]e choose to sample specific issues only; we look for precise information to shed light on the emerging theory[, ...] to develop our emerging categories and to make them more definitive and useful[; ...] to refine ideas, not to increase the size of the original sample. Theoretical sampling helps us to identify conceptual boundaries and pinpoint the fit and relevance of our categories" (Charmaz 2000: 519, added italics).

The researcher samples to better understand ideas that are repeatedly present; act as conditions or variations of a major category; or appear inconsistent or unexplained. For example, if a researcher is studying the concept of "work flow in a doctoral project", he or she might sample data from doctorates in various disciplines, or across countries, or at different stages in the student's experience, etc, depending on which settings would best help explain and interpret the problem under investigation (Strauss and Corbin 1998: 202). New empirical settings can be determined with questions like, "What would happen if...? When? How? Where? The answers to these questions serve as the basis for sampling and then making comparisons across those various conditions" (op cit: 203-4). The chosen destinations are those that add density and the conceptual properties and dimensions of the emerging theory, and therefore help identify how the theory varies across relevant contexts.

Guideline 5: Theoretical saturation

Data sampling and analysis continue until the concepts appear to be theoretically saturated; that is, when "more data about a theoretical category reveals no new properties nor yields any further theoretical insights about the emerging grounded theory" (Charmaz 2006: 189). At this point, "the events/behavioural actions [in the data] may vary in detail or in fact just be repetitious – but anyhow the indicators seem to 'add up to the same thing' analytically. ... Nothing new happens as he or she reviews the data. The category and its properties exhaust the data," writes Strauss (1987: 26). An example of a category that became quickly saturated in my research was Citigroup *executing an extraordinary financial transaction*. The properties of this concept – its size, speed, surprise, etc – were indicated in many documents, but it quickly became well-delineated. Saturation not only delimits the sample size, but it is also a central element of verification and authenticity in a grounded theory, because the concepts and their context-specific variations are confirmed by data.

Abiding by these five guidelines thoughtfully would, on its own, set a researcher well on his or her way to being a grounded theorist. However, grounded theory also provides tools that help operationalise these guidelines, which I favour.

2.3.2. Techniques

Grounded theory appears to me to be the only qualitative methodology that outlines transparent and auditable *analytical techniques* (see Dey 2007, Holton 2007, Morse 2007). By analytical techniques, I mean the means of rendering conclusions from data; or the procedures of interpretation. By and large, other qualitative methodologies provide careful advice on harnessing good experiential data, and advert against context-free or skewed interpretations. Handbooks of qualitative research, such as Denzin and Lincoln (2000, 2005) and Huberman and Miles (2002), begin with ontological and epistemological philosophies and illustrate those philosophical camps as applied to specific contexts. These are excellent guides for discovering one's academic voice and world view, and they changed my epistemological positioning and research objectives significantly, by exposing me to a much wider set of issues than I had been aware of. However, these seminal works can hardly be said to outline analytical techniques, not least because such techniques are often seen as positivistic and detached, contrary to qualitative, interpretivist practice (Charmaz 2006: 132). The techniques mentioned in standard qualitative research literature – such as coding, comparing categories, and theoretical sampling, among others – are borrowed from grounded theory.[10]

I find these techniques valuable because they supplement epistemological *objectives* and methodological *strategy* by *operationalising* the analysis process. So doing, they make the analysis auditable. That is, "once an analyst explains in detail how he or she arrived at a conceptualisation other researchers, regardless of their perspective, should be able to follow the analyst's path of logic and agree that it is one plausible explanation for what is going on," write Strauss and Corbin (1998: 146). As a postpositivist, I find that this auditability makes the analysis more persuasive across specialisations, and therefore more useful across substantive contexts. The following is an overview of the techniques employed in this research, and how they relate to the temperamental guidelines outlined above.

Technique 1: Open coding

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[10] This appropriation of GTM techniques by other qualitative research traditions might explain the somewhat surprising claim in the back cover of the *Sage Handbook of Grounded Theory* (Charmaz and Bryant 2007) that "Grounded Theory is by far the most widely used research method across a wide range of disciplines and subject areas, including social sciences, nursing and healthcare, medical sociology, information systems, psychology, and anthropology".

Coding is the basic analytical operation, and it means attaching a conceptual label to a segment of data, such as a word or sentence. Codes may be generic processes that describe an action or interaction at a conceptual level, like 'managing risk'. Coding begins as a word-by-word or line-by-line analysis of a text. In the coding process, "Data are broken down into discrete parts, closely examined, and compared for similarities and differences [using the comparative method.] Events, happenings, objects, and actions/interactions that are found to be conceptually similar in nature or related in meaning are grouped under more abstract" conceptual codes, write Strauss and Corbin (op cit: 102). Once a specific, evolving code is found to describe a wider set of data, it is a 'category'. Conceptualisation through questioning and comparison reveals categories' *properties* ("generic or specific attributes of a category") and their *dimensions* ("the location of a property along a continuum or range") (op cit: 117). For example, the category 'managing risk', may have properties described with codes like 'collecting information' and 'hedging an investment'. The property 'collecting information' may in turn have several dimensions like 'consulting colleagues', and 'consulting documents'. Coding without any preconceived categories is known as 'open' coding.

Technique 2: Axial coding

Axial coding is used once open coding has led to the emergence of several conceptual categories, and its purpose it to establish the categories' internal relationships, to give them more explanatory power. Concretely, the process is to "code intensely and concertedly around single categories," writes Strauss (1987: 64): "The analyst hypothesises about and increasingly can specify varieties of conditions and consequences [associated with the category.] By doing this, the analyst begins to build up a dense texture of relationships around the 'axis' of the category being focused upon" (ibid). For example, axial coding for the category 'managing risk' would involve conceptualising the relationships between various properties like 'collecting information' and 'hedging an investment' and their dimensions. Some of the questions explored would be, 'How is information collected for the purposes of hedging an investment?', 'Who mediates this process?', 'When does the process fail?'. In answering these questions, the analyst re-orders and re-words the various properties and dimensions to ensure they closely represent the data, at a conceptual level. It is key to stay focused on the specific category and data set, "not allowing diversionary coding temptations to interfere with this specific and highly directed coding" (Strauss 1987: 65). Ultimately, the operational purpose is to "reassemble data [and concepts] that were fractured [or, segmented] during open coding," in order to "explain, in a general sense, what is going on" (Strauss and Corbin 1998: 124, 145).

Technique 3: Selective coding

The analytical process leads the analyst to identify a core category, or unifying theme, for what he is researching (Guideline 3). This category represents the main pattern of behaviour that is problematic in the research. Once a core category is decided upon, the analyst is likely to begin theoretical sampling; looking for data that shows variations of the core category in new places, or time-periods, with new people, etc (Guideline 4). This is where selective coding comes in. It is the process of coding the relationships between the core and other categories. It is like axial coding, but between the core category and others, rather than between categories and their properties and dimensions. This process is central to developing theoretical propositions. For example, in Chapter 3, I identify the *expectation that Citigroup would help to ensure market confidence* as a central category. At the end of that chapter (Section 3.4), I integrate other categories with this central concept, by arguing that *ensuring market confidence* entails *foreseeing and treating risk*, for example. The latter category is presented as a necessary condition for the core category, based on selective coding. The reader will also notice that the category *foreseeing and treating risk* is a re-formulation of 'managing risk'. This re-formulation was done through axial coding, to be more representative of the different dimensions (foreseeing, treating) observed in the data. Selective coding is, in sum, "the process of integrating and refining the theory" (Strauss and Corbin 1998: 143).

Other established coding techniques and rules-of-thumb may be deployed for specific problems and interests, should they arise (Strauss and Corbin 1998, chs. 7, 11, 12; Strauss 1987, ch. 8; Charmaz 2006, ch. 5). Among those that I found useful were counterfactual analysis, noted earlier. It involves trying to falsify one's hypothesis by asking, 'what would it take to prove me wrong?' and then looking for that data. I use this explicitly in Chapter 4 (Section 4.2), where I conclude that the political resistance to sovereign wealth funds was better explained by politicians' desire that the funds observe certain norms of market conduct, than it was by protectionist instincts in government. As I have noted, Strauss, Corbin and Charmaz advocate strongly that techniques should be tailored to the specific problem at hand. Indeed, as Barney Glaser (1978: 2) wrote, grounded theory methodology is valuable because it ensures that methods are "directly formulated, controlled by or related to how the theory will be developed", provided that the central 'temperament' guidelines that I described are observed. Researchers may also develop their own procedural operations (Strauss and Corbin 1998: 273).

Technique 5: Code logging

I developed a code logging process to help me administrate my thinking between the coding and memo-writing stages. Grounded theorists write memos to capture new thinking during the coding processes, and many memos evolve into the final written product. However, maintaining analytical momentum (Guideline 2) is difficult when the analyst is administrating many codes and eager to remain faithful to the data – good ideas may leave one's mind as quickly as they emerged. To resolve this problem, and to give me a sound basis to go back and review my propositions, I found it helpful to maintain a log of where I found each code. I illustrate the log's component parts contextually in Chapter 3, Section 3.1.3. On a spreadsheet, I listed the emerging categories, properties and dimensions vertically. Then I created a matrix, listing all the data sources horizontally. When each code appeared in a data source, I noted its prominence in it. A 1 signalled the code appeared in the source, a 2 signalled it was analysed in some depth, and a 3 signalled that it was the main focus of the source. Alongside, I also noted where two codes where strongly associated with each other. For example, if the data described process A as causing process B, then I cross-referenced each process in the log. The log was a 'live' tool. It changed significantly, both in format and density, as I re-ordered concepts through axial and selective coding. For some time, I had supporting tools, like a code definitions spreadsheet, where I ordered the emerging concepts. As concepts became theoretically saturated, I stopped logging where they appeared. As a result of the code logging process, I had a reference guide indicating where to find information on each concept whenever I turned my attention to a particular memo. Thus, code logging facilitated both the "ideas manufacturing" process, and the quality control.

2.3.3. Quality: A grounded theory's claims, and criteria for evaluation

The balanced emphasis on temperament and technique lends grounded theory methodology a postpositivist epistemology. The process of abstraction is, ultimately, an interpretive one (Charmaz 2006). However, it is an interpretation that seeks to approximate truth. As Lomborg and Kirkevold (2003: 194) put it, "Neither the recognition that the truth is never fully established nor that theories are historically embedded [contradicts] the existence of a reality that is – at least partly – independent of human consciousness". On this premise, I now clarify how generalisable my CMR propositions aim to be across substantive contexts. First, I discuss the problem of generalisability by arguing that a theory is only useful and relevant if it is somewhat generalisable, and that generalisation is increasingly accepted in qualitative research. Then, I draw out a distinction between grounded theory and case study analysis: grounded theory seeks to conceptualise empirical settings comprehensively, not to outline an "accurate" or "thick" description of events. Finally, I set out the quality criteria for a good grounded theory.

2.3.3.1. Why generalise: Making qualitative research useful

The usefulness of qualitative research is an unclear notion. Usefulness often entails applying analytical insights outside the contexts from which they were derived; *useful* analytical insights are effectively *tools*. Yet, qualitative research tends to be interpretivist in nature (Schofield 2002), and interpretivists are sceptical of applying analytical insights across contexts. Denzin (1983), for example, writes that, "for the interpretivist every instance of social interaction, if thickly described (Geertz 1973), [...] must be seen as carrying its own logic, sense of order, structure, and meaning" (p. 133-4). This means, add Guba and Lincoln (1981), that "it is virtually impossible to imagine any human behaviour that is not heavily mediated by the context in which it occurs [and therefore] One can easily conclude that generalisations that are intended to be *context-free* will have little *that is useful* to say about human behaviour" (p. 61, italics added).

I would argue that research findings that cannot be generalised to new contexts will also have little *that is useful* to say about human behaviour. Building knowledge solely for the sake of *understanding* social phenomena may be worthwhile, but it is hardly *useful*. To be useful, social science research should, at a minimum, be generalisable within substantive environments and across similar ones.

Indeed, over time, compromise positions on generalisations have emerged from within the interpretivist tradition. For example, Lincoln and Guba, by 2002, write that case studies "serve as metaphors <u>useful</u> to the reader to <u>stretch and test</u> his or her own knowledge; they provide the <u>vicarious experience from which the reader may learn</u> (as we do from all experience)" (p. 206, underlining added). To live vicarious experiences is to transfer knowledge into a new setting; e.g. new research or interventions. According to this view, even interpretivist case studies do not provide merely transitory knowledge that is irrelevant outside its specific context; they have utility. If we agree that it is desirable for research to be useful, and that to be useful, research results must be at least tentatively generalisable, then we must determine how to achieve that generalisation.

2.3.3.2. Generalisation through comparisons

Grounded theory methodology differs from other qualitative research traditions because it aims for conceptual theory with generalisable properties, and has different criteria from case studies (Glaser 2007: 99). In traditional qualitative research, the objective is to provide "accurate" or "thick" descriptions of events or actors through case studies (Schofield 2002: 179; Geertz 1973). These descriptions are usually not generalisable in a strict sense, even if they provide vicarious insight for new applications. They focus on obtaining and presenting in Denzin's words (2002), "personal experience stories and self-stories that embody, in full detail, the essential features of the phenomenon..." (p. 360). Grounded theory's objective, by contrast, is to derive theoretical concepts that render faithful abstractions of the researched experiences.

These two objectives, thick description versus conceptual theory, have significant parallels. The grounded theory ethos that "data is king", and the criterion that collection and analysis should continue until a category is theoretically saturated, demonstrate grounded theorists' focus on accurate renderings of theory. Indeed the exhaustive coding of data might be characterised as creating a "thick theory", rather than a "thick description". In addressing this distinction, Dey (2007), a grounded theorist, strikes a conciliatory tone:

> "The nature of a case is problematic in grounded theory, especially as Glaser and Strauss deliberately rejected a case-based approach to sampling in favour of analysing social processes comparatively across different settings. However, even settings can be treated as cases and used for systematic comparison..." (p. 180).

This thesis analyses and compares three empirical settings of varying scope – Citigroup's Eurobond controversy, the rise to prominence of sovereign wealth funds, and the regulatory debate during the credit crunch. Rather than approaching them as case studies, I treat them as settings where through careful comparisons I can identify generic processes to build theoretical propositions. Whereas case study analysis would dig into the data in a search for an interpretive meaning, the propositions I develop rise from the data through comparison and abstraction. This helps make the resulting theory tentatively generalisable, and therefore useful. This conviction is evident even in constructivist grounded theory (Charmaz 2006: 133).

2.3.3.3. Substantive grounded theory: Claims and criteria

Varying levels of generalisability are evident in grounded theory methodology, in the lexicon of *substantive theory* versus *formal theory*. Substantive theory is a theoretical rendering of specific sets of actors or events, not yet extended beyond one or a few similar contexts. It is tentatively generalisable within its empirical settings whilst acknowledging situational idiosyncrasies, and offers an interpretive frame for researching and shaping emerging situations in other contexts. A substantive theory becomes more generalisable when the researcher samples for variations of the core category across more empirical contexts. The new settings are selected on the basis of whether similar social processes are evident there (theoretical sampling). With enough investigation, a substantive theory may eventually become a formal theory. Glaser (2007) writes that the level of abstraction is not the defining feature of a formal theory: "Let the level of abstraction fall where it may," he writes, "as the generation of formal theory pursues the general implications of the core variable" (p. 102). In other words, however abstract a core concept, it only substantiates formal theory if it is generalisable.

This thesis presents a substantive theory which has predictive power that is, on one hand, limited by the recognition that reality is historically and culturally embedded and never fully apprehendable, and, on the other hand, supported by comparisons and conceptualisations of similar social processes across empirical settings. From this broad characteristic, two specific claims follow. First, the propositions from this thesis should improve the understanding of these episodes such that another analyst with a similar theoretical background and following the same procedures would arrive at similar conclusions. Put differently, the theory should be valid and reliable within the studied empirical contexts. Secondly, the theoretical propositions should be usable by other researchers as potential explanations for new emerging phenomena. For example, in Chapter 6, I note that the debate that recently emerged about private capital markets known as 'dark pools', *might* be understood as an attempt to define a 'corporate market responsibility' for the market actors involved. The sporadic bursts of scrutiny affecting hedge funds may also have a similar interpretation. If I have done my job well, then the propositions around 'corporate market responsibility' should help researchers and practitioners to learn from, adapt to, and shape some emerging situations in financial market governance.

These objectives are consistent with the quality criteria for grounded theory advanced in the literature, of which there are two strands: classical and new. After outlining both sets of criteria, I specify which I set out to meet.

Figure 2-6. Criteria for evaluating a grounded theory I (adapted from Glaser 1978: 4-5)

Classical criteria	
Fit	Categories fit the data; data not selected to fit an extant theory; most of the categories are generated directly from the data; categories are refit to new data, and there is emergent fit between data and pre-existing categories
Work	Theory explains what happened, predicts what will happen and interprets what is happening.
Relevance	Theory allows core problems and processes to emerge; theorist does not have to spend time to convince others of the relevance of his work.
Modifiability	Categories allow for ready, quick modification to help explain surprising or new variations in an ever changing world, as new data emerges; and can be extended to new substantive contexts; maintains tractability and hence relevance.

As Lomborg and Kirkevold (2003) note, these classical criteria are "internally related":

> "It seems reasonable to believe that, all being equal, a relevant theory should work in practice, and that a theory generated from empirical data should be relevant. If one recognises that social reality is dynamic and therefore continuously goes through slight changes, then the fitness of a theory must be understood as being situated in a context with possibilities for modification as the theory is brought into new contexts where new data is available" (p. 191).

Newer criteria demonstrate grounded theory's move into a more constructivist domain.

Figure 2-7. Criteria for evaluating a grounded theory II (adapted from Charmaz 2006: 182-3)

New criteria	
Credibility	Achieving intimate familiarity with the topic; sufficient data to merit the claims; systematic comparisons between the categories
Originality	Categories are fresh and offer new insights; new conceptual rendering of the data; challenge, extend, or refine current ideas
Resonance	Categories portray the fullness of the studied experience; reveal unstable 'taken-for-granted' meanings; analysis offers insights to people in the analysed environment
Usefulness	Interpretations that people can use practically; generic processes; analysis sparks further research in other areas; contributions to knowledge and making a better world

Two sets of criteria overlap, as the criteria of fit and credibility both call for an accurate theoretical rendering of data. Relevance and resonance are also closely related: the theory is readily apprehendable by those familiar with the studied phenomena. However, some divergence is evident as new grounded theory has moved away from positivism. The new criterion of resonance, "portraying the fullness of the studied experience", invokes thick, descriptive renderings, more commonly associated with constructivist research. The classical criterion of "work" is phrased as a very positivist and realist criterion, invoking a seemingly immutable external reality.

Whereas a researcher might ordinarily pick one set of criteria, a postpositivist researcher who recognises both positivist and non-positivist insights may well need to meet both. To do so, I should caveat the two more extreme criteria of *resonance* and *work*. The "fullness of the studied experience" should be captured by good *fit* and *credibility*. The theory should *work* well, but inevitable historical and social idiosyncrasies should be recognised. In Chapter 6, I present the propositions and assess how they meet these quality criteria.

2.4. Researching three empirical settings

A journey begins before the travellers depart.
Kathy Charmaz (2006: 1)

For a postpositivist, a research problem "exists when there is a [perceived] discrepancy between what ought to be and what is" (Morçöl 2002: 109, citing McKenna 1980). To perceive this discrepancy, researchers rely on their theoretical sensitivity, derived from their research background and experience. My curiosity was initially piqued by an article about a Eurobond trade by Citigroup, which is reproduced on the next page. The transaction became known as the 'Dr Evil' trade, after the nickname that Citigroup traders gave to their software programme. Recalling my undergraduate study of economics, I thought 'this is not how the economy is meant to work'.

In this event, the discrepancy between what seemed to be (making money from having large amounts of it to begin with) and what ought to be (making money from selling better products, asking lower prices, or making efficiency gains) was curious. Six days after this article, I read that the UK's Financial Services Authority (FSA) would be investigating Citigroup for violating principles of conduct, despite Citigroup not having broken the law. According to the press, the bank had broken a "gentlemen's agreement" in the market (*e.g. The Times* 2004), but it was unclear what that gentlemen's agreement had been. When the FSA (2005) fined Citigroup for having demonstrated "undue regard for the efficient and orderly operation" of the market, it seemed to suggest that even highly transparent and efficient markets like the MTS do not self-correct. The FSA's judgement prompted the question 'how are firms responsible for ensuring orderly financial markets?' This is where the research began.

Figure 2-8. First report that inspired the thesis

Citigroup's brazen bond bet pays off

But sooner or later there will be a casualty

The Guardian, Wednesday 11 August 2004

How do you make £8m in half an hour? The answer, it seems, in the case of Citigroup, is to sell a container-load of bonds issued by eurozone countries, creating a market panic in the process, before then buying back a chunk of the same bonds at lower prices.

This, or something like it, seems to have happened on a quiet day last week. Citigroup, the world's largest financial institution, refuses to talk in detail about the saga, but it is nevertheless clear that it sold an astonishing **€11bn** (£7.3bn) worth of eurozone government bonds via the Italy-based MTS electronic trading system.

Across a wide range of debt instruments, this had the predictable effect of pushing down prices - by about 40 ticks, or 0.4% of a percentage point.

It may not sound much but, when you are dealing in billions, small margins can still translate to substantial profits. **When Citigroup bought back €4bn of the same bonds half an hour later it will have benefited by about €12m,** assuming a more conservative profit (or spread) of about 30 ticks.

Eurozone bonds will seem pretty esoteric stuff to many readers, but many dealers who found themselves on the losing side of these transactions reckon Citigroup is guilty of something akin to market manipulation. **MTS, which is owned by a group of banks, is sufficiently concerned to have placed a temporary restriction of €1bn** on the amount that any bank can trade within two minutes.

Of course, Citigroup did nothing illegal here. It legitimately filled orders that had been placed by willing counterparties, all of whom were grown-up financial institutions used to dealing in large numbers.

The novel aspect was to trade in such size across a range of debt at such speed. It looks to have been a clever, if controversial, piece of market trading.

Even so, two thoughts occur. One is that eurozone governments will not like the idea that a US investment bank is using its huge balance sheet to play silly buggers with their debt, particularly if the effect is to reduce liquidity; Citigroup, which likes to act for governments directly, will have received some black marks in certain European capitals.

Second, the tale illustrates the truly huge sums now involved in what the investment banks call proprietary trading, and outsiders think of as gambling with the bank's capital.

The buccaneering Citigroup trade was clearly well-designed and executed - but, sooner or later, there will be a major casualty in this game.

As theoretical underpinnings for the Citigroup episode emerged, it became necessary to analyse how well they applied to new settings, and I sought other episodes that appeared to display similar characteristics as the Citigroup case, thus giving the emerging concepts more fit, relevance, and modifiability over time. I was not seeking to confirm or refute the sensitising concepts (Strauss and Corbin 1998), or à priori constructs (Eisenhardt 2002), that emerged from the Citigroup episode. Rather, I sought out how they appeared to vary in a new context. I identified two other episodes, as well as data sources that were consistent both with the concepts I was researching, and across the episodes. In the following paragraphs, I explain how these decisions were made.

2.4.1. Selecting empirical contexts

In 2007 I became aware, through news reports, that politicians and analysts were expressing concerns about the market conduct of sovereign wealth funds (SWFs). The funds, which are government-owned, were very large and growing quickly and it was feared that they might destabilise markets (IMF 2007) or invest in order to further political objectives. Sovereign funds became highly controversial in 2007, sparking reviews of national investment policy in many Western countries, which in Germany's case let to a new regulatory institution. The controversy had an interesting parallel to the Citigroup case. Much like it was unclear what "gentlemen's agreement" Citigroup had broken, no one accused sovereign funds of actual misconduct. Their very expansion was based on chasing financial returns, and none of their investments had been viewed as untoward. Yet, political pressure soon emerged for SWFs to sign codes-of-conduct that would ensure that they adopted practices that would safeguard efficient and orderly financial markets.[11] Good market conduct, adopted to mitigate regulatory risk, would supplement legal and competitive behaviour. In this case therefore, and as with Citigroup, regulatory authorities appeared to be holding sovereign wealth funds responsible for their impact on markets.

In the Citigroup episode, the main pattern of behaviour that needed to be investigated was why the trade had been controversial, given that it was legal and followed basic economic tenets. The explanation I advance is that there was a requirement that banks would help ensure market confidence and stability on the MTS bond exchange, even if that entailed higher administrative costs (e.g. risk management) and opportunity costs (abstaining from certain transactions). I wanted to understand to what extent, and how, there was a similar expectation of sovereign wealth funds. Despite the controversy surrounding them, there were no empirical grounds that would justify it. Based on press and regulatory data, I argue that the controversy represented an attempt to define good market conduct for the funds, which were newly significant actors in international financial markets. The codes-of-conduct, which ended the controversy, were characterised as capitalism "user-manuals" for SWFs. They could be regarded as guidelines for responsible financial market participants, and they were predicated on many of the same behaviours that regulators had invoked for Citigroup. Therefore, the SWFs episode helped to substantiate and add variation to the propositions I was developing.

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[11] There were salient concerns that SWF investment (1) signalled a reversal of decades of privations and might lead to inefficient industries or (2) was carried on such a large scale that it would destabilise markets (Chapter 4, Section 4.2.3).

My discovery of the sovereign wealth funds episode was what Strauss and Corbin (1998) call a "fortuitous" variant of theoretical sampling:

> "The researcher happens on theoretically significant events quite unexpectedly during field observation, interviewing or reading documents. It is important to recognise the analytic importance of such an event or incident and to pick up on it. This comes with having an open and questioning mind and with being alert" (p. 209).

Although the selection of the episodes was sequential, the analysis was cyclical. Comparing generic processes across episodes helped me to ask new questions of my preliminary substantive conclusions, and to review them. I demonstrate my preliminary conclusions in each episode's chapter (3, 4, 5), and then integrate them in a single theoretical chapter (6).

My initial intention was to use the two episodes – one micro and one macro – to conduct the kind of comparative analysis that Moses and Knutsen (2007) discussed: "comparing particular events and general norms helps us to understand the event as more than just particular, or local [... and] to uncover meanings by juxtaposition of the particular against the general" (pp. 238, 240). However, the financial crisis that erupted during this research gave rise to a third phenomenon that appeared to reinforce the contemporaneous relevance of my research. Many started to blame the crisis on an "age of irresponsibility", a new concept in the public domain (Brown 2008, Obama 2009). By then, my analysis of Citigroup and SWFs suggested that they had been held accountable for protecting market confidence and stability. Against this background, "irresponsible banking" seemed an essential issue to account for in the emerging propositions.

A significant international regulatory debate emerged as to what had gone wrong in the lead-up to the crisis, and how to resolve it. Blame for the crisis was attributed to a wide range of actors, from regulators who did not prevent excessive risk in the system, to financial institutions who lent and traded imprudently, and consumers who borrowed beyond their means. As in previous episodes, I focused on financial firms' behaviours. The regulatory debate held that banks had somehow acted irresponsibly even where they had complied with the applicable regulations, and (especially) where they had maximised returns – ostensibly the two sole responsibilities of business (Friedman 1970). In this way, the central problematique of the debate on corporate conduct was similar to those of the Citigroup and SWF cases. Using the techniques of theoretical sampling and theoretical coding, I analysed what the regulatory debate and the ensuing coverage in the news had to say about the specific themes identified in the earlier episodes: risk management, investment policy, and firms' proactive improvement of their shortcomings. The Credit Crunch episode contributed new concepts as well as variations on existing themes. Like the SWFs episode, this episode was another case of "fortuitous" theoretical sampling, where I happened on significant new events in the course of my research. It is a tribute to grounded theory methodology that it allowed me to extract new theoretical insights from the emerging episode. The case enabled me to broaden the scope of analysis to the full systemic level. Thus, I completed a trajectory from analysing a single actor in a well-defined market, to a set of similar actors across several markets, to a wide range of banks and bank-like institutions across all (Western) financial markets.

To clarify the similarities and differences in each of these episodes, the following table draws some distinctions.

Figure 2-9. The episodes' conceptual features

	Citigroup controversy	SWF prominence	Post-Credit Crunch debate
Problematique	Controversy around a legal, profitable trade	Controversy around rise of new market actors	New debate on "irresponsible banking"
Conceptual account (explanation)	Firms' responsibility to ensure market confidence	Efforts to establish 'good market conduct' for SWFs	Responsibility for firms to help regulators pursue objectives
Financial actors	Large investment banks	Large investment funds	Large banks and funds
Market domain	Bond markets	Bond and equity markets	Credit markets and others
Data sampling	All news reports on 'Citigroup' and 'MTS'; related regulation	All news reports on 'SWFs' and 'controversy'; related policy documents	Selected news reports and policy documents on financial regulatory reform
Contribution I	Theoretical account of the Citigroup episode	Theoretical account of the SWF episode	Theoretical account of the Credit Crunch episode
Contribution II	Sensitising concepts, theory 'building blocks'	Conceptual variation, tentative propositions	Theoretical saturation, leading to final propositions

2.4.2. Selecting data

Insofar as the question of how firms are responsible for ensuring orderly markets is a general question about broad-based expectations of corporate conduct, I sought data that would convey a broad basis for answering it. The first data type was news reports of the episodes. It is well known that news reporting influences societal responses to markets (Islam 2002, Herman 2002, Shiller 2002, Dyck and Zingales 2002, Stiglitz 2002), and sometimes alert researchers to new research problems. In her study of "Social construction of a perfect market", Garcia-Parpet (2007) was persuaded to return to a specific market because "Media coverage ... made me aware of the fact that this market form was threatened" (p. 46). In not dissimilar fashion, the media alerted me to the Citigroup case. However, I took my use of the media a step further than Garcia-Parpet, and used it as a data source in itself. News articles are rich in insight because, as Shiller (2002) puts it, "Significant market events generally occur only if there is similar thinking about large groups of people, and the news media are essential vehicles for the spread of ideas" (p. 84). The media's contribution to public debate occurs both through reports and a word-of-mouth effect, particularly when journalists, market actors, government officials and academics form de facto epistemic communities. Like Shiller and other political economists and sociologists, I take it as given that the media provide valuable data about market expectations (see also Knorr Cetina and Preda 2005). The challenge was to use that data consistently with my epistemological positioning, attending to skewed or biased reporting. The next subsection below discusses how I dealt with this problem.

As news reports emphasised the centrality of regulatory and political reactions to the controversies, it became necessary to analyse those reactions in more depth, and therefore regulatory and policy papers were also sampled. The reports indicated that non-market actors were the main catalysts for deciding how the episodes would evolve. In the Citigroup episode, the reporting focused primarily on the regulatory implications of the bank's conduct. Citigroup's apologies, for example, were interpreted as attempts to manage regulatory risk. When other banks discussed how to retaliate, they focused on the possibility of lobbying the regulators against Citigroup. Ultimately they decided they could not, because Citigroup had not broken the law; they expressly decided to wait for the regulators' decisions. In the sovereign funds controversy, the main drivers were once again political. The 'grand debate', and the impending resolution, was whether Western governments would block SWF investments. It was not, for example, how joint ventures between SWFs and other financial actors would evolve within the market environment. The resolution came through codes-of-conduct for SWFs (brokered by the IMF and the US government), which thus acquired central analytical value. Finally, in terms of the fall-out from the credit crunch, the loudest invocations of the "age of irresponsibility" came from government, through the UK Prime Minister and US President. On this basis, all three episodes have regulatory and political documents that earned their way into the theory. That is, comparing this data to the concepts identified in the news reports would help to increase the concepts' density and variation, without having to draw on extant theoretical justifications for data selection and without compromising the theory's parsimony.

While official documents are very commonly used as data in grounded theory, news reports are not. In their helpful correspondence with me, Barney Glaser and Kathy Charmaz could not point me to other examples. Strauss and Corbin 1998 (p. 52) list newspapers as useful primary data, but do not discuss how to treat it. Therefore, I have devoted particular attention to that in the following explanation of my sampling decisions.

2.4.2.1. News reports as data

Asserting that the media facilitate the spread of ideas and capture debates about financial markets is, of course, not the same as assuming that the media are neutral. Shiller (2002) argues that, "Although the media ... present themselves as detached observers of market events, they are themselves an integral part of these events" (p. 84). Indeed, news reports may elevate their subjects to undue importance. That is, a reader may conclude that a reported event is more significant, either epistemologically or in application, than subsequent events justify. This is why Taleb (2004: 50) writes, tongue-in-cheek, that "To be competent, a journalist should ... play down the value of the information he is providing ...". Even if the reported event or debate finds traction and *becomes* relevant, it may serve the specific agendas of the news corporation (Herman 2002), and therefore not faithfully represent the substantive debate in society. These limitations could be problematic for theory-building insofar as they would yield a skewed or incomplete understanding of the empirical content. However, I argue below that neither the possibility of hype nor skew are limitations in this study. If it was hype it found traction, and some skew in the reporting could be beneficial, provided that the selection of sources is well carried out.

Hype is the first problem. Shiller (2002) cautions the following: "One can argue that [the media] ought to focus on a variety of topics of interest to general audiences so that the public can refine their views. Yet, in doing so, the media seem often to disseminate and reinforce ideas that are not supported by real evidence" (p. 86). Like Taleb (2004, ch. 11) and Veldkamp (2004), Shiller concludes that news reports may ascribe high significance to ultimately irrelevant news, or "noise", as Taleb calls it. Financial markets are "naturally attractive" to the media, Shiller writes:

> "because, at the very least, [financial markets] provide constant news in the form of daily price changes ... Nothing beats the stock market for sheer frequency of potentially interesting news items. The stock market also has star quality. ... Financial news may have great human interest potential to the extent that it deals with the making or breaking of fortunes" (2002: 85).

From a different – constructivist – tradition Gabriel Garcia Marquez (2002) argues that the demands of technology, which have narrowed the time and scope for research and reflection, are to account for many of the inaccuracies and banalities in the news: "Reporting is, in reality, a meticulous and accurate reconstruction of facts. In other words, it is the news in its entirety, as events actually occurred, presented in a way to make the reader feel as though he actually witnessed them ... In my view, it is the haste and restriction of space that have reduced the stature of reporting ..." (p. 251).

These critiques beg the question: do the reports in my data point to a legitimate, relevant phenomenon, or were issues amplified in order to increase newspaper circulation? There is both the possibility that journalists needed new material to report in order to meet deadlines, and the possibility that they sustained the controversy in order to push an agenda. I would argue that neither possibility compromises my analysis.

The dataset is partly shielded from the first risk because the episodes are not related to frequent price moves and span a relatively long period of time covering relatively few major events. The Citigroup and SWF episodes did not comprise a large number of pivotal events, meaning that there were few *logistical* pressures incentivising reporters to exaggerate the event. In the Citigroup case, there were only five or six turning points through the course of the year that actors reacted to markedly.[12] In relation to sovereign funds, there were roughly three.[13] The high intensity of reporting, in light of infrequent events, may reflect beneficial "research and reflection" (cf. Garcia Marquez 2002: 251); "an effort to make sense" of events (cf. Shiller 2002: 88). Nevertheless, some could argue that persistent reporting in the absence of new events was evidence that the newspapers were pushing an agenda. I would contest that, as I now argue.

The media's economic and political agendas – their skew – are explored from liberal and critical perspectives by Stiglitz (2002) and Herman (2002), respectively. Stiglitz (also citing Sen 1980) argues that "independent" media influence governments to act more in the public interest. Islam (2002) corroborates this in a literature review which concludes that "independent" media with good information and broad reach are often associated with positive economic performance. From this perspective, it is possible to increase the level of transparency and faithfulness in journalists' accounting of debates in society by choosing "independent" sources, with good quality information and broad reach.[14] Herman (2002), also citing Herman and Chomsky (2002, ch. 1) is critical of this view. "As part of the market," he argues, "the media are unlikely to be hostile to the market and oppose polities that dominant members of the market support" (p. 78). Yet my analysis shows that the "hostile to market / favourable to market" distinction is not clear-cut. The media introduced issues and reported controversies that, over time, challenged several dominant ideas in free-market thinking, in particular the idea that markets are self-correcting. Indeed, these challenges are what

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[12] They were the bank's trade, the MTS exchange's judgment, Citigroup's apology, a leaked confidential memo, the FSA's regulatory judgment, and perhaps Germany's initial investigation.
[13] The publication of reports on SWFs by Morgan Stanley and the IMF, the US and EC principles for SWFs, and the final international code of conduct.
[14] Stiglitz (2002) defines this "reach" as reducing natural information asymmetries in the substantive environment.

made the present research worth pursuing. As a result, I find Stiglitz's, Sen's and Islam's arguments (that it is possible to find faithful media sources) a good theoretical basis for using these sources.

The question of whether the newspapers hyped up the controversy does not strike me as a limitation in this study because, either way, the controversies found traction. If everyone agrees that a topic is controversial, then it becomes controversial (Lomborg and Kirkevold 2003). The controversies led to regulatory and political responses and, in addition, some of the debates in the dataset, regarding what constitutes good conduct in financial markets (beyond compliance), continue to resonate with current debates (Chapter 5) about the efficiency of financial markets in light of the financial crisis. If the debates exist, my objective is to make sense of them within a setting where they are carried out, namely independent press.

Undoubtedly, it is interesting to research how the media select issues to report, and how that affects market expectations. However, the present research concerns the *content* of those expectations about the market, not their provenance. In economic sociology, this angle may be seen as a valuable contribution. Smith-Doerr and Powell (2005), argue that there is a "tendency [in market networks research] to focus on the structure of relationships, and neglect the content of their ties" (p. 394). I contend that the content of market expectations discernible in news reports is, in itself, rich and critical enough to merit researching. To increase the credibility of my analysis, I also compare my preliminary conclusions to regulatory documents, and across substantive contexts.

It should be noted that there are many precedents for taking news reports of controversy 'as they are' in order to develop new theory. One might expect this practice to be restricted to positivistic economists who thrive on observer-independent data, but it is not. Richard Swedberg's (2005) article, "Conflicts of interests in the US brokerage industry" is an example; the eminent sociologist frequently references specific media reports as evidence of broader social sentiment. For example, he uses a *New York Times* article as evidence that "it was apparent to many observers that business analysts were getting careless and irresponsible in their analyses" (p. 190). Similarly, in their article "A price is a social thing: Towards a material sociology of arbitrage", Beunza, Hardie and MacKenzie (2006) cite some of the same reports that appear in my Citigroup dataset as a basis for their interpretation. Notwithstanding precedent, and in keeping with a postpositivist approach, I seek to maximise the positive aspects of bias (i.e. being embedded in market and regulatory networks), and minimise the negative aspects (hype and skew). I do this by selecting newspapers using criteria that fulfil Islam's (2002) and Stiglitz's (2002) notions of independence, good quality information and broad reach within the substantive environment.

The newspapers that met the criteria are the *Wall Street Journal*, the *New York Times*, and the *Washington Post* – from the US – and the *Financial Times*, the *Daily Telegraph*, *The Times*, the *Guardian*, and the *Economist*, from the UK. These newspapers are all Western, in order to exploit a direct relevance to the studied phenomena. Direct relevance means the propensity to influence and operate within the same domain as major financial market and regulatory actors – to capture the word-of-mouth effect. A source with direct relevance is useful because it has access to more information and because it adapts its messages more quickly in response to evolving expectations. The newspapers are American and British because Western financial markets operate predominantly from there, and those countries have long served as models of market-based economies. Indeed, in these countries the structure of corporate governance is underpinned by an assumption of transparency (Moon 2004). As a sub-criterion, these newspapers are known, by common knowledge, to be read by decision-makers in market and policy circles.

The sample excludes tabloids, which are often sensationalist. There is value in sensationalism insofar as it magnifies certain expectations, but it can also obscure our view of core messages in the market, since, by assumption, tabloids are not widely used by financial market actors and regulators to inform financial and regulatory decisions. Consequently, I am not looking for popular attitudes in these episodes, but rather for specialised attitudes. The newspapers in the data set have a strong focus on business issues, and thus a higher propensity to report nuance.

These criteria naturally create some limitations. Non-Western media might espouse 'freer' perspectives, unencumbered by peer pressure and Western liberal frames of reference. Sensationalist media might pinpoint where wider popular attitudes differ from expectations in the market. However, these media sources have not, as grounded theorists put it, "earned their way" into the theory. That is, the data does not present questions or inconsistencies that could be helped with these other types of sources (see Glaser 1978: 34-44). I research the 'view from within' in liberal, capitalist society. This means using, as Strauss and Corbin (1998) put it, for "data [which] have the greatest potential to capture the types of information desired" (p. 204).

The choice of newspapers, rather than other sources, is also intentional. Newspapers offer a valuable contrast between reports (where journalists 'try to be objective'), columns (where individuals are required to present an interpretation), and editorials (where the newspaper stakes its position institutionally). The fact that newspapers register the passing of events, actions, themes, contradictions, and reactions in detail allow the researcher to wade through valuable 'unresolved' uncertainties that gripped the episode on a daily basis. The analyst is then able to conceptualise them independently from – and then compare them with – the 'resolved' interpretations ex post, including those in columns. Thus newspapers are unique because they offer a comprehensive registry of events alongside an archive of interpretations, both of them widely accessed by diverse actors in the market and non-market environments, such as bankers, consultants, regulators, politicians, and academics. This makes them deeply substantive, multi-dimensional, and influential data sources.

2.4.2.2. Regulatory and policy documents

As I explained earlier, the media reports suggested that the substantive regulatory and policy documents should be consulted. These documents would help discover conceptual properties and dimensions of the reported data. Another justification for drawing on these documents accrues from political economy theory. If one accepts a distinction between the market and non-market domain (Baron 2003), then regulatory and political documents (which I will refer to here simply as 'regulation') may been seen as attempts to maintain efficient and orderly markets. That is, in Western capitalist society regulation looks to compensate for market failures, including where the market does not self-correct adequately. Thus if the central research question is 'how are firms responsible for ensuring orderly financial markets', there is a predetermined rationale for consulting how that function is carried out by firms' regulatory counterparts. This general proposition is compounded by a more specific rationale in the controversial episodes I am analysing. The regulation delineates what the market actors are perceived to do on their own, can be allowed to do, must be proscribed from doing, and should be encouraged to do. In this respect, they provide a sound data-driven basis for theorising how orderly markets are maintained.

Notwithstanding, regulatory data faces a similar, if milder, problem as media data. Like media, regulators are not neutral. They may face pressures to act idiosyncratically; for example, they may come under pressure to arrive at a quick decision over a contentious transaction (Mayhew 2006). Regulation in specific episodes may therefore not provide generalisable insights about broader trends in markets. However, it is in the nature of regulation to establish precedents and directly influence future expectations both in the market and non-market environments. Whereas individual news reports may be unread or ignored, regulation, strictly speaking, is not. All financial firms employ compliance personnel whose purpose is to examine regulation – circumvent it perhaps, but examine it nonetheless. Therefore, regulation is always material to the substantive environment. Once the key processes outlined in them are conceptualised and compared with other data and other substantive settings, they acquire theoretical significance and provide interpretive frames that can be used to assess new situations. Regulation's traction is evident in the episode data itself. For example, several sovereign wealth funds argued against the political pressure on them by pointing out that hedge funds had received relatively lower scrutiny. Private equity firms signed a code-of-conduct under regulatory pressure and urged sovereign funds to do the same. These different industries used regulatory decisions in different domains to justify their own expectations. The regulatory data in the three episodes therefore provides insights with some basic theoretical resonance beyond the substantive contexts.

For this reason, and to maintain epistemological consistency with the media reports analysis, the regulatory documents are analysed *primarily* for their content 'as is', rather than for how it was internally constructed. Insights into the social context of their construction emerge naturally elsewhere. First, the media data reports the broader social context of the regulatory decisions, and the conditions under which they occurred. Because my analysis compares how generic processes are manifest in the two datasets, my conclusions incorporate the more salient aspects of the social, contextual contingencies of the regulatory decisions. In addition, much of the regulatory data itself notes the rationale for its own construction endogenously. Regulatory documents pertaining to Citigroup explain the FSA's principles-based approach to regulation; the FSA's express 'mindset'. The codes-of-conduct for SWFs outline which public and private sector parties were involved in their design, yielding a fundamental lesson for my analysis: that firms 'signed up' to ensuring orderly markets, under the pressures reported in the news. Similar insights emerge in the credit crunch episode, where the emergence of a political debate on "irresponsible banking" carries its historical relevance endogenously. Ultimately, this matters for my claims on generalisability and resonance. Because the broader embeddedness of the regulation appears in the *content* of the datasets themselves, and because the episodes are contemporaneous, I maintain that the documents provide basic theoretical resonance and support tentative generalisations.

To select which regulatory documents to analyse, I followed the same methodologically grounded principle of direct relevance used to select news sources. While I guided the news sources selection with extant criteria of objectivity, reach and quality (Stiglitz 2002, Islam 2002), to mitigate concerns about the nature of reporting, I guided the regulation selection with theoretical sampling. First, I identified the most relevant documents to the controversies, which were cited in the news reporting. This included the regulatory investigations into Citigroup, the policy documents issued on SWFs, and the regulatory and political statements on irresponsible banking. Then, conceptualisation of that data threw up additional questions whenever phenomena were inconsistent or unexplained. This led me to sample other regulation. For example, the FSA's (2005a) Final Notice to Citigroup was based on the regulator's Principles for Business, but did not invoke Principle 5, on market conduct. Because the news data and other regulators had investigated potential market abuse, I sampled the regulation on market abuse nonetheless, in order to help delineate which aspects of market conduct were and weren't material to the episode. Where comparisons between the data did not yield inconsistencies or unexplained phenomena, including based on my own theoretical knowledge, I did not sample further.

Each dataset is described in detail in the first section of each empirical analysis chapter.

2.4.2.3. Focus on documentary analysis

A priori, my epistemological and methodological approach would not justify introducing new data sources, and here I explain why interviews or questionnaires of market participants were not pursued. Because the research question is about firms' responsibilities, one might have intuited that individuals in firms would provide valuable insights. Moreover, such data is common in doctoral work. It is worth, however, distinguishing between capturing perspectives from a population of market participants within substantive contexts, versus capturing idiosyncratic perspectives from individuals outside the problematiques being analysed. The former is part of my analysis insofar as each of the empirical chapters draws on a range of direct quotations from market participants, harvested from media data, in the context of a societal debate. Idiosyncratic individual perspectives, however, drawn from interviews or questionnaires would be unnecessary (undermining parsimony) and skewed (undermining credibility), as I now explain.

To be consistent with my overall approach, sampling should be driven by conceptual problems and empirical gaps identified during the analysis. The data does not suggest that any idiosyncratic perspectives remained unexplained. Indeed the financial institutions in each episode adapted to the expectations held of them: Citigroup apologised, sovereign funds signed a code of conduct, and although the Credit Crunch episode continues, banks have begun addressing concerns over remuneration, for example, by adopting new compensation structures (AFP 2009). The market perspectives that led to these resolutions are analysed extensively from the news data, particularly in Chapter 3, in light of a putative 'gentlemen's agreement' within the bond market. The central concern of the market participants and other commentators in the data was what governments would do next (which justified the regulatory sampling), and the regulatory data accounted for how firms were being held responsible for systemic impact. 'Corporate responsibility' is, in any case, a construct advanced primarily from the non-market domain (Baron 2003, Jones 1996). Finally, the reports and regulation data captured broad, system-level expectations and events. Purposefully sampling idiosyncratic market perspectives could introduce skew and reduce parsimony because the data had not earned its way into the theory.

Several cognitive and practical challenges contributed to this rationale. The question of firms being responsible for orderly markets is interesting because it problematises dominant thinking about markets, but this creates cognitive obstacles. Even if the conceptualisation of certain behaviours as CMR makes sense based on sampling of documentary data, it was likely to seem 'academic' to market participants (in the colloquial sense, meaning peripheral), particularly as much of this research took place while markets were booming, before the Credit Crunch. Moreover, incentives existed to downplay the concept of CMR because accepting it could implicate changes to established working practices for respondents, higher costs and foregone opportunities. It might also characterise some of respondents' past conduct as irresponsible. As we now know from the post-Credit Crunch debate, financial incentives and risk management practices leading to irresponsible finance are strongly entrenched. Respondents also face legal, ethical, and professional constraints in discussing controversies related to their employers. On these grounds (the value of) idiosyncratic contributions would be limited.

Finally, the value and quality of idiosyncratic perspectives is particularly questionable in lieu of my conclusions. It would be entirely possible, given the cognitive and practical challenges above, that idiosyncratic responses from firms would state that CMR does not exist – that firms are only responsible for compliance and profit-maximisation. This would not detract from the proposition that firms are held responsible for the practices that I have conceptualised as CMR. In other words, it is sufficiently valid to argue that CMR conduct mitigates regulatory risk, if that argument is based on regulatory data. In recognition that regulators do not operate in isolation from firms – on the contrary, that expectations spread through numerous information channels and epistemic communities – I look for insights from market participants in the media data. The reader will find many contrarian, and often contradictory, testimonies from market participants in the empirical analysis.

2.5. Implications of research design: The epistemological boundaries of CMR

Depending on how data is selected and rendered, all theories acquire epistemological de-limitations. In this thesis, the research strategy implies five such boundaries, which I discuss in more length in later chapters.

Firstly, the research design gives the theory a systemic perspective. The reports and regulation apply to broad sets of actors involved in the episodes. While specific people, processes and events are discussed, my conceptualisation of what they have to say and their implications is rendered from a broad systemic perspective because those events are compared with, and conceptualised from, other data in the episode. Therefore, this is a thesis about financial markets broadly, and addresses internal corporate processes (e.g. corporate governance) primarily for their impact on the financial system (e.g. mitigating market risk). This provides a theoretical framework that other researchers may use to analyse specific corporate conditions, such the management constraints that a particular actor faces in implementing corporate market responsibility.

Secondly, and by extension, the primary dynamic is between expectations of CMR behaviours on one hand and regulatory risk on the other. The controversies of the three episodes were embedded in this dynamic: i.e. the regulatory and political reactions to (possibly) irresponsible conduct. Researchers may alternatively be interested in the dynamics between CMR and, for example, asset prices or contractual relationships. To that end, the thesis contributes a number of categories, properties and dimensions (like forms of corporate governance) and, with its systemic perspective, provides a basis for new research into how CMR processes interact with other processes in and outside the firm.

Third, the systemic perspective is further bounded to financial, rather than industrial, markets. The three episodes vary in nature and scope: a single bond market (Citigroup); bond and equity markets (SWFs); and retail/investment credit markets (credit crunch). By conceptualising generic social processes across these environments, I claim resonance and tentative generalisability to other segments of financial markets; such as dark pools and hedge funds (Chapter 6, Section 6.4). Researchers focusing on those settings should find the propositions of CMR to be valid and useful interpretive frames. However, I have not advanced propositions regarding other economic sectors, such as manufacturing, construction, etc. Future research could make that excursion in two ways. First, some individuals, like Adair Turner, Chairman of the FSA, have suggested that banks have a special obligation to help non-financial industries (FSA 2005b). The US and UK government's pressure on 'bailed out' banks to increase lending might be interpreted to resonate with Turner's sentiment. Exploring financial actors' responsibility to industrial markets might therefore lead to a broader construct of 'corporate economic responsibility'. Similarly, researchers may seek to understand how CMR is manifest inside altogether different industries like manufacturing, in the West and beyond.

The research takes a Western (particularly, Anglo-American) view by design. It draws on Western media and regulation because it was based on a perceived inconsistency between mainstream economic theory, which is predominantly Western, and empirical controversies occurring in Western countries. This perspective is, of course, fertile at this time in history when financial markets and conventional economic theory are undergoing extensive review. (The 'corporate responsibility' construct is itself primarily Western; Roche 2002.) By the same reasoning, however, analysing these propositions in non-Western environments would also be valuable. For example, economic sociologists argue that market actions are embedded in social norms (Granovetter 1985). Examining CMR propositions in non-Western societies, where different social norms exist, could extend the theory, and potentially yield new insights into management practice and market governance there.

Finally, the sampling methods and data types that I used imply that this research is embedded in a contemporaneous historical context. I did not make historical embeddedness (which is a primary concern for constructivist theories) a primary focus of the central propositions because the data did not invoke it as a significant enough factor. However, this is largely a matter of salience because explicitly historical processes conditioned the analysis. For example, the political resistance to sovereign funds was often contextualised as a protectionist reaction to the historic shift in financial power away from Western companies and into non-Western governments ('state capitalism'). I argued that an alternative explanation, based on the requirement of good conduct by SWFs, explained the resistance more adequately because even recalcitrant Western countries courted SWF investment (Chapter 4, Section 4.2.3). Not having embedded historical context at the centre of the theory means neither that historical context is absent, nor that theory is context-free.

The temptation is to claim that CMR is becoming increasingly apparent and relevant historically. The catalysts for the episodes were large financial institutions, operating under voluntary governance arrangements, and increasingly across borders. These conditions, which are embedded in the CMR propositions, appear to be increasingly evident. This might therefore suggest that CMR is *increasingly* relevant historically. Pursuing this claim would be a worthwhile direction for future research, sampling across historical time periods. For example, one might comparatively analyse expectations of financial firms during the mercantilist era, or debates in the post-WWII period when powerful new international financial institutions emerged. For now, my claim to historical context is contemporaneous, as follows: CMR propositions are valid and useful (1) to interpret things that are happening 'out there' in financial markets, and (2) to fuel fruitful new research into emerging phenomena in financial market governance.

2.6. Conclusion

With this review of my philosophical inclinations and research method, I have set the objective of building a substantive theory that explains the empirical data and provides an interpretive frame to help understand other situations. Like other postpositivists, I believe one can try to understand what is really happening 'out there' by drawing on systematic and transparent analytical techniques. Still, one must recognise that these tools are mediated by personal, often unconscious, knowledge and norms, and by broader structural and historical trends. In conveying theoretical explanations, we must therefore note which underlying conditions and contingencies are material, to make our theories genuinely useful and tentatively generalisable.

My propositions on corporate market responsibility are built cumulatively in the following chapters. The first concepts emerge in the analysis of Citigroup's Eurobond controversy, which suggested that banks in that market were implicitly expected to help maintain market stability, primarily by stabilising their liquidity provision and by foreseeing and treating market risks. These concepts are then compared in another setting, the rise to prominence of sovereign wealth funds. There, codes-of-conduct for the funds help us understand which behaviours large financial institutions that are relatively new to international financial markets are accountable for, under the threat of political sanctions. Analytical scope broadens again in the third empirical setting, where the debate on irresponsible banking that began during the current financial crisis generates concepts that add further empirical density and variation to the properties of 'corporate market responsibility'. Finally, a theoretical chapter compares and integrates the conceptual accounts of the episodes into a substantive set of propositions, and discusses its contributions to existing theory and future research.

Chapter 3: Citigroup's Eurobond controversy

"There are five words that never fail to excite and motivate us: 'It's never been done before'."

Citigroup brochure[1]

3.1. Introduction

At 10:28am on Monday, 2 August 2004, four traders in Citigroup's European government bond trading desk activated a proprietary software programme to sell a large amount of bonds very quickly. Twenty seconds later, unsure whether the trades had succeeded, they submitted another sell order. By 10.29, Citigroup had sold €13 billion worth of 119 different European government bonds across 11 platforms of the Rome-based MTS bond exchange (Mercato dei Titolo di Stati). This was roughly the same value of bonds as the entire market would typically trade over one day. After reconfiguring their spreadsheet, the traders bought back €4 billion in bonds, realising a profit of €15 million at 11.25am.

Although Citigroup was not charged with market abuse, which is illegal, the operation was highly controversial and led to a fine against the bank. At the time, it provoked "bankers' wrath" (DT1), and "launched a wave of ill will in the bond markets", according to the *Daily Telegraph* (DT2).[2] The MTS exchange imposed emergency trading limits on the entire market (FT1). Citigroup's rivals, primarily investment banks, "panicked" during the trade, overwhelmed by its size and speed, and some withdrew from the market for three days. The financial press reported a near consensus that Citigroup had broken "a gentlemen's agreement". Yet, no one articulated clearly what that agreement had been or what it was for. When the UK's Financial Services Authority ruled on the transaction, in June 2005, it levied a fine of £14 million, corresponding to the profit from the transaction plus £4 million, its biggest fine to date. The bank had not contravened any applicable rules, but the FSA held that it "executed a trading strategy without due regard to the risks and likely consequences of its action for the efficient and orderly operation of the MTS platform" (FSA2). Both

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[1] Cited in *Bloomberg* (2006).

[2] Given the large number of documents in the data sample, the referencing format has been simplified in each empirical chapter (3,4,5). For news reports, a set of initials denote the newspaper title, and a number denotes the article's place in the data sample chronologically. For example, 'FT45' denotes the 45th article by the Financial Times in the sample. The full sample can be viewed in Part 1 of the bibliography. The other initials are WSJ (Wall Street Journal), NYT (New York Times), WP (Washington Post), DT (Daily Telegraph), TT (The Times), and GU (The Guardian). For regulatory documents, a similar format applies: FSA (Financial Services Authority), UKP (UK Parliament), EC (European Commission), and CMVM (Portugal's financial regulator). Documents that are not part of the data sample have been cited conventionally in Part 2 of the bibliography.

the ineffable gentlemen's agreement and FSA's expectation that Citigroup would help ensure an orderly market are intriguing, and the subject of this chapter.

The notion that a firm ought to help ensure an orderly market is unusual from the point of view of conventional economic theory. Economics holds that markets are self-correcting, provided that actors are rational and, as was the case on the MTS, information is freely available. In Milton Friedman's (1970) words, "The social responsibility of business is to maximise profits". Friedman's statement was a response to the concept of corporate social responsibility (CSR), which holds that it behoves a firm to have a positive impact on society. But CSR theorists agree with economists regarding the market, as I discussed in Chapter 1. The CSR literature distinguishes between a firm's social responsibilities (to the non-market domain) and their economic responsibility. In CSR theory, "economic responsibility" is to produce goods efficiently and legally, as economists would have it (Carroll 1979, 1991; Mitchell 1998; Schwartz and Carroll 2003; Wartich and Cochran 1985; Wood 1991). Against this theoretical background, the expectation that Citigroup go beyond legal, competitive profit maximisation in order to ensure orderly markets is unusual.

To answer the question of how Citigroup was expected to ensure an orderly market, I derived a theoretical account of the episode, by looking in detail at the public debate held in the financial press, and at the regulators' concerns for the transaction. In this data, I found that market participants, observers, and regulators expected that Citigroup (and other participants on the MTS) would sustain help to sustain market confidence by stabilising liquidity and implementing corporate governance mechanisms that would foresee the bank's impact, particularly on market risk. Citigroup was responsible for helping to ensure market confidence, even if that meant foregoing a profitable business opportunity.

3.1.1. Purpose and contributions of this chapter

As told in the introductory chapter, it was an early report of Citigroup's trade inspired this thesis, and the FSA's ruling that crystallised its research question: how are firms responsible for ensuring orderly financial markets? This chapter begins to answer the question by building a substantive, grounded theory to account for two problems: that the FSA would sanction Citigroup for disrupting a market, even legally, and that the public controversy that played out in the financial press was based on a "gentlemen's agreement" that no one articulated.

The chapter's contributions come in three sizes. The broadest contribution is to set the foundation for a substantive theory about firms' responsibilities to markets which has resonance and usefulness across substantive contexts. The propositions from this chapter are the basis for sampling data across other contexts, in later chapters. Secondly, the chapter contributes the first grounded theory of the Citigroup episode. It should help interested researchers to identify new underlying processes in their studies of Citigroup or financial markets more broadly, and to debate extant theories. Finally, the diminutive contribution is at the level of words and concepts: the chapter develops a number of data-driven constructs that are interesting heuristically in their own right. For example, the data helps to identify the necessary conditions for a controversy in financial markets, such as what constitutes an *extraordinary financial transaction*, and the dimensions of *judging conduct*. These heuristics are potentially useful for analysing similar episodes.

3.1.2. Chapter outline

After describing the data sample and providing insight into my experiences coding it, the analytical presentation begins in Section 3.2 with a study of the controversy, based on reports in the financial press. The objective is to explain the controversy by drawing on other processes that are described in the data. These include how Citigroup executed an extraordinary transaction, how others judged its conduct, and what this meant for market confidence.

Section 3.3 applies the same approach to analyse financial regulators' reactions to the transaction, based on regulatory documents from the UK's Financial Services Authority primarily, the lead investigator. The regulatory documents highlight new dimensions of the episode, which media reports had largely neglected; for example, the degree to which the transaction had been approved at senior levels of the bank, and what controls were in place to manage the risks involved.

Finally, the emerging concepts and theoretical propositions are integrated to account for the full episode, and I derive directions for the next chapter.

3.1.3. Sampling and analytical approach

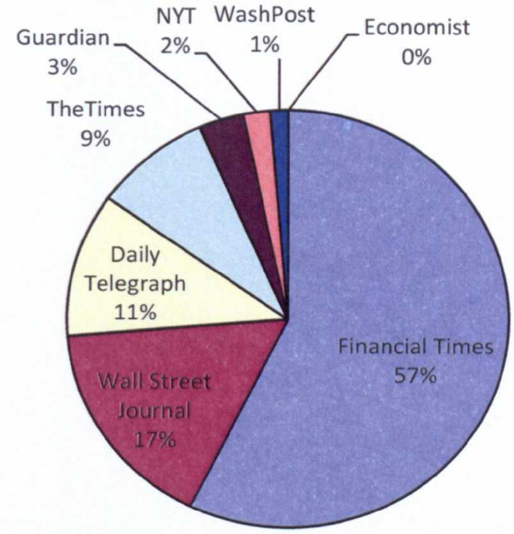
As detailed in Chapter 2 (Section 2.3), the sampling and analysis in this thesis is based on grounded theory principles and techniques.

The first dataset comprised media reports of the Citigroup trade and its aftermath. Sampling was carried out across eight Western newspapers judged to have direct relevance to the episode – that is, influencing and operating among major financial market actors and regulators, and hailing from market-based economies. The publications were the *Wall Street Journal*, the *New York Times*, and the *Washington Post* – from the US – and the *Financial Times*, the *Daily Telegraph*, *The Times*, the *Guardian*, and the *Economist*, from the UK. To compile the reports, I searched for all articles containing the words "Citigroup" and "MTS" on the Google News Archive search engine, and then on each publication's website for a cross-check. As mandates grounded theory methodology, sampling continued until the emerging concepts were theoretically saturated; that is, when new information did not add any new theoretical insights.[3] This dataset comprises 167 articles. The reports range from August 2004 through July 2005, and further theoretical sampling looked at data for the three months preceeding this period. A timeline of the episode is provided at the start of the next section.

The chart below shows how the articles were distributed across publications. The *Financial Times* (FT) published the first article on the case, one day before the others, and published by far the most reports (87). This was a valuable find in terms of building theory that would resonate in the market: the FT has been the most widely read newspaper in financial circles annually since 2004, according to the *Global Capital Markets* survey (Financial Times 2009). The *Wall Street Journal* published the second-highest number of articles (25), also testifying to the episode's resonance in the industry. The *Economist* was an outlier insofar as it mentioned Citigroup in many articles but never in relation to this episode, so it does not figure in the sample (it is a weekly publication, but describes itself as a newspaper).

[3] For example, it did not take long for the concept of *executing an extraordinary transaction* to become theoretically saturated. The key properties were trade's *size*, *speed*, and *surprise*. After a short time, new reports did not add any new information to help develop that concept further, which meant that it was theoretically saturated. After the FSA imposed its fine on Citigroup, roughly one year after the trade, new reports on the episode did not add conceptual variation to the analysis already carried out, and therefore sampling stopped.

Figure 3-1. Distribution of news reports by publication

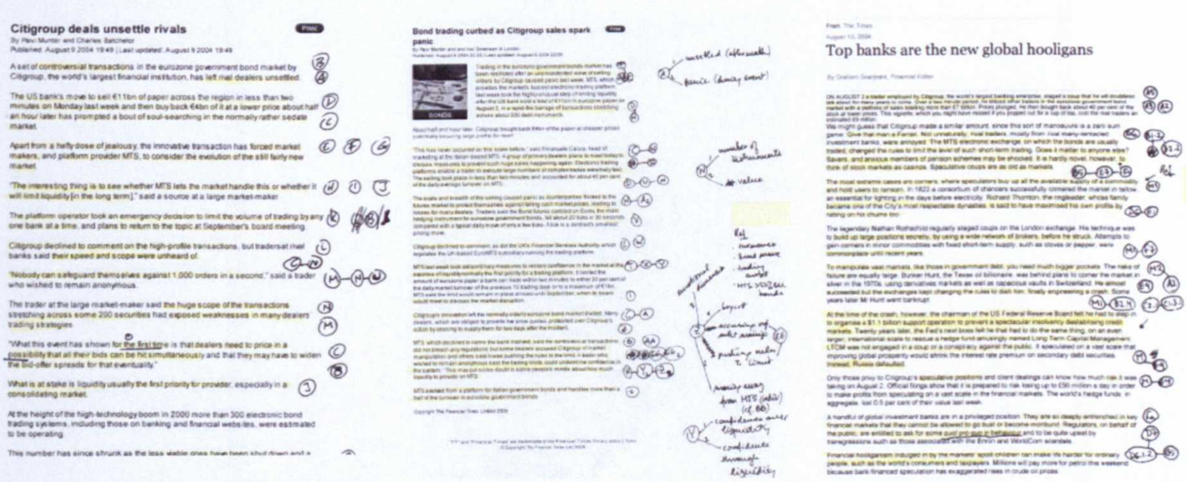


The second dataset, which is analysed in Section 3, is made up of regulatory documents related specifically to the Citigroup trade, and background guidance documents that guided the regulators' decisions. Although seven European regulators investigated Citigroup, only the UK's FSA and Portugal's CMVM reprimanded the bank and published the results of their investigations. In the FSA's judgement, it gave grounds to sample other regulatory documents, namely the FSA's Handbook outlining its regulatory approach and provisions, and UK law. The sampling decisions had to be well calibrated in order to provide a representative account of the regulatory issues that really mattered in the episode. The decisions were guided by the principle of theoretical sampling, described in the earlier chapter. Theoretical sampling means looking for information that adds variation and density to the key concepts being developed. For example, in order better to understand the issue of *market conduct*, I sampled the relevant sections from the FSA's Handbook, to add density to the FSA's interpretation, as well as the European Union's Market Abuse Directive (EU 2003), to understand how the concept could vary. This kind of sampling underpins the process of comparing different data on the same emerging concepts, thus ensuring that the emergent concept fits the data, is modifiable, and works.

Analytical approach

Once the initial data sets are established, the process of coding data is meticulous, cyclical and quickly rewarding as one delves deeper into the documentation. Coding at its most basic means attaching an abstract label to a segment of data (like a word or sentence in an article) that explains, as a generic action or process, 'what is going on here' (Charmaz 2006: 69, Strauss & Corbin 1998). I began by coding the data word-for-word or phrase-by-phrase, in order to capture as much nuance as possible, keeping an extensive log of emerging categories, their possible relationships, and methodological notes. Figure 3-2 (below) shows three of the first reports on Citigroup, and my initial coding on the margins of each document. Each letter code corresponds to a concept. The centre picture shows some concepts (e.g. *banks being unsettled*) acquiring different dimensions (e.g. *boycotting Citigroup, withdrawing from the MTS, lodging protests*). Connections between concepts also quickly became evident. They are represented by a line connecting different codes.

Figure 3-2. Codes quickly becoming denser and more complex (Left to right: FT1, FT2, TT2)



I soon found the operating question 'what is going on here' difficult to apply to newspaper reports because the answer could refer either to the subject matter or to the reporting style. I changed the operating question to 'what is being reported here'. This helped me to focus on reported events, processes, and attitudes, when segments of data had become confusing or too many ideas emerged simultaneously. More importantly, analytically, the change helped me ensure I was *analysing the episodes through media data*, my stated intention, rather than analysing the media itself.[4]

Two working tools were indispensable in this process. First, a <u>code definitions</u> spreadsheet was built as each code emerged, providing a comprehensive view of all the concepts, and facilitating their ordering into categories, properties and dimensions. This document began as a simple list of codes and corresponding concepts. For every phrase where I noted a new conceptual property or

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[4] Abolafia (2005) applies a similar but more interpretative coding technique to analyse transcripts of meetings of the US Federal Open Market Committee (see p. 210).

dimension, I created a reference number, noted it in the margin of the article, and again in the definitions spreadsheet. When the list became unwieldy, because codes were overlapping, I consolidated the document into with a new list of bundled codes, and new reference numbers. This consolidation is known as conceptual ordering (see Strauss and Corbin 1998: 19-21), re-organising the data codes into a scheme that delineated their relationships, properties, and dimensions. An example is shown in Figure 3-3 below.

Figure 3-3. Excerpt from code definitions tool: properties and dimensions of the emerging concept 'B: *signalling controversy*'

New reference	*Old reference*	Property	New reference	*Old reference*	Sub-property	New reference	*Old reference*	Dimensions
B1	*A*	**Banks being unsettled**	**B1.1**	*A*	**Panicking**	**B1.1.1**	*V*	Hedging
						B1.1.2		Withdrawing
			B1.2	*A*	**Feeling emotional**	**B1.2.1**	*E*	Jealous
			B1.3		**Expressing uncertainty about the future**			
			B1.4	*Z*	**Lodging protests**	**B1.4.1**	*Z*	Against Citigroup
						B1.4.2	*GG*	Against MTS
			B1.5	*Z*	**Taking relatiatory action (gateway to new category)**	**B1.5.1**	*BB*	Collective
						B1.5.2	*O*	Individual (pricing, boycotting)
						B1.5.3		Not expecting FSA sanctions for Citi
						B1.5.4		Not expecting end to electronic
B2	*T*	**Operator curbing market**	**B2.1**	*K*	**Shutting down trading**			
			B2.2	*T*	**Imposing trading limits**	**B2.2.1**		2-month suspension for violating it
						B2.2.2		Unprecedented or emergency
			B2.3	*T*	**Assessing new rules**	**B2.3.1**	*I*	Leaving it to the market
						B2.3.2	*T*	Impose new rules
			B2.4		**Taking action (tbc)**	**B2.4.1**		Consulting with dealers
B3	*L*	**Citigroup explaining the deal**	**B3**	*L*	**Declining to comment (weak signal)**			
			B3.1		**Briefing the regulator**			
B4	*HH*	**Regulators beginning investigation**	**B4.1**		**Market conduct guidelines**	**B4.1.1**	*W*	Regulator declining to comment
						B4.1.2		Unsure how to react
			B4.2		**Market abuse rules**			
			B4.3		**Launching formal investigation**			
B5		**Savers, pension funds being shocked**						
B6		**Rival exchanges criticising ownership structure**						
B7		**Damaging one's reputation**						
B8		**Damaging relationship with customers**						

The second working document was a code log that set out articles contained which concepts, and the major relationships between concepts (see below). Both of these tools, the code definitions and code log, were indispensable for the theorising process.[5] It was based on these documents, that I was able to write more extensive memos to flesh out the concepts and set the basis for this chapter. The reader will note in the following sections that I build a theory of the episode by establishing relationships between these various coded concepts.

[5] The two documents were merged into one for the analysis in Chapters 4 and 5.

Figure 3-4. Excerpt from code log, showing each coded concept (left-hand columns) referenced against each article (right hand columns), and relationships between the concepts (shaded columns)

Category	Property	Subproperty	Dimension	Headline	earlier articles hidden -	Citigroup contac	related code	Citigroup faces b		MTS to Keep Cur		MTS Will Keep C		Coup could lose		On Europe: Citig	
				Da		#		#		#		#		#		#	
				Ref		TT1		DT1		WSJ1		*WSJ2*		DT2		FT8	
	A1									2	G3	*2*	*G3*			2	
	A2									2	A4/G3	*2*	*A4/G3*				
	A3							1		2	G3	*2*	*G3*			1	
	A4									1	A2	*1*	*A2*			3	B2/B4
	A5					1											
	A6					1				1		*1*					
A	A7					1											
	A8					1											
	A9															1	
	A10	A10.1														2	
		A10.2															
	A11	A11.1															
		A11.2															
	A12																
	B1	B1.1	B1.1.1			1										3	B2.2
			B1.1.2														
		B1.2	B1.2.1			1										1	B2.2
		B1.3															
		B1.4	B1.4.1			1	B4/D4										
			B1.4.2													1	
		B1.5	B1.5.1					3						2	E1/E5/B4/D1		
			B1.5.2														
			B1.5.3														
			B1.5.4														
	B2	B2.1								1		*1*				1	A2/B4
		B2.2	B2.2.1			2		1								2	B1.2/B
			B2.2.2							1		*1*					
B	B3	B2.3	B2.3.1			1		2	L								
			B2.3.2							1		*1*					
		B2.4	B2.4.1							1		*1*					
		B3								1	L/C1.2.1	*1*	*L/C1.2.1*				
		B3.1						1									
	B4	B4.1	B4.1.1			3	B1.4/D4	2						1	B1.5.1	1	A2/B2
			B4.1.2														
		B4.2															
		B4.3															
	B5																
	B6																
	B7																
	B8																

3.2. Controversy and Expectation: News reports of the episode

The catalyst for the entire Citigroup episode can be summarised thus: on 2 August 2004, Citigroup executed a very large operation, selling over 200 debt-based securities (range), worth approximately €13 billion (value), in under two minutes (speed) to counterparties who were obligated to buy them. One hour later, it bought back €4 billion of the same bonds, increasing its profit. A regulatory investigation concluded that the trade's "effect on the MTS was a temporary disruption to the volume of bonds quoted and traded on the platform, sharp falls in bond prices and in some cases the temporary withdrawal of some participants from quoting on that platform" (FSA 2005).[6] Conceptually, the trades constituted an *extraordinary financial operation*. (Throughout the thesis, the phrases in italics refer to conceptual categories, properties, and dimensions that have emerged from the data. They are usually phrased as actions or generic processes, in keeping with grounded theory practice, to help infer relationships between them. To emphasise a phrase conventionally, an underlined font is used instead.)

It was an extraordinary event because it involved a wide *range* of transactions; a high monetary *value* traded; an unprecedented *speed*; a clear *responsibility* for the event (a strategy, not an accident); and because it was, on the whole, *unprecedented*; *induced losses*; and *took others by surprise*. The operation's very large size was reported as a reason for all that happened next; it is emphasised in every article and always associated with controversy. It is also related to other important questions, such as the operation's ambiguous legality, the conditions its competitors were operating under, and the timing chosen (the first Monday of August, typically a quiet trading day).

Controversy as the central feature of the episode

And yet, whilst catalytic, *executing an extraordinary transaction* it is arguably not the central feature of the episode. The reporting focused much more on the ensuing controversy than on the details of the operation itself. Reports of ensuing events, such as rival banks plotting sanctions against Citigroup, the MTS operator deliberating on new trading rules for the exchange, Citigroup's regulatory problems in Japan, the debates on alternative bond trading business models, investors'

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[6] It was also revealed that, prior to the bond trades, Citigroup had bought a large number of futures contracts, because it had expected competitors to turn to the futures market to hedge the risk from falling prices in the cash market. This was not known until several months later.

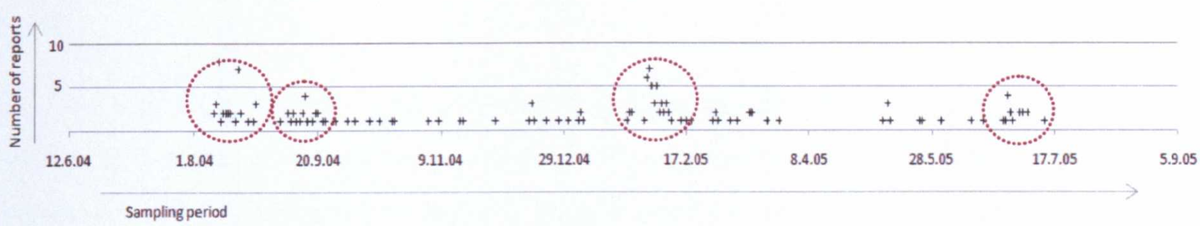
bids to acquire the MTS, etc, are always associated, in the analytical codes, with *signalling controversy.* If the reports had instead focused on the operation itself, one would expect to find more details, including the specific debt instruments traded, the dynamic price effects, the sequence of trades over time, the software utilised, the individuals and personalities involved, the competitors' losses, or any precedents. Even if these details had not been immediately available, one would expect to find speculation about them, though questioning of people familiar with the event, for example. Instead, the reporting focused overwhelmingly on the *signalling of controversy,* and nearly every article on the operation can be understood as a report on the controversy.

The controversy is all the more a central problématique because although disapproval of Citigroup's conduct is nearly universal, the reasons why observers disapproved are not clear-cut. The *Oxford English Dictionary* defines controversy as, "debate or disagreement about a matter which arouses strongly contrasting opinions", and the *Random House Dictionary* as, "a prolonged public dispute, debate, or contention; disputation concerning a matter of opinion". While there are several signals that Citigroup *broke a gentlemen's agreement*, thus *destabilising the market*, the data does not elaborate a standard of conduct, rule, or law, precedent, or explicit expectation that Citigroup broke or failed to meet. This purported "gentlemen's agreement" itself is not well articulated. In other words, the "contrasting opinions" leading to controversy are not explicit, making this an interesting, multilayered episode.

By analysing the data most closely related to the controversy, an explanation for it emerges that centres on three factors: (1) the extraordinary nature of the transaction in itself, (2) the mix of judgments that observers had of Citigroup's conduct, and (3) the transaction's effect on market confidence and stability. Taken together, these factors point to <u>an emerging expectation that Citigroup would help ensure market confidence and stability</u>, even at the expense of a potentially profitable transaction. I argue that this expectation explains the extent of the controversy. Moreover, by analysing these three factors and their relation to the other concepts that emerged from the data, such as *providing liquidity*, I derive a set of theoretical building blocks that account for the entire episode.

Before outlining the signals of controversy, I set out below a timeline of the entire episode and a graphic showing the intensity of reporting around key events. In the graph, the vertical axis numerates the number of reports and the horizontal represents the time period. Each cross represents the number of reports on a given day. Four distinct periods contain higher intensity reporting over several days. The first, on the far left, contains initial reports of the operation, largely centred on the MTS operator's imposition of trading curbs. The second is immediately to its right, and reports the lifting of trading curbs, the beginning of regulatory investigations, and Citigroup's apology for the trade. In early February 2005, in the middle of the graph, a large number of articles reported the discovery of a secret Citigroup memo that set out the objectives of the operation. Finally, on the far right, articles reported the FSA's fine on Citigroup. This demonstrates some of the reporting emphasis, but my analysis is not grouped around these periods; it is ordered around conceptual categories from the data throughout.

Figure 3-5. Reporting frequency and timeline



02 August 2004	Citigroup operation; MTS imposes trading limits
09 August 2004	First reports of operation emerge
11 August 2004	FSA begins consultations
12 August 2004	Citigroup rivals meet to discuss sanctions
19 August 2004	FSA announces investigation
08 September 2004	MTS lifts trading limits
14 September 2004	Citigroup apologises for the trade
05 October 2004	European regulators announce investigations
04 November 2004	MTS reported to have lost business after the trade
08 November 2004	MTS implements opt-out system to protect banks on the exchange
31 December 2004	Citigroup's Eurobond business reported to "dwindle"
24 January 2005	Germany announces a criminal investigation against Citigroup traders
31 January 2005	Secret memo reveals Citigroup's plan for the operation
03 February 2005	Citigroup apologises for the trade, condemns the traders
08 February 2005	EU parliament calls for Europe-wide regulation
28 February 2005	Italian regulator launches criminal investigation
22 March 2005	Germany drops criminal charges and changes its law
27 June 2005	FSA fines Citigroup £14m

3.2.1. Signalling controversy

The descriptor "controversial" features in the opening sentence of the vast majority of reports in the sample, sometimes among other adjectives including "astonishing", "audacious", "brazen", "buccaneering", "clever", and "daring". The reporting of *banks being unsettled*, both during and after the operation, was especially extensive in the early data. First, traders *panicked* during the operation itself. The *panic* dimension was manifest through large-scale *hedging* in the futures market (FT8) and by some banks temporarily *withdrawing* from the market (FT12). The *emotional feelings* generated by the operation – "unsettled", "angered", "annoyed", "concerned", "jealous", "privately seething" – also signalled controversy. The data frequently links these emotions to uncertainty about the future of the market. In one article titled "How Citigroup launched a wave of ill will in the bond markets", one trader said, "If it happens again we will pull out" (DT3). Dealers also began *lodging protests*, both directly to reporters and to the UK's Financial Services Authority (TT1, FT12), and *taking retaliatory action*, collectively and individually. Two reports covered a meeting of 10 of "the City's leading investment banks ... [convened] to formulate sanctions against Citigroup" (DT1). The banks decided to publicise the operation to their clients in order to *damage* Citigroup's *reputation* (DT2). Retaliatory options are also manifest an individual bank level, such as widening bid-offer spreads (but losing competitiveness) (FT1) or boycotting the offender (DT2) or the market (FT27).

The MTS exchange itself also signalled controversy by temporarily *limiting transactions in the market*. As a result of the operation, the MTS exchange adopted a set of "extraordinary" (FT2), "emergency" (WSJ1) measures limiting the amount any bank could trade over 120 seconds to €1 billion, with the ultimate penalty being suspension from the market. The Citigroup operation had totalled €11 billion. The stated intention of these temporary measures was to *restore market confidence* (WSJ1, FT8).

Controversy was also signalled by *regulators beginning investigations*. Citigroup submitted details of the trade to the UK's FSA "after rivals complained that the Wall Street firm had breached a 'gentleman's agreement' barring firms from swamping the market with a barrage of sell orders" (TT1). One week later, the regulator launched an official investigation into Citigroup's "unusual trading activity", stating, "The FSA's key aims include maintaining efficient, orderly and clean financial markets. In the view of the FSA, achievement of that aim requires large players in financial markets to have regard to the likely consequences of their trading strategies" (FT12). Regulators from Germany, France and Italy began informal investigations at around the same time, and a meeting of "debt issuers representing the Organisation for Economic Co-operation and Development's 30 countries" was convened to "discuss the implications of Citigroup's raid on the European bond market" (TT6).

Figure 3-6. The category *Signalling controversy*: properties and (dimensions)

Banks being unsettled
('Panicking', Strong Hedging)
(Feeling emotional; 'concerned', 'jealous', ...)
(Lodging protests; boycotts; negative messaging)

Operator limiting the market
(Imposing trading limits)
(Assessing new future rules)
(Reigning in liquidity)

Regulators beginning investigations
(Market conduct guidelines)
(Market abuse rules)
(Formal investigation)

Rival exchanges criticising MTS ownership

Hurting one's reputation
(With customers, with savers/pension funds)

Report also conveyed the operation *hurting Citigroup's reputation* among stakeholders. According to the *Times*, "Citigroup's standing in several closely watched league tables slumped amid signs that some borrowers are refusing to hand the bank lucrative bond mandates following the controversy" (TT6). A trader cited in the Telegraph had stated, "European governments want their bonds to be tradeable and bond issuers will not like this because it threatens the trading system" (DT2). In a *Wall Street Journal* article titled "Citigroup image takes a buffeting", the operation was reported as one in a string of damaging events for the bank: "Japanese regulators sought penalties against a local unit for allegedly taking advantage of clients, while in Europe the company conceded that a huge and controversial bond trade it conducted last month was likely problematic. The developments come as Citigroup is seeking to rehabilitate its image after a series of scandals in the US in recent years involving troubled clients and alleged conflicts over research policies". The *Financial Times* reiterated this view, saying that "The reputation of the bank has been under pressure", as Tom Maheras, Citigroup's head of global capital markets, wrote in an internal memo that "Unfortunately, we failed to fully consider [the transaction's] impact on our clients, other market participants, and our regulators" (FT29).

3.2.2. Drivers of controversy: Executing an extraordinary operation, judging conduct, and hurting market confidence

Executing an extraordinary financial operation

"The attack, when it came, was not from al-Qaeda but from the world's biggest bank."

James Moore, Daily Telegraph[7]

The controversy would not have occurred, according to the media's reporting, had it not been for the operation's size. Size, however, is not sufficient to account for the operation's *extraordinary* nature, however. It was also extraordinary because it *induced major losses*, to a *(large) number of competitors*, 26 banks, most of the other dealers on the MTS. The size of the losses was not reported, but often qualified. The operation *took others by surprise*, with traders expressing *shock* and *disbelief*: "'What the hell are they up to? This is weird,' said one trader watching his screen go red," reported *The Times* (TT4). This *surprise* is related to who was *responsible* for the transaction.

[7] In DT3.

One report highlighted, for example, the possibility of error: "The first guess was that a Citigroup trader had committed a lucky 'fat finger' error with the trades. Such mistakes happen every few months. Citi is not known for taking big market risks, so its involvement in the trade came as a surprise to its rivals" (DT3). Another cited a trader saying: "'Everyone was calling one another trying to guess what had happened and what would happen next. It was easy to see who was responsible, but nobody could believe the audacity'" (TT4). The issue of *being responsible* for the transaction has dimensions including the *institution* (the report above said Citigroup was not known for taking major risks, for example – contrary to other reports, c.f. FT10), and *individual* responsibility can also be traced, in this case to Spiros Skordos, who led the operation. Skordos was name-checked by *The Times* on three occasions (TT1, TT2, TT3), and a *Financial Times* column (FT10) called for his sacking.

Figure 3-7. The category *Executing an extraordinary financial operation*: properties and dimensions

Range
(Instruments, Settings)
([Un]availability of precedents)
Value
(Relative to overall trading, Absolute)
([Un]availability of precedents)
Speed
([Un]availability of precedents)
Being responsible
(Purposeful, Mistake)
(Institution, Individual)
Inducing losses
([Large] Number of competitors)
Taking others by surprise
(Speculation, Disbelief, Shock)

Very large and fast transactions routinely result in major losses across many platforms without provoking a strong reaction from stakeholders in the media, or claims of wrongdoing. Indeed, data showing traders and influential columnists believing that Citigroup's transaction had been acceptable despite being "astonishing" or "astounding" is evidence that extraordinary properties are not necessarily controversial (see FT4). For this reason, the extraordinary nature of the transaction is not enough to explain the controversy. Citigroup's conduct was judged in other ways.

Judging Citigroup's conduct

"Citigroup made money on the trades which means other people lost money. It cannot be allowed to get away with this."

Rival trader[8]

The controversy stemmed from an extraordinary event, but also from a degree of uncertainty. Uncertainty sustains controversy; when it abates, debates reach closure, questions are answered.

[8] Cited in DT10.

Citigroup's operation was not illegal (e.g. NYT1) and, according to the market operators themselves, did not violate the MTS platform's specific trading rules (FT2). But Citigroup did appear, perhaps, to *push the rules to the limit*, or to *violate a gentlemen's agreement*, and there was uncertainty regarding whether or not it had been right to do so. Thus the controversy arose also because observers were uncertain or ambiguous in their judgement of Citigroup's conduct.

Judging conduct was a resolute process among banks, who almost unanimously disapproved of the transaction. Collectively, senior managers from 10 of Citigroup's competitors met for dinner in Soho on 10 August, to "formulate sanctions against Citigroup" (DT1). "The options discussed," according to the *Daily Telegraph's* source, "included restricting Citigroup's access to the [MTS] system" (ibid). However, the bankers concluded that there was little they could do on a political level, such as lobbying for Citigroup's expulsion from the MTS. One trader said, "We don't think that they did anything illegal so there is nothing we can do. We will wait to see what the FSA does and how bond issuers react" (DT2). The banks did decide, however, to seek to damage Citigroup's reputation by speaking about the transaction in their pitches to European bond issuers. The second news report regarding the dinner carried the headline, "Coup could lose Citigroup work, say rivals" (DT2).

If Citigroup's reputation deserved a concerted effort to damage it – indeed if that effort was worth the cost and had a chance of success – then it stands to reason that Citigroup was judged to have done something wrong. However, all parties agreed it was not breaking the law. Illustrating the ambiguity of judgment succinctly, one trader said: "Really what they did was smart. They didn't do anything wrong, they just cornered the market. I'll tell you this though, $25m doesn't seem like a lot of profit to make when you've for the whole world lining up against you" (DT3). Thus the transaction was controversial as the judgements of its propriety were mixed. Questions were raised about whether the ultimate judgement *pushed the rules to the limit*, *broke a gentlemen's agreement*, or, indeed, *did nothing wrong* or *illegal.*

Articulating a gentlemen's agreement

To be clear, many observers noted that the reason for controversy had been Citigroup breaking a gentlemen's agreement. This notion emerged in the second day of reporting, with the *Financial Times's Lex* column asking, "Has Citigroup, with its audacious selling of €11bn [sic] of eurozone government bonds within two minutes, been very clever or has it overstepped the boundaries of fair trading?" (FT4). The column largely sides with Citigroup, saying "gentlemen's agreements are not a sensible way to manage risks" (ibid), but sheds no light in any context as to what the gentlemen's agreement or the "boundaries of fair trading" are. The *Wall Street Journal* cites traders calling the operation "savvy, if not slightly untoward", and refers to MTS having introduced measures to stop "this kind of behaviour" (WSJ1), without articulating the "kind". The *Daily Telegraph* reports that rival traders had "felt themselves protected by a 'gentlemen's agreement'", but does not elaborate what it was (DT3). The *Guardian*'s *Notebook* column judged that, "Of course, Citigroup did nothing illegal here. It legitimately filled orders that had been placed by willing counterparties, all of whom were grown-up financial institutions used to dealing in large numbers. The novel aspect was to trade in such size across a range of debt at such speed. It looks to have been a clever, if controversial, piece of market trading" (GU1). In all bar one of the references to Citigroup having behaved in an untoward manner somehow, there was no clear articulation of what standard of conduct had been broken (see also TT4, FT59).

The one exception was a *Times* report which cited a gentlemen's agreement "barring firms from swamping the market with a barrage of sell orders" (TT1). The *Financial Times* also intimated that Citigroup broke an agreement by "splitting its bond sales into as many as 200 separate deals, ... [ensuring] each was within the trading limits of the counterparties" (FT59). This corroborates the many codes in the data that link the size of the transaction to the controversy. However, if violating the agreement was a basis for controversy, one might reasonably expect to see more than one or two articulations of what the understanding had been in a sample of 167 reports. No individuals were cited to support the statements. A leaked Citigroup memo setting out the rationale for the trade stated that Citigroup expected other banks to engage in "copycat trades". (It was part of Citigroup's broader objectives; next subsection below.) If copycat trades were plausible, then either there was no agreement barring them, or traders at Citigroup – the world's largest bank – did not know about it, or Citigroup believed that the rest of the market would be willing to shelve the agreement. The fact that Citigroup did not acknowledge any possible controversy arising from the trades in its plan challenges the notion of a clear gentlemen's agreement existing.

What is a gentlemen's agreement? I set out three definitions below; first, from a language dictionary; then from *Wikipedia*, to indicate common or colloquial usage; and finally from a legal dictionary, to indicate usage in the context of contractual obligations. In combination, they illuminate possible reasons why the gentlemen's agreement was so difficult to articulate.

Figure 3-8. Definitions of 'gentlemen's agreement'

Source	Definitions
Random House Dictionary (2008)	1. "An agreement that, although unenforceable at law, is binding as a matter of personal honour. 2. "An unwritten agreement by socially prominent clique, private club, etc., to discriminate against or refuse to accept members of certain religious, racial, national, or other groups."
Wikipedia (2008)	1. "An informal agreement between two or more parties. It may be written, oral, or simply understood as part of an unspoken agreement by convention or through mutually beneficial etiquette."
West's Encyclopaedia of American Law (2008)	1. "...parties may honour them because moral obligations compel observance or because future relations will be more difficult if the present arrangement is broken."

The *Wikipedia* definition notes that gentlemen's agreements may be unspoken – that is, implicit – a matter of etiquette. This resonates with the media descriptions of the operation as "untoward" without articulating the reason. The *West's* legal definition holds that such agreements are observed to maintain good relations, while the dictionary alludes to arrangements made by a substantive elite. Perhaps the banks all recognised implicitly that certain trades could destabilise a market and sour relations among them. In addition, there is evidence to suggest that this understanding existed only at the highest levels of the organisation. For example, the regulatory sanction, which I analyse in the next section, emphasised strongly that one Citigroup's biggest failings was not to vet the operation at high management levels. Some traders and commentators outside of that management elite had felt that the operation was legitimate because bond markets are "hypercompetitive", "cut-throat", "testosterone-fuelled" environments (FT28), and hence a gentlemen's agreement would be difficult to enforce. One of Citigroup's competitors said, "Citigroup spotted a way to make a quick buck. I guess we just have to say well done to them" (FT24). The fact that the gentlemen's agreement was not articulated in the media reports, despite being noted so frequently as a reason for the controversy, suggests that some

Figure 3-9. The category Judging Citigroup's conduct: properties and (dimensions)

Expressing disapproval
(formulating sanctions)
(discussing boycott)
(planning PR campaign)
Assessing degree of wrong-doing
(breaking the law, breaking rules, being untoward)
(expecting regulatory reaction)
Articulating a gentlemen's agreement
(implicit rules, explicit unwritten rules)
Reacting Citigroup memos
('acting in stakeholders' best interest')
([not] being 'investment-driven', being a 'US bank')
(soliciting Citigroup documents)

members of banking circles understood implicitly that some commercial behaviours complicate relationships and are seen as untoward, even if they are legal and competitive. I develop this argument in more detail below, after analysing a set Citigroup's memos. The memos suggest that Citigroup's management was also aware of this perspective.

Citigroup's memos: acting in stakeholders' best interest

The media picked up five direct 'testaments' from Citigroup during the episode; two of which were memos that highlighted which behaviours were perceived as "untoward".[9]

Before the first memo was leaked, Citigroup issued a brief statement during the second day of reporting, saying only that "The growth of European government bond electronic trading platforms has promoted significantly increased capacity in the European cash markets, and Citigroup *continues to be a major provider of liquidity* on these platforms" (DT1). Chuck Prince, Citigroup's chief executive officer, was later reported to have called the trades "knuckle-headed" (FT51), signalling a hardening stance within the bank against the traders.

Roughly five weeks after the operation, after the MTS lifted the temporary curbs on trading, newspapers picked up on a leaked Citigroup memo from Tom Maheras, head of global capital markets, stating that:

- The operation was an "innovative transaction that sought to access liquidity in the European bond markets", involving a "willingness to commit capital" and "thinking creatively"
- "Citigroup is committed to holding itself to the highest standards in its business practices. We did not meet our standards in this instance and, as a result, we regret having executed this transaction. <u>Unfortunately, we failed to fully consider its impact on our clients, other market participants, and our regulators.</u>"
- "We need to be sure that in whatever we do, we fully consider the impact of our actions on our clients and the markets. <u>We must exercise sound judgement, know our markets and our clients well and act in their best interests</u>" (compiled from FT28, FT29, TT6, DT7, NYT1, TT7, underlining added).

This memo – in particular the reference to act in markets' best interest – was explicitly interpreted as an attempt to placate regulators and Citigroup's government clients. In other words, it was recognised as 'the right thing to say'. Statements in the media described the memo, which was sent to all of Citigroup's 40,000 banking employees, but not to its clients, as an "astonishing" (FT28), "humiliating" (DT7), and "unprecedented apology" (TT6). The *New York Times* called it "an indication

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[9] The bank also declined to comment on several occasions.

that the bank is taking the investigation and the complaints seriously", and drew a parallel between Marehas's language and that used by the FSA: "When the inquiry was announced, the regulator said that market participants should have 'regard to the likely consequences of their trading strategies in the market concerned'" (NYT1). The *Daily Telegraph* cited Citigroup's "rival traders" as saying that the bank would have counted on the memo being made public, and calling it a form of "birch beating in public but [also] a high risk strategy". The *Financial Times* wrote: "A public statement of contrition may go some way to placating the regulators, although it could backfire if the widespread circulation of an ostensibly internal memo is seen as manipulative" (FT28). Whether the bank had indeed intended to pre-empt the tone of potential regulatory sanctions, it is noteworthy that "acting in markets' and clients' best interests" was isolated as an objective independent of profit-making, and as a means to mitigate regulatory risk.

A second memo, leaked in late January 2005, revealed that the bank had set out to destabilise markets and therefore damaged Citigroup's standing significantly. The document set out the original rationale for the trade, the method, and its objectives. The trade's objectives had included imposing costs on competitors, decreasing the attractiveness of German bond futures, spurring copycat trades, "killing off smaller dealers", and "turning the European government bond market into one that more closely resembles the US government bond market" (memo reproduced in FT53). Described as "hideously embarrassing" by *Financial Times's Lex* column (FT54), which originally supported Citigroup, the memo undid Maheras's PR effort. In response:

- Citigroup issued a statement saying "Unfortunately the traders involved made inappropriate, unrealistic and in certain instances juvenile remarks about the trading strategy before it was executed. We regret these comments, which do not represent the views of the supervisors who approved the trade, or of the management" (DT11);
- The MTS solicited a copy of the document, citing their "astonishment";
- The German regulator specified that their criminal investigation into market manipulation centred on six individuals, including the head of Citigroup's European government bond trading desk;
- The president of the European Central Bank, Jean-Claude Trichet, called for a "thorough and deep" investigation into the operation, saying he felt "'very, very strongly' that fairness was essential to financial markets. 'We have an enormous stake in markets functioning fairly and correctly" (FT66).

It was at this time that the *Wall Street Journal* revealed that Citigroup's strategy had been dubbed "'Dr. Evil', taking its name from the 'Austin Powers' spy-spoof movies, according to a report by a German financial regulator" (WSJ18).

While Maheras's apologetic memo had noted that the bank had other objectives than profit-making – namely to "act in markets' and clients' best interest" – this strategy memo was seen to display other ulterior motives for the trade. According to the *Wall Street Journal*, a "German regulator's report criticised the strategy outlined in the [transaction strategy memo] as 'not investment driven' but instead aimed at harming Eurex's reputation" (ibid, underlining added).[10] In an editorial entitled "Citi takes on Europe", the *Financial Times* took a similar view:

> "When US banks venture overseas, they often do so under the banner of spreading American capitalism. But where they actually make a lot of money is by exploiting undeveloped markets that are in a transitional phase, such as European private equity dealing or Japanese distressed debt. It looks like this is what Citigroup had in mind with its controversial government bond trades in the eurozone last summer. [...]
>
> The unwritten rule of US capitalism – that if something is not explicitly banned, it can be done – is one way of creating innovation and achieving market change. In fact, Citi's trades have prompted MTS to look at reforming its rules [...]" (FT61).

The reactions to both Citigroup memos – the Maheras apology and the transaction strategy memo – both centred on Citigroup's role in supporting the market. The Maheras memo apologises for Citigroup not having acted in the market's, market participants', and clients' best interests. This was seen as a way to placate regulators and clients, as if the commentators believed this is what the regulators would like to hear. The second memo proved controversial because it revealed that the bank had intended to alter market operations and increase costs for smaller competitors. This data suggests that a prime explanation for the controversy was that the bank had been expected to support the market, even at the expense of profitability.

Hurting market confidence and stability

"Anyone expecting ethical behaviour in an inter-bank dealing environment is having a laugh."

Anonymous 'senior source' [11]

European regulators and politicians, the MTS operator, and the most outraged competitors did not invoke a gentlemen's agreement as a reason for their displeasure, but rather the operation having damaged market stability and confidence. Whilst market confidence and market stability are ostensibly distinct concepts in a theoretical sense, they are used interchangeably in the data to describe similar phenomena. They are often conflated because the stability of the MTS market

[10] Accusations that Citigroup's operation had not been "investment driven" are particularly interesting in the following chapter, which looks at the expectations and fears held for state-owned investment funds.
[11] Cited in TT4.

during the operation is said to have threatened confidence in the MTS business model in the longer run (see FT8, and FT1, FT7, FT15, FT16, FT17, FT18). (We return to this theme when discussing the MTS model of rule-making, in light of MTS's competitors' reaction to the controversy.)

The FSA signalled that the operation would be controversial when it launched a formal inquiry on 2 August (first reported on 18 August). Its stated purpose was to look into "unusual trading activity" on the grounds that its "key aims include maintaining efficient, orderly and clean financial markets. In the view of the FSA, achievement of that aim requires large players in financial markets to have regard to the likely consequences of their trading strategies," it stated (cited in FT12). Concluding the investigation, the regulator based its fine on the judgement that "Citigroup Global Markets Limited planned, authorised and executed a trading strategy without having due regard to the risks and likely consequences of its action for the efficient and orderly operation of the MTS platform" (TT12). There is no data to suggest that the regulator focused either on the size of the trades per se, nor on established norms in the market. Rather it directed its attention to "the efficient and orderly operation" of the market, which is to say, the market's stability. Although the size of the trades is a necessary condition for the investigation, it would be remiss to ignore that the higher-order principle of orderly markets was the regulators' primary focus.

Figure 3-10. The category *Ensuring market confidence and stability*: properties and (dimensions)

Dosing the liquidity available in market
(Operator, Dealers, Government)
(Quote-driven system, order-driven system)
Assessing risk
Restricting access to the system
Investing on commercial grounds
Political ownership of the MTS
(False liquidity)

In the immediate aftermath of the transaction, the MTS operators imposed emergency limits on the amount of trading allowed on the exchange in order to "restore market confidence" (FT2, WSJ1, FT12, FT27, WSJ4). This was one of the earliest and strongest signals of controversy, as the main topic that first brought the incident to light. Roughly five weeks later, on 13 September, the MTS lifted the curbs: "MTS Chief Executive Gianluca Garbi said the platform operator's board never discussed making any changes to its trading system, which some had anticipated, and views risk as inherent in any market-making activity. 'Now everyone knows the risk; knowing it now, they can put safeguards in place', Mr Garbi said" (WSJ4). Thus MTS emphasised their expectation of sound risk management, rather than an understanding that banks would not execute large trades. (In the next section, regulatory papers indicate that sound risk management practices and due process were key expectations for regulators as well.)

Among rival banks, the operation was controversial primarily because of its extraordinary nature (even inspiring a "hefty dose of jealousy" for its sophistication and profitability, FT1), and because of its dubious relation to market norms, but the impact on market confidence also features significantly. One trader said, "Citigroup made money on the trades which means other people lost money. It cannot be allowed to get away with this. If we allow this to happen the system will break down, and we do not what that to happen because the system is good for everyone" (DT1). The head of European bonds at JP Morgan, Nicolas Galmiche said, "The most important thing is for markets to stay liquid and transparent. The trade itself was unimportant; what we are watching carefully is its consequences" (FT28).

3.2.3. Unifying theme: The expectation of ensuring market confidence

I would content that the expectations which Citigroup violated, leading to controversy, were broader than the narrow issue of large trades or a specific gentlemen's agreement. Rather, the data suggests that the higher-order principle of ensuring market confidence was fundamental. The single proposition that accounts for this data is: <u>controversy arises because there was an expectation that traders should help ensure market confidence and stability</u>. A report of the FSA's final judgement provides similar phrasing: "The FSA said the trades temporarily disrupted the MTS system and caused a sharp fall in bond prices. Consequently, the bank behaved without 'due regard to the risks and likely consequences of its actions for the efficient and orderly operation of the MTS platform', the regulator said, pointing out that this contravened the principles of responsible market conduct" (FT99). This report conveys a sense that Citigroup broke a specific rule, albeit an implicit one.

All of the categories and properties in the data that relate to *signalling controversy* are accounted for in this proposition. Put differently, in the language of grounded theory, this *expectation* is the core category in this episode. It is the concept that "accounts for most of the variation in [the] pattern of behaviour," (Strauss 1987: 34). It is also "related to as many other categories and their properties as is possible, and more than other candidates for the position of core category," the criterion advanced by Strauss (op cit: 36). By relating this central proposition to the other categories that emerge in the data, we will arrive at other propositions that explain the episode more fully, and provide higher density and theoretical saturation to this proposition.

Core category as process: Observing the rules, providing liquidity

Citigroup's operation succeeded by exploiting the market-making system on the MTS exchange. The rules of this system require dealers to publish the prices at which they will trade European government bonds. Market-making, also known as a quote-driven system, increases liquidity because all bonds must have a price (be liquid), and increases market confidence and stability because it "tends to smooth price movements, making investment safer and ultimately cutting the cost of borrowing for governments" (TT2). The less liquid alternative, popular in the US, is the order-driven model, where securities are priced ad hoc by the parties to individual transactions (WSJ1, FT59). The MTS's visible, given pricing enabled Citigroup to execute simultaneous trades on a scale that would otherwise have been difficult through order-driven negotiations (WSJ1). In addition, it meant that Citigroup's competitors were committed to buying the bonds, having previously published their prices. Thus the market-making context was necessary condition for the controversy in this episode.

The MTS rules were seen as controversial in themselves because of *European governments' influence* over the MTS. This view was held primarily by MTS's competitors, and *Wall Street Journal* and *Financial Times* editorial writers. The rules were introduced when the Euro was established, in order to minimise the risk that smaller Eurozone governments, which had acquired the same currency as larger governments, would not find buyers for their debt (with currency risks eliminated, traders might opt to buy only debt with the lowest default risks, like German bonds). The rules ensured liquidity for smaller debt instruments. In return, there is an explicit but unwritten (FT8) understanding that governments reward the banks who participate in these secondary markets (trading bonds) with very lucrative primary market deals (issuing new bonds) (TT4, WSJ1, FT8, FT12, FT13, FT17). Critics argue that the MTS exchange enables European governments to reduce borrowing costs by creating "virtual liquidity" that may not otherwise have been there (TT4), and disadvantages other exchanges (FT7). Citigroup's operation helped bring this dimension of controversy, the *MTS's political ownership* to the fore.

By comparing the category, *observing MTS rules*, to the *signalling of controversy*, and *judging conduct*, we can draw an immediate conclusion: <u>under this system, explicit rules need to be moderated by dealers in order to ensure market confidence and stability</u>. Consider that observing MTS rules aims to guarantee liquidity; that is their objective. However, it is also the case that injecting too much liquidity, as Citigroup did, threatens market confidence by creating price volatility and inducing losses. Indeed, the MTS operator <u>restricted</u> liquidity in the market in response to the operation, by limiting the size of trades. Thus while banks have a firm obligation to provide liquidity through transparent pricing, they also have an implicit responsibility not to create excess liquidity.

Put differently, the explicit rules require implicit rules in order to meet their objective. From this analysis one can also conclude that stable liquidity promotes market confidence and stability. Unstable liquidity leads to controversy if an extraordinary transaction is involved in creating the instability.

In the data, *providing liquidity* is invariably associated with the objective of market confidence and stability, not only through the MTS rules above, but also the underlying conditions in global markets when the operation took place. The general market conditions at the time of the trade were a *consolidating market* (FT1), with the number of exchanges decreasing. In addition, "profit-margins in the inter-dealer, or wholesale trading, of eurozone government bonds [had] dwindled as pricing in the maturing market has become more efficient. This [had] been driven by a move to electronic and internet-based trading, which cuts costs and increases pricing transparency", according to a *Financial Times* report (FT3). The report concludes that, "unwelcome though they may be to rivals, larges trades of this sort are probably here to stay. Citigroup's market coup reflects the growing power of a handful of leading banks in the capital market arena" (ibid). The growth in large trades, due to technical innovation and the multitude of debt instruments, many of which are not liquid, is a contextual factor highlighted in several reports (e.g. FT6). These contextual conditions may help explain the extent of controversy. One dealer said he would leave the market if he saw another similar operation to Citigroup's because the bond market was becoming less profitable (DT1). By definition, it is large institutions that have the liquidity available to execute large transactions. Given that the FSA highlighted large institutions as having a particular duty to assess the impact of their transactions on the market (DT4), we can also deduce that this contextual data leads to the core category through this proposition: large, liquid dealers are particularly responsible for market confidence and stability.

3.2.4. Preliminary propositions

Based on the analysis thus far, the following propositions account for the media data in the Citigroup episode:

P1 There is an emergent expectation that traders should help to ensure market confidence and stability. (core proposition, which accounts for the central pattern, *controversy*, and to which other propositions and categories are related)

P2 Controversy occurs even when specific standards are not breached, provided that there is an extraordinary financial transaction and that observers are driven to judge an actor's conduct.

P3 In a market-making system, explicit rules need to be moderated by dealers in order to ensure market confidence and stability. It is not sufficient to observe explicit trading rules.

P4 Stable liquidity promotes market confidence and stability. Unstable liquidity leads to controversy if an extraordinary transaction is involved in creating the instability.

P5 Large, liquid dealers are particularly responsible for ensuring market confidence and stability.

P6 Ensuring market confidence reduces regulatory risk.

These propositions emerge from the express views of actors that were directly involved in the incident, such as Citigroup's competitors, as well as more distant observers, such as editorial writers. As I noted in Chapter 2, Section 5, on the use of media reports as data, these propositions represent the spread of ideas and expectations in societal circles that are particularly concerned about financial markets and market conduct; such as banking practitioners, academics, corporate executives, politicians, and other groups in the newspapers' readership demographic. In the following section, I pursue more specifically the regulatory interpretation of the trade, and its implications. Whereas in media reports the central pattern of behaviour was the controversy that followed the trades, the regulatory documents focus on the trade itself. Regulators are the enforcers of market guidelines and rules, and de-limit which behaviours are sanctioned or proscribed. They are therefore central to the question of how firms are expected to contribute to orderly markets.

3.3. The Visible Hand: Regulatory accounts

"Repeated violations of the duty of defence of the market ..."

CMVM, Portugal's regulator, ruling on Citigroup[12]

The UK financial regulator's decision against Citigroup helped to crystallise the key question confronting us. The FSA ruled that Citigroup's trade was improper because it had been conducted without due regard for "the efficient and orderly operation of the MTS platform", the market (FSA2). Yet Citigroup had not broken any market rules and its operation did not constitute market abuse; it had acted to maximise its profitability; and the market had extreme transparency (the market-making rules). Therefore, from an economic perspective, it was surprising that the 'invisible hand' had not sufficed to ensure an orderly allocation of resources, which economic theory suggests it would have under those conditions. The FSA's ruling begged the question, how are firms responsible for orderly markets?

The analysis of media reports provided part of the answer to this question. From them we deduced that Citigroup had been expected to help ensure market confidence, and that this required it to stabilise liquidity in the market, even if that was not its own calculus of self-interest. Thus the public controversy was explained. Those reports represented a debate on Citigroup's conduct, among a broad set of actors. In this section I turn to a more specialised group, regulators, in order to add variation and density[13] to the propositions identified until now. Undoubtedly, the debates reported in the media and the expectations of regulators overlap, but regulators provide a distinct dataset because they are explicitly responsible for market supervision. Regulators' specific insight into what role firms play in market governance is highly material, and I use it to refine the analysis. Moreover, the regulatory repercussions of the trade were a significant focus of the reporting, and Citigroup's own apologies widely interpreted as an attempt to placate the regulators.

As a starting point, a factual timeline of the operation was outlined by the FSA (FSA1).

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[12] CMVM1.

[13] The objective is to identify new properties, dimensions, and relations between concepts.

Figure 3-11. Official timeline of the Citigroup transaction (Adapted from FSA1: 3-7)

Date / Time	Occurrences
Early July 2004	European government bond trading desk is urged to increase profits "by taking more proprietary market risk and developing new trading strategies".
16-29 July 2004	A trader develops a strategy based on capturing market liquidity on the MTS, and emails the basic strategy to colleagues: 1) create a 'basis position' long in cash bonds and short in bond futures[14]; 2) on a chosen day, close short futures position by buying futures, leaving a long cash bond position; 3) rapidly sell the long cash position on MTS, capturing all available liquidity. (Citigroup's futures position would benefit because competitors would likely buy futures to hedge against the falling price of cash bonds.) Traders design a software application using a spreadsheet to carry out the operation and nickname it 'Dr Evil'.
Friday 30 July	Traders attempt the operation and begin to buy futures, but then decide to unwind that position because the price of futures is rising quickly.
Monday 2 August	Traders discuss the operation with management in the morning and conclude that the market is sufficiently stable to proceed.
9.12am-10.29am	Traders purchase 66,214 futures contracts, mostly German Bunds. Futures' and cash bonds' prices rise.
10.28am	Traders begin to sell approximately €10.6 billion[15] in cash bonds.
20 seconds later	Traders are unsure whether the sales are confirmed and resubmit a sell order.
10.29am	A total sale of €12.9 billion in cash bonds is concluded.
10.30am-11.25am	Realising that they had build an unexpected short position on cash bonds, traders reconfigure the spreadsheet to work in reverse, i.e. to buy bonds.
11.25am	Traders purchase €3.8 billion of cash bonds, neutralising their risk position and realising a profit of $18.2 million.

The FSA's Final Notice concluded that Citigroup's management had failed to control trading operations appropriately and had not acted with "due skill, care and diligence" (ibid). I analyse this judgement in detail below, after accounting for the other European investigations.

Regulatory interventions outside the UK

Of the seven European financial regulators who opened investigations into Citigroup's trade, only Portugal's CMVM (Commissão do Mercado de Valores Mobiliários) joined the FSA in fining Citigroup. CMVM imposed a penalty of €950,000 and published its judgement in a single phrase: "Repeated violation of the duty of defence of the market relative to eight treasury bonds issued by the Portuguese State and admitted to negotiation in the Special Market for Public Debt [MTS]" (CMVM1,

[14] A long position is taken when traders expect the price of the security to increase over time; a short position is when they expect the price to fall.
[15] Author's estimate, based on the FSA account (FSA1): traders needed to sell between €8 and €9 billion, and estimated the spreadsheet's failure rate at 20% to 30%, which they compensated for by overselling.

author's translation). CMVM designated the infraction category as "Integrity, Transparency and Fairness in the Market" (ibid). The linguistic flourish in CMVM's statement – Citigroup's "duty to defend the market" – is notable for its 'hardness'. Not only does the market require "defending", but it is a firm's "duty", not prerogative, to protect it. This hardness may be attributable to linguistic differences, but the inference is clear: markets do not defend themselves.

The German regulator, BaFin (Bundesanstalt Finanzdienstleistungsaufsicht), and the Italian regulator, Consob (Commissione Nazionale per le Societa e la Borsa), launched a criminal investigation against the Citigroup traders, on the charge of market manipulation, which is illegal.[16] The events that led to this charge were not extensively reported in the media. Before carrying out the large sale of bonds, the bank had built up a position in the Eurex Eurobond futures market, expecting that its panicked competitors would buy futures in order to hedge their cash position on MTS. If it could be established that Citigroup's intention had been to make a profit on the subsequent sale of futures by sending a misleading signal through its sale of cash bonds, then the trades might have constituted a case of market manipulation. Moreover, it was revealed in a leaked Citigroup memo that Citigroup had aimed in its operation to decrease the attractiveness of German bonds in the long-term. However, for reasons that have not been reported and I have not been able to determine, both cases were dropped, and Citigroup did not suffer any regulatory penalty in either country (Mayhew 2006). German law was changed after the trade (DT14), but it is unclear what the change was.

Other regulators considered launching a charge of market manipulation but did not. In the UK, "market abuse" (which includes manipulation, insider dealing, or improper disclosure) was an initial focus of the FSA investigation, but subsequently dropped because, according to Gans (2006), "no UK securities [had been] traded" (p. 44)[17]. Interestingly, according to an advocacy paper published by the British Banking Association and Clifford Chance (respectively, a lobby group and a law firm), the Belgian regulator CBFA "initially sought to take action against Citigroup on the grounds of market abuse, but subsequently classed the alleged abuse as <u>identical</u> to that previously 'prosecuted' by FSA, and as such, chose not to commence disciplinary proceedings under the principle of [double

[16] Market manipulation occurs when a transaction deliberately sends misleading signals about the demand for, supply of, or fair value of a particular asset. Several commentators in the media (e.g. WSJ24) described the FSA's actions as market manipulation. The FSA Handbook groups market manipulation alongside insider dealing and improper disclosure of information as different forms of market abuse.

[17] Other explanations exist for the FSA's decision and I address them more fully below.

jeopardy][18]" (BBA and Clifford Chance [undated]: 4, underlining added). These accounts of the British and Belgian regulators' motives are slightly incongruous, given that the FSA had in fact not prosecuted the market manipulation charge and therefore the Belgians may have been able to do so. (Carlos Conceicao, the ex-FSA official who headed the Citigroup investigation, is now a partner at Clifford Chance and co-authored the report cited.)

In the end, no charges of market manipulation were brought against Citigroup by any regulator and Citigroup was not judged to have broken the law. Instead, it was punished by the FSA for not having had the right internal systems and controls in place to ensure that the trade did not proceed.

Focus on the FSA

The FSA's documentation is perhaps the most comprehensive data on this episode of any supervisory agency. This is primarily because it played "a leadership role in agreeing the scope and content of the investigation [...]", coordinated information gathering and exchange between the other European regulators (Gans 2006: 44; BBA and Clifford Chance [undated]), and "carried out supplementary interviews and documentation reviews" pertaining to Citigroup's submission to the investigation (Gans, op cit). It was the only regulator to interview the key individuals involved in the trade (ibid). Its regulatory judgement was trusted by "all of the other interested regulators [who] appeared to be comfortable in relying upon the FSA to complete the investigatory phase" (ibid). In some respects, one could therefore argue that the FSA's view reflected the main thrust of regulatory concerns in Europe.

In some respects, focusing on the FSA has an additional advantage – apart from it setting out all available facts on the trade – this regulator is very close to industry bodies. All of its policy documents incorporate references to external stakeholder consultations, and whilst not wishing to assess their consultative process, my view is that this proximity lends some weight to the idea that the FSA's expectations are well known, sometimes shared, by market actors. Indeed the FSA had been reputed as a so-called "light-touch" regulator (Reuters 2007), relative to its European and American counterparts, deploying methods that resonate with preferences of financial sector firms. For a regulator, it is as close to a market actor as one can be. Its judgement may well be representative of broad sections of market sentiment. (I also note that the FSA is a private company

[18] The principle of double jeopardy "is intended to prevent multiple prosecutions in different jurisdictions for the same alleged criminal offense" (BBA and Clifford Chance, undated: 1).

mandated by the government to supervise the industry, and its board is made up of former financiers.)

I turn now to a conceptualisation of the regulatory account of the MTS trade. The analytical scheme draws on the same grounded theory approach and methods as the rest of the thesis. I begin by theorising key the concepts in the FSA's documents regarding Citigroup, and establishing how they relate to the propositions already deduced from media reports. Then, I sample and analyse other documents by the FSA that are related to the key concepts and propositions. This is the practice of theoretical sampling, which means looking for new data that can illuminate new properties and dimensions of the key concepts (such as market abuse), until those concepts are theoretically saturated – that is, when new data tells us nothing new about them. Thus the early detailed coding of the Citigroup judgement becomes progressively more abstract as I seek to conceptualise, rather than describe, the episode. The objective, throughout, is to build theoretical propositions that account for how firms may be responsible for orderly markets, in the perspective of state regulators.

3.3.1. The FSA's judgement: Foreseeing and treating risk

"In a quickly changing marketplace, principles are far more durable" than rules.

FSA (2009a)

The FSA issued its Final Notice to Citigroup on 28 June 2005, roughly nine months after the trade, following consultations with other European regulators, Citigroup employees, and market participants (FSA1). It provided a detailed technical account of the planning, execution, and price and liquidity effects of the trade. Its conclusion stated: "the FSA notes that <u>the main issue of regulatory concern was the failure by CGML [Citigroup Global Markets Limited] to consider the impact the trade would be likely to have (and indeed did have) on MTS</u>" (FSA1: 14, underlining added). The regulator imposed its largest financial penalty to date, £13.9 million, which comprised £9.9 million in relinquished profits and a further £4 million in punitive damages (FSA1: 1). Fitigroup was found to have contravened two of the FSA's Principles for Business:

- Principle 2 (Skill, care and diligence): "A firm must conduct its business with due skill, care and diligence." Citigroup:
    - "did not have due regard to the inherent risks including the likely consequences the execution of the trading strategy could have for the efficient and orderly operation of the MTS platform."

- "did not ensure that clear parameters for the size of the trade were understood, communicated and reviewed."

- Principle 3 (Management and control): "A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."
  - "There was a failure within CGML to escalate the detailed trading strategy on 2 August 2004 adequately and in advance to senior management, and a failure to consult with applicable control functions."
  - "There were inadequate systems for supervision of traders." (FSA1: 2)

Before setting out my analysis of the FSA's judgement, I outline the FSA's approach to principles-based regulation, and its Principles for Business.

Principles-based regulation

The FSA supervises markets through what is called principles-based regulation, broad guidelines for conduct. This contrasts, for example, with the American approach of rules-based regulation, which employs detailed prescriptions. The FSA's reasoning for using principles-based regulation provides some insight into what lay behind the Citigroup sanction.

Principles-based regulation, which has been in place since 2001, is a way to operationalise risk-based regulation, which means addressing issues that pose a risk to the institution's statutory objectives (FSA4). In the FSA's words, "Risk-based regulation will remain central to determining how we prioritise our resources, as principles-based regulation steers our expectations of firms and the way we deal with them" (op cit: 4). It continues, "Principles-based regulation means, where possible, moving away from dictating through detailed, prescriptive rules and supervisory actions how firms should operate their business. <u>We want to give firms the responsibility to decide how best to align their business objectives and processes with the regulatory outcomes we have specified</u>" (ibid, underlining added). In justifying its transition to this approach, the FSA emphasises strongly its view that principles are a more effective means to achieve the desired regulatory outcomes, because detailed rules may stifle innovation or open loopholes that companies may exploit (op cit: 6-7). "In a quickly changing marketplace," it states (ibid), "principles are far more durable".

The FSA's 11 overarching Principles for Business are as follows.

Figure 3-12. FSA's "Principles for Business" (FSA3)

Principles	Description
1. Integrity	A firm must conduct its business with integrity.
2. Skill, care and diligence	A firm must conduct its business with due skill, care and diligence.
3. Management and control	A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. Financial prudence	A firm must maintain adequate financial resources.
5. Market conduct	A firm must observe proper standards of market conduct.
6. Customers' interests	A firm must pay due regard to the interests of its customers and treat them fairly.
7. Communications with clients	A firm must pay due regard to the information needs of its client, and communicate information to them in a way which is clear, fair and not misleading.
8. Conflicts of interest	A firm must manage conflicts of interests fairly, both between itself and its customers and between a customer and another client.
9. Customers: relationships of trust	A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement.
10. Clients' assets	A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. Relations with regulators	A firm must deal with its regulators in an open and cooperative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would reasonably expect notice.

In addition to analysing the FSA's take on the specific principles contravened (Principles 2 and 3), I also seek to identify other principles on the list that appear embedded in the ruling (Principle 5, on market conduct), and principles that do not feature on the list above. I analyse Principle 3 first, and only then Principle 2, consistent with the FSA's Final Notice to Citigroup.

Controlling affairs with adequate risk management

Citigroup contravened Principle 3 (management and control) in two respects: it failed to *escalate the trading strategy to senior management adequately,* which could have prevented the trade from going ahead, and it failed to *operate adequate systems to supervise traders*. These are properties of *controlling affairs with adequate risk management*. In order to flesh out these properties' dimensions – or manifestations – I analyse the codes found in the regulator's Final Notice.

The interactions between the trading desk, which executed the operation, and senior management were central to the FSA's judgment. *Escalating the strategy to senior management* means ensuring that management is aware of the strategy and, ultimately, approves it. In the escalation process, some parts of the management were aware of the basic strategy, but not its size:

> "The Traders discussed the strategy with the head of the Desk. Following this discussion the Head of Desk on 28 or 29 July 2004 sought approval from the European Head of Interest Rate Trading [...]. The European Head of Interest Rate Trading authorised the trade [...]. However, there was not a common understanding between the Traders, the Head of Desk, and the European Head of Interest Rate Trading as to the parameters of the size of the trade. CGML did not therefore *ensure parameters for the size of the trade were clear*, understood and communicated" (FSA1: 5, italics added).

The traders' *risk position* after the first set of trades also appeared excessively high, being "more than four times the level at which the Desk was authorised to hold a position overnight, although there are no intra-day limits and trades frequently exceed end of day limits during the day" (ibid). Despite traders not having breached formal limits, the FSA cited this as further evidence that parameters for the size of the trade were not clearly set out by management (FSA1: 6). The traders had also estimated that 20%-30% of their trades would fail (because they would be executed very quickly using partly untested technology) and programmed their spreadsheet to oversell by 20%-30%. According to the FSA, "These estimations for the failure rate were not considered by management as part of the authorisation process" (ibid).

Ultimately, although the traders escalated the strategy two levels up, Citigroup's failure to *operate adequate control systems and policies* meant that the escalation was not steered correctly to control functions; that is, "not considered by Compliance, Legal or independent Risk Management [...]" (op cit: 10). "Accordingly", writes the FSA, "insufficient weight and attention was given to:

> "the franchise risk [also known as <u>reputational risk</u>] to which the trading gave rise;
>
> "the <u>execution risk</u> arising from, amongst other things, the use of a spreadsheet that was not fully testable;
>
> "the <u>market impact risk</u>, i.e. that the trade might have an adverse effect on price and on quotation levels on MTS and the effect this might have on market confidence; and
>
> "<u>legal and regulatory risk</u> resulting from the above" (ibid, underlining added).

The regulator also judged that systems for *supervising traders on the Desk* were inadequate, which enabled traders to exceed the size of trade previously considered by management (ibid). The traders had built a special spreadsheet, Dr Evil, to interface with the MTS system and execute the trades. Dr Evil was so effective that "Within about the first 20 seconds of the spreadsheet being deployed, the Traders were unaware that CGML had received sale confirmations of the trades [... They] became concerned that the spreadsheet had not worked and that CGML continued to retain a significant risk position [totalling €3.8 billion]. Accordingly, the spreadsheet was activated again with sell orders being re-submitted [...]" (op cit: 7-8).[19] This incident raises a number of questions about the intentionality of the trade and the mooted market manipulation charge. I review these implications in more detail later.

Citigroup was not charged with market misconduct, but the FSA highlighted *providing market conduct training* as a desirable feature of management control systems. It found that traders had been "inadequately trained in respect of observing proper standards of market conduct", specifically because:

> "market abuse training was only provided to CGML employees on the introduction of the market abuse regime on 1 December 2001, a date known as 'N2' and not thereafter;
>
> "the Traders employed at the time did not attend the market abuse training provided on 'N2';
>
> "[the email setting out the basic strategy for the trade] contained language which suggested that the author had been inadequately trained on market conduct issues [...]" (op cit: 10).

Coding the data cited above, in respect of Citigroup's violation of Principle 3, *Controlling affairs with adequate risk management,* we can deduce a set of properties and dimensions for this concept, which I have summarised in Figure 3-13. The first property is to *escalate the strategy to senior management*, with particular emphasis on *escalating in advance* of the trade and on *consulting with control functions*, such as the compliance and risk management departments. Then, *operating supervisory systems for traders*, such that execution can be monitored, particularly when it comes to *observing clear parameters for the size of trades* and *being aware of trading positions and risk exposure* as the trade progresses. Thirdly, adequate risk management requires *assessing the potential impact of trades on risks across the corporation.* This is distinct from managing financial risk during the operation itself (for example through hedging). Rather, it relates to contextual factors, such as *reputation risk, execution risk* (technological or human failure), *market impact risk* (adverse effect on market confidence), and *regulatory risk* (potential sanctions). Finally, the data also associates *market conduct training* with adequate controls; particularly its

Figure 3-13. The category *Controlling affairs with adequate risk management*: properties and (dimensions)

Escalating the strategy to senior management
(Before/after the trade)
(Consulting with the control functions, e.g. risk teams)
Operating control/supervisory systems for traders
(Observing clear parameters for size of trades)
(Being aware of trading positions and risk exposure)
Assessing potential impact of trades
(Reputational risk, aka 'franchise risk')
(Execution risk)
(Market impact risk)
(Legal & regulatory risk)
Training in respect of market conduct
(Frequency of training)
(Attendance at training)

[19] Note that this human faltering was partly responsible for the size of the trade.

frequency and distribution. Together, these properties and dimensions account for the FSA's reading of how Citigroup failed to control its affairs adequately (Principle 3).

It is a critical insight that Citigroup was expected to use its discretion to decide how to apply the relevant principles. The processes I have just described, which the FSA judged were inconsistent with Principle 3 (management and controls), are not detailed prescriptions in the FSA's Handbook. The document "Senior Management Arrangements, Systems, and Controls" (FSA5), which the FSA refers to in the Final Notice against Citigroup, elaborates the principle. In respect of escalation and risk assessment, the document states:

> "Depending on the nature, scale and complexity of its business, it may be appropriate for a firm to have a separate risk assessment function responsible for assessing the risks that the firm faces and advising the governing body and senior managers on them [and/or] delegate much of the task of monitoring the appropriateness and effectiveness of its systems and controls to an internal audit function [...]" (op cit: 3).

It was Citigroup's responsibility to identify the need to refer the trading strategy to the legal, compliance, or risk management departments. The regulation does not specify detailed parameters for the decision. Similarly, the regulatory document has no reference to market conduct training being a part of adequate management and control, even though the FSA judged the lack of training to represent a failure of that management. Again, from the regulator's perspective, it was beholden on Citigroup to define the right processes to meet the FSA's guidelines in respect of management and control.

Exercising due skill, care and diligence

The FSA's Principle 2 (skill, care and diligence) is notable as a regulatory principle because one might have expected it to be endogenous to the market. That is, any firm that operates without due skill should theoretically be cleared out by the invisible hand of the market if its competitors better it; theoretically, there is no more need for a "due skill" principle than there is for a "make profits" principle. However, from a regulatory perspective, the point is that <u>a lack of skill, care and diligence in a financial market threatens the financial system and its stakeholders as the whole</u> – the invisible hand may be too slow to deal with it.

Citigroup breached the principle of due skill because, according to the FSA, it:

> "did not have due regard to the inherent risks including the likely consequences the execution of the trading strategy could have for the efficient and orderly operation of the MTS platform;"
>
> "did not ensure that clear parameters for the size of the trade were understood, communicated and reviewed" (FSA1: 2).

In justifying this judgment, the FSA begins: "From its inception, the trading strategy was clearly careless in view of the ordinary levels of trading volume on MTS and the amount of visible quotes on that platform. It was foreseeable that the execution of the trading strategy ran the significant risk of disrupting visible quotes and therefore the efficient and orderly operation of the MTS platform" (ibid). In this reading, the *trade's size* was central to the ensuring and *foreseeable market risk*. The MTS's rule that all market actors had to display their price quotes, meant that Citigroup could rapidly capture all of the liquidity on the market, thus *hurting market confidence*. This conclusion is consistent with the primary concerns expressed in media reports, which emphasised the effects of the trade's size on market confidence.

The property *assessing the potential impact of trades*, which was also raised in the context of the earlier principle, management and controls, has a negative dimension here. The FSA stated that "to the extent that the risks inherent in the trading strategy were considered [...] the exercise was carried out with insufficient skill, care and diligence" (op cit: 11). That is, to the extent that Citigroup correctly assessed the risks, they were careless to pursue the trade.

Figure 3-14. The category *Exercising due skill, care and diligence*: properties and (dimensions)

Assessing the potential impact of trades
(Assessing market risk)
(Assessing execution risk)
(Using well-structured analysis)
Operating control/supervisory systems for traders
(Implementing the risk assessment)
Escalating the strategy to senior management

Further, the traders were unable to create "*a reasonable or statistically meaningful basis for assessing what would happen*" once they deployed Dr. Evil, and therefore acted "without any scientific basis" (ibid, italics added). Overestimating the spreadsheet's failure rate, they sold bonds in excess of what they "needed to sell in order to return to a flat [risk-neutral] position" (ibid). It is notable that the FSA did not rely on a specific parameter of 'reasonableness' or statistical significance. In the text, it related this lack of what I call *structured analysis* both to *market risk* and *execution risk* (ibid).

The lack of appropriate *escalation* was also cited as a lack of due skill (ibid).

Based on this analysis, Figure 3-14 summarises the properties and dimensions of *exercising due skill*. The FSA did not reference any other parts of its regulatory framework in ruling on Principle 2. However, its "Code of Practice for Approved Persons: Specific", part of its Handbook dealing with Principle 2, prohibits "Undertaking transactions without a reasonable understanding of the risk exposure of the transaction to the firm" (FSA3: 3). Citigroup's failure to escalate appropriately may also be covered by the Handbook's provision against "providing inaccurate or inadequate information to a firm, its auditors or an actuary [specialist risk manager] appointed by his [the trader's] firm" (op cit: 2).

Using corporate governance to foresee and treat risks posed by the trade

On close examination, even though Citigroup was judged to have contravened two separate principles, the FSA's justifications under each principle overlap markedly. The figure below shows how the conceptual properties are distributed between the two principles. (C represents principle 3 *controlling affairs* and E represents principle 2 *exercising due skill.*) In both cases, there is a strong emphasis on <u>the failure of corporate governance mechanisms to *foresee and manage risks posed by the trade*</u>. Indeed, the properties abstract to create a new combined category: *foreseeing and treating risks posed by the trade*, which accounts for the failures under both principles.[20] Later, we will use this category, and its relationship to others, to derive theoretical propositions that account for the regulatory concerns.

Figure 3-15. The combined category Using corporate governance systems to foresee and guard against risks

Assessing the potential impact of trades [C,E]
(Assessing market risk) [C,E]
(Assessing execution risk) [C,E]
(Using well-structured analysis) [E]
(Reputational risk, aka 'franchise risk') [C]
(Legal & regulatory risk) [C]

Escalating the strategy to senior management [C,E]
(Before/after the trade) [C]
(Consulting with the control functions, e.g. risk) [C,E]

Operating control/supervisory systems for traders [C,E]
(Observing clear parameters for size of trades) [C,E]
(Being aware of trading positions and risk exposure) [C]
(Implementing the risk assessment) [E]

Training in respect of market conduct [C]
(Frequency of training) [C]
(Attendance at training) [C]

[20] The process of comparing conceptual properties and dimensions is known in grounded theory methodology as conceptual ordering, detailed in Chapter 2, Section 3. Because the two categories *controlling affairs* and *exercising due skill* account for much of the same phenomena, they abstract to a higher category, following the concept-indicator model.

Being responsible at corporate level

The FSA held Citigroup *responsible at corporate level*, even though senior management were unaware of the transaction, and even though the email setting out the basic strategy for the trade "was not seen by all of the Traders and not all of the Traders agreed with the author's assessment of the possible side effects and benefits and the strategy evolved in the days leading up to 2 August 2004" (FSA1: 5). Despite the operation involving a handful of individuals, the FSA ultimately concluded: "The matter of regulatory concern is the serious corporate failings of CGML. The FSA is not taking action against any of the individuals concerned" (op cit: 14). The corporation was ultimately punished for allowing the trade to proceed, rather than for the trade itself, a point I develop in the next section (the trade did not constitute market abuse but was deemed inappropriate). It is key that the UK's Financial Services and Markets Act (UK1), which underpins the FSA's regulatory regime, specifies that a "'behaviour' includes action or inaction" (Section 118[10]). Senior management's inaction to prevent the operation was punishable. They were responsible for preventing it.

Citigroup's size was a key dimension of corporate-level responsibility, according to the regulator. Under the heading, "Seriousness", the FSA stated:

> "CGML is part of the largest financial institution in the world. CGML has the financial resources at its disposal to ensure [compliance, and to] take significant risks. The FSA therefore expects high standards of a firm of CGML's size. It behoves a firm such as CGML to take particular care [...] to consider all the risks associated with its trading for the efficient and orderly operation of the platform" (FSA1: 14).

This factor is significant when we consider the conditions under which these expectations apply.

3.3.2. The requirement of good market conduct

While the FSA (FSA1) concluded that "the main issue of regulatory concern" was Citigroup's failure "to consider the impact the trade would be likely to have" on the market (p. 14), it did not cite its Principle 5 on market conduct in the Final Notice. Principle 5 states that "firms must observe proper standards of market conduct" (FSA3). As I noted, Gans (2006) states that even though the FSA's "initial focus was on controls and market conduct (Principles 3 and 5), [... t]here was no action as no UK securities were traded" (p. 44). This explanation is puzzling because the UK's Financial Services and Markets Act, which is the basis for all financial regulation, holds that market abuse penalties apply if the behaviour in question occurs either in the United Kingdom or in a market "which is accessible electronically in the United Kingdom" (UK1, Section 118, Subsection 5). Citigroup's operation fulfilled both of the conditions cited there and, in addition, the Act does not mention a requirement that UK securities be traded. The FSA itself justifies the absolution solely on the grounds that the trading strategy "did not deliberately set out to disrupt [the market, and] did not depend on price positioning or other distortive behaviour" (FSA1: 14). "It might be said", posits Mayhew (2006) in *European Company Law*, "that the FSA's findings were influenced by the prospect of achieving an early result which could be announced to the market [...] Regulators with power to settle cases have imperatives other than the jurisprudential purity of the outcome" (p. 218). Whatever the most fitting account, it remains that regulators across Europe did not find Citigroup guilty of market abuse – and this episode is more interesting for it. It would not have been very interesting to explore why the bank was punished for breaking the law. What is interesting that it was punished for authorising a legal but "careless" trade (FSA1: 11). To paraphrase the FSA's judgement, Citigroup management should have known better than to authorise the operation.[21] But should have known what? Below I outline what constitutes market abuse under the FSA's and European regulatory regimes, and specify in what respects Citigroup's trade appeared to constitute misconduct.

The FSA's Code of Market Conduct regards the following behaviours as market abuse.

Figure 3-16. Types of market abuse (adapted from FSA3)

Type	Variations
Insider dealing (MAR1.3)[22]	Deals made on the basis of inside/non-trading information; or of the anticipated impact of another impending deal, such as buying a company's shares before it is bid for.
Improper disclosure (MAR1.4)	One's disclosure of inside information other than in the exercise of professional duties.
Misuse of information (MAR1.5)	Behaviour based on information that is "generally unavailable" but which does not qualify as inside information.
Manipulating transactions (MAR1.6)	Transactions that give a misleading impression about the supply, demand, or price of particular securities; or "secure the price of [a security] at an abnormal or artificial level".
Manipulating devices (MAR1.7)	Transactions which "employ any form of deception or contrivance", such as praising a particular stock without disclosing one's interest in it, in order to drive up the price.
Dissemination (MAR1.8)	Disseminating false or misleading information.
Misleading behaviour and distortion (MAR1.9)	Behaviours which do not qualify as manipulating transactions or devices, but have a similar effect; e.g. moving an empty cargo ship to mislead about commodity supply.

[21] Cf. "the FSA notes that the main issue of regulatory concern was the failure by CGML to take due care to consider the impact the trade would be likely to have (and indeed did have) on the MTS" (FSA1: 14).
[22] "MAR1.x" is a reference to the relevant section of the "Code of Market Conduct" (FSA3).

Of the behaviours designated above, those associated with "manipulating transactions" (MAR1.6) seem to resonate with Citigroup's operation, as the following table demonstrates.

Figure 3-17. Market abuse and resonance with the MTS trade

Manipulating transactions: Examples[23]	Resonance with MTS trade
Parties trading securities in order to force price to an artificial level and subsequently profiting from that price level. (MAR1.6.4[5])	Citigroup's purchase of €4bn in bonds at a depressed price level subsequent to their sale of €13bn.
Trading on one market with a view to improperly influencing the price of a related investment on a different market. (MAR1.6.4[7])	Citigroup's deliberate hedge on the Eurex futures market, for its sale in the cash bond market.
The trader "has another, illegitimate, reason behind the trade" (MAR1.6.5[2])	The Citigroup email specifying objectives like 'decreasing the attractiveness of the Bund market', which the FSA said showed the author was not adequately trained in good market conduct.
<u>Mitigating factor</u>: If the trade creates an exposure to market risk, rather than closes it. (MAR1.6.6[3])	Citigroup's trade created a higher exposure to market risk. This mitigates the charge of market abuse, although it supported FSA's the charge of inadequate controls.

This resonance between Citigroup's trade and these elements of misconduct helps account for the references to market manipulation both in the regulatory and media data.

It is notable that there was a limit to what Citigroup had to 'do for the market' – its competitors were also expected by the regulator to manage the risks of a potential market coup like Citigroup's:

> "In considering the seriousness of the contravention the FSA takes into account the losses caused to other market participants as a result of the contravention. However, it also recognises that the counterparties to the trades conducted by CGML are professional market counterparties who can be expected to understand the nature of their commitments when providing quotations on MTS" (FSA1: 15).

This sentiment is consistent with the reports that held, for example, that Citigroup "legitimately filled orders that had been placed by willing counterparties, all of whom were grown-up financial institutions used to dealing large numbers" (GU1).

[23] FSA's (FSA3) Code of Market Conduct.

Remedying shortcomings

As a mitigating factor in its sanction, the FSA acknowledged Citigroup's "very good co-operation with the investigation" (op cit). It briefly noted Citigroup's behaviours that amounted to *remedying shortcomings*, summarised in Figure 3-18.

Figure 3-18. The category *Remedying shortcomings*: properties and (dimensions)

Cooperating with regulator
Apologising publicly
Emphasising values from CEO-level downwards
Frequent training in market conduct
(web-based resourcing)
(re-scheduling annually)
Investing in surveillance software
Strengthening compliance department
(increasing head count)
(locating compliance staff on trading floor)

3.3.3. Preliminary propositions

The core category, or unifying theme, that captures regulators' expressed concerns is: *using corporate governance mechanisms to foresee and guard against risks posed by a transaction, particularly market risks.* This conceptual category accounts for how the FSA and CMVM summarised their judgements, the FSA's detailed analysis of *controls* and *due skill* principles, and the mooted investigations into market abuse in Germany and Italy. The other categories are *being responsible at corporate level, carrying out market-friendly transactions,* and *remedying shortcomings.* The relationships between these categories determine the following propositions:

P7 There is a regulatory expectation that firms will implement corporate governance mechanisms that foresee and guard against a transaction's broader impacts. The key operational impacts to consider are market risk, execution risk, reputational risk, and legal and regulatory risk.

P8 In some cases, firms will be required to identify, by their own means, the best way to guard against those risks.

P9 Inaction, or failure to prevent transactions that disrupt the market, may draw regulatory sanction even if the trades do not constitute market abuse; therefore, there is a proactive responsibility to protect the market.

P10 Firms may be held accountable at corporate level for infractions of individuals even when these infractions are not criminal offenses.

P11 Cooperating with regulators and improving compliance and risk management systems before the end of the investigation decreases the risk of sanctions.

Some of these propositions extend, and others supplement, the propositions deduced from media reports of the episodes. In the following section, we integrate both sets of conclusions to arrive at a theoretical account of the episode.

3.4. The Citigroup episode: Theoretical base

The controversy that followed the Dr Evil trade is a prime subject for theoretical rendering. The episode is unusual, and appears to defy a quick explanation, for two reasons. First, whilst intense, the controversy was not based on a clearly understood disagreement or debate. Citigroup had been "untoward" (to use a median term), but the rules it broke were not articulated explicitly. One banker's citation conveyed a contradiction succinctly: "Really what they did was smart. They didn't do anything wrong, they just cornered the market. I'll tell you this though, $25m doesn't seem like a lot of profit to make when you've got the whole world lining up against you" (DT3). If Citigroup had been smart and done nothing wrong, then what justified the world lining up against them? The ambiguous nature of the controversy was compounded by a second factor, which was the regulator's reprimand for Citigroup's failure to ensure an orderly and efficient market. From an economic perspective, if the bank had been smart and done nothing wrong, then market should have remained orderly and efficient or the regulator should have intervened to change the rules. Thus, the question emerged, 'how are firms responsible for ensuring orderly financial markets'. This section begins to answer it.

Earlier, I conceptualised processes like *executing an extraordinary operation*, *judging conduct*, and *exercising due skill*, based on coded data about the controversy and the regulatory decision, and then developed basic theoretical propositions about how those processes related to each other. Now, I integrate those propositions to create theory 'building blocks' that (1) account for the episode, and (2) provide a frame to analyse other empirical episodes in the next chapters. To begin, the table below recaps the theoretical propositions already derived.

Figure 3-19. Recapping the theoretical propositions

Based on media data	Based on regulation data
P1. There is an emergent expectation that traders should help to ensure market confidence and stability.	P7. There is a regulatory expectation that firms will implement corporate governance mechanisms that foresee and guard against a transaction's broader impacts. The key operational impacts to consider are market risk, execution risk, reputational risk, and legal and regulatory risk.
P2. Controversy occurs even when specific standards are not breached, provided that there is an extraordinary financial transaction and that observers are driven to judge an actor's conduct.	P8. In some cases, firms will required to identify, by their own means, the best way to guard against those risks.
P3. In a market-making system, explicit rules need to be moderated by dealers in order to ensure market confidence and stability. It is not sufficient to observe explicit trading rules.	P9. Inaction, or failure to prevent transactions that disrupt the market, may draw regulatory sanction even if the trades do not constitute market abuse; therefore, there is a proactive responsibility to protect the market.
P4. Stable liquidity promotes market confidence and stability. Unstable liquidity leads to controversy if an extraordinary transaction is involved in creating the instability.	P10. Firms may be held accountable at corporate level for infractions of individuals.
P5. Large, liquid dealers are particularly responsible for ensuring market confidence and stability.	P11. Cooperating with regulators and improving compliance and risk management systems before the end of the investigation decreases the risk of sanctions.
P6. Ensuring market confidence reduces regulatory risk.	

Together these propositions account, on a conceptual level, for Citigroup's Eurobond controversy. It should not be possible to find significant data that does not feed into these propositions; that is the grounded theory criterion of fit. However, this is not to say that there is no data contradicting the propositions. In any theoretical account, outliers and exceptions help to assess the account's credibility. For example, I noted some bankers' judgements that absolved Citigroup and others that blamed MTS and its 'artificial' market-making rules. To integrate these exceptions into the theory, I compared them with other dimensions of the concept, and calibrated my judgement accordingly. For example, when outlining the properties of *judging conduct* (Figure 3-9), I noted each of those opposing sentiments. My contention that there is no significant data unrelated to these propositions also means that the documents analysed do bear some information that did not "earn its way into the theory", as grounded theorists put it (e.g. Glaser 1978, Charmaz 2006). Some data is far removed from what emerged as the central concepts of concern. I would highlight, for example, reports on Russian investors' bids to purchase the MTS platform, which noted the Citigroup trade incidentally.

As a matter of process, the sets of propositions above were derived separately, in part to help the reader take stock of some of the incremental steps in the theory-building. The task now is to integrate them to increase their parsimony.

Strauss and Corbin (1998: 270) note that a grounded theory expressed as a woven narrative serves to demonstrate the inherent conceptual linkages systematically. Following this recommendation, the following two sections outline the theoretical of account of this episode as a narrative. This narrative represents the foundation, or building blocks, for the emerging theory.

3.4.1. Narrative theoretical account: Core proposition

The core proposition that accounts for the main pattern of behaviour in the media data (controversy), and in the regulatory data (punishment), is that there is an expectation that traders should help to ensure market confidence and stable liquidity, particularly in view of extraordinary transactions. This is accomplished by enforcing corporate governance mechanisms that foresee and guard against a range of potential risks. These risks include market risks, primarily, as well as reputational risks, execution risks, and legal and regulatory risks. Corporate governance mechanisms may need to be linked specifically to market rules, and to make a judgement on when those rules need to be moderated (for example, if rules promote higher liquidity, this does not mean that an extraordinary flood of liquidity would be welcome).

The main responsibility falls on the bank at a corporate level (in all but a handful of reports, market participants, commentators and politicians did not refer to individual traders, and those traders were absolved by the regulators). Inaction, or failure to prevent risky transactions (with the dimensions of risk noted above), may draw regulatory sanction even if the final trade does not itself constitute illegal behaviour. Therefore, a bank is not only accountable for improper behaviours, but it has a responsibility to prevent them.

The boundaries of proper and improper market conduct are not clear, but are moderated both by implicit expectations in the market, and by porous regulatory principles. In the market, so-called "gentlemen's agreements" may be wholly implicit, and may not even be known by all market participants. However, failure to abide by them may generate controversy. Similarly, even if a specific regulatory principle is not judged to have been contravened, e.g. through market abuse, other regulatory principles may be invoked to punish the bank on similar grounds, e.g. failing to prevent market disruption.

3.4.2. Narrative theoretical account: Contingent propositions

The preceding propositions are contingent on a transaction's properties, dominant market conditions, the protagonist's subsequent response, and its corporate size and influence.

An extraordinary financial transaction (larger, faster, more surprising), is likely to generate more controversy, and court regulatory scrutiny, if it impacts on market confidence or liquidity, or if the protagonist's nationality or political clout are significant.

In a market-making system, explicit trading rules need to be moderated by participants. It is not sufficient to observe trading rules because, even though market-making is designed to increase liquidity, injecting too much liquidity may have the inverse effect of reducing the number of participants. The principles for moderating trading rules are generally implicit and not necessarily consensual, and therefore require good judgment.

After an incident of misconduct, and before regulatory sanction, public apologies and guidance to employees may placate public and political criticism. In addition, implementing remedial measures, such as increasing compliance capacity and improving how closely traders work with compliance professionals, decreases regulatory risk.

All of the above propositions are particularly relevant for larger firms. Larger firms have more liquidity and are frequently perceived to have a special responsibility to the market, both by market participants, commentators and politicians whose views are reported in the news, and by the regulator. This is also because larger firms have more resources to disrupt markets and to improve control systems and prevent such transactions.

3.5. Conclusion

Our conclusion is one rarely seen in the study of bond markets:[24] that banks are expected to take special steps to ensure that markets function well, moderating their transactions and corporate governance not only in pursuit of utility and transparency (which are common standards), but also in pursuit of market confidence, stable liquidity, and corporate foresight and control. If they do not, then the risk of controversy increases, bringing regulatory risks. Through several contingent propositions, I have conveyed under what conditions this is likely to apply.

This argument is substantive, based on data from European government bond markets, and tentatively generalisable within those markets. That is, if another bank attempted a similar operation on the MTS exchange, then a similar controversy would likely ensue. The debates that followed the trade codified a set of principles and expectations of corporate behaviour. Some of these principles may not have existed before the trade. I found very little evidence that a specific gentlemen's agreement discouraging such trades had existed ex ante, but did find evidence that suggests the Citigroup traders did not know about it. However, after the controversy, the boundaries of good conduct became clearer and precedents were established. On this basis, we can say that Citigroup's Eurobond controversy codified the expectation of firms' responsibility for orderly markets in the MTS system at least.

While this makes the episode interesting in its own right, the more exciting contribution for the thesis is the set of sensitising concepts and frames of reference that one may use to analyse other empirical settings. In the following chapter, I broaden the empirical scope to focus on a whole group of actors, sovereign wealth funds (SWFs), rather than a single actor like Citigroup. As the SWF data yields new properties and dimensions to these concepts, the resulting propositions acquire greater explanatory power.

[24] Cf. Beunza, Hardie and MacKenzie (2006).

Chapter 4: Sovereign wealth funds' rise to prominence

"This is a further sign of how the world economy is changing. It is not happening overnight. But it is happening gradually. What that also means is that the rules by which markets are run may need to evolve."

Gerard Lyons, Chief Economist, Standard Chartered Bank, on SWFs[1]

"They don't like us, but they want our money."

Norwegian SWF official[2]

4.1. Introduction

Variously labelled "new global power brokers" (McKinsey 2007), "giant locusts" (DT50), and "a force for stability" (FT149),[3] sovereign wealth funds were held to more scrutiny in recent years than almost any other kind of financial market actor. These government-funded investors have existed in their current form since the 1950s, but for decades kept a low profile. According to data in the Google News Archive in June 2008,[4] sovereign funds were mentioned in only two news articles in the nine years between 1998 and 2006 – once in 2003 and once in 2006. Then, in 2007 alone, they received 1,400 mentions in the same media outlets, and more again the following year. It was a rapid, if controversial, rise to public prominence, as the funds diversified away from low-yielding bond markets in the early 2000s and began to invest in high-profile companies and real estate in the West. Western governments rushed to agree international policy approaches to them, and succeeded – arguably to a greater extent than they did for investment banks in the wake of the Credit Crunch. Codes-of-conduct outlining sovereign funds' "responsibilities", as the EU Commissioner for Monetary Affairs called them (BBC 2008), were drawn up by the International Monetary Fund (IMF) and the US Treasury in 2008, with input from the European Union. The purpose of these agreements with SWFs was "to help maintain a stable global financial system and free flow of capital and investment" (IMF2: 4).

Manifest in the codes-of-conduct is the notion that SWFs have to do more than pursue commercial objectives and comply with regulations, in order to maintain an orderly and efficient financial system. This is a very similar problematique as the Citigroup case, although in that episode the

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[1] Cited in FT122.
[2] Cited in GU25.
[3] As in the other chapters, the referencing format has been simplified for documents in the data sample. See Part 1 of the bibliography.
[4] The archive covered all of the newspapers in my data sample, in addition to "hundreds" of other sources.

controversy was a reaction to misconduct, whereas the SWF controversy is in anticipation of misconduct. SWFs are unconventional market participants. Some hold capital with a mandate to stabilise their domestic economy in the event of a downturn. During a global liquidity shortage, they might therefore withdraw capital quickly from international markets, destabilising asset prices. Often staffed by civil servants rather than professional investors, their risk management and accounting standards are not uniform, and possibly unreliable. They could threaten market efficiency if they moved to exert operational control over companies that they acquire, or exerted political influence to gain an unfair advantage. And, as primarily non-Western holders of international currency reserves, they could opt not to re-invest their capital, which would worsen global macroeconomic imbalances. In 2007, most Western governments began to debate whether new regulations would be required to deal with the funds.

SWFs had their advocates in the UK government and European Commission (EC), among others. Following classical economic reasoning, advocates emphasised that sovereign funds were helping to recycle capital into the West, through their equity and real estate investments, and thus redressing imbalances. In addition, they were supporting Western financial firms, which showed early signs of liquidity shortages at the start of 2007. Indeed, the funds' track-record was very positive. None of their activities had been destabilising or untoward.

Some governments swung significantly between supporting and opposing restrictions on SWFs. The US initially blocked an investment by Dubai Ports World on security grounds but then led the push for a voluntary, self-regulation approach for SWFs, publishing the first code-of-conduct. Australia initially changed its foreign investment laws to keep out SWFs, but eventually offered those funds tax incentives to go to Australia.

What all sides agreed was that the issue was controversial. As most SWFs lacked transparency and explicit governance models, few observers knew their governance structure or management systems, both of which are material for the broader financial system, especially in light of the funds' size. Controversy abated when SWFs adopted codes-of-conduct, particularly the IMF's Santiago Principles, largely authored by SWFs themselves. If sovereign funds have special responsibilities to the international financial system, then these codes-of-conduct embody them.

This chapter argues that the controversy surrounding SWFs was an attempt to define what constituted responsible market conduct for them. The concern about SWFs was very similar to the concern about Citigroup's operation in the previous chapter: that they would threaten the efficiency and orderly operation of markets, even if they continued to comply with regulations and maximise returns. I contend that this is a better explanation for the SWF controversy than another that was advanced in the data; that Western governments were 'simply' pursuing classically protectionist agendas, keeping out foreign competitors in order to protect domestic interest groups. Although this appears partly correct, protectionism did not emerge where we would most have expected it. Moreover, 'protecting' domestic interest groups required welcoming sovereign funds to provide liquidity. Based on my argument that the chief concern was to promote responsible market conduct, I analyse the codes-of-conduct for SWFs and code them as generic processes. Comparing them with the processes that emerged in the Citigroup episode, I advance several propositions about how these firms are expected to contribute to orderly markets: to operate risk management systems that anticipate the impact of investment transactions; to implement a transparent investment policy based on commercial objectives; and to improve their shortcomings proactively, even if they are not in breach of regulation. These propositions account for the Citigroup and SWFs controversies and provide a frame of reference to examine the post-Credit Crunch regulatory debate in the next chapter.

4.1.1. Purpose and contribution of chapter

The purpose of this chapter is to develop a theoretical explanation for the episode. The episode's value is anchored in the analysis of Citigroup in Chapter 3. It concerns very different actors than Citigroup, and yet, the data suggests that the core processes underpinning responsible conduct are similar in both cases. The SWF setting is broader, and covers markets for virtually all kinds of securities, and involves more types of firms (SWFs, private equity funds, and others) and more regulatory jurisdictions. This shift from a micro to a macro empirical setting increases the analytical relevance of the research. Another benefit is that it is highly socially and historically embedded in processes like a shift in economic power away from private firms specifically and from the West more broadly. This increases the accuracy, or faithfulness, of the emerging theory.

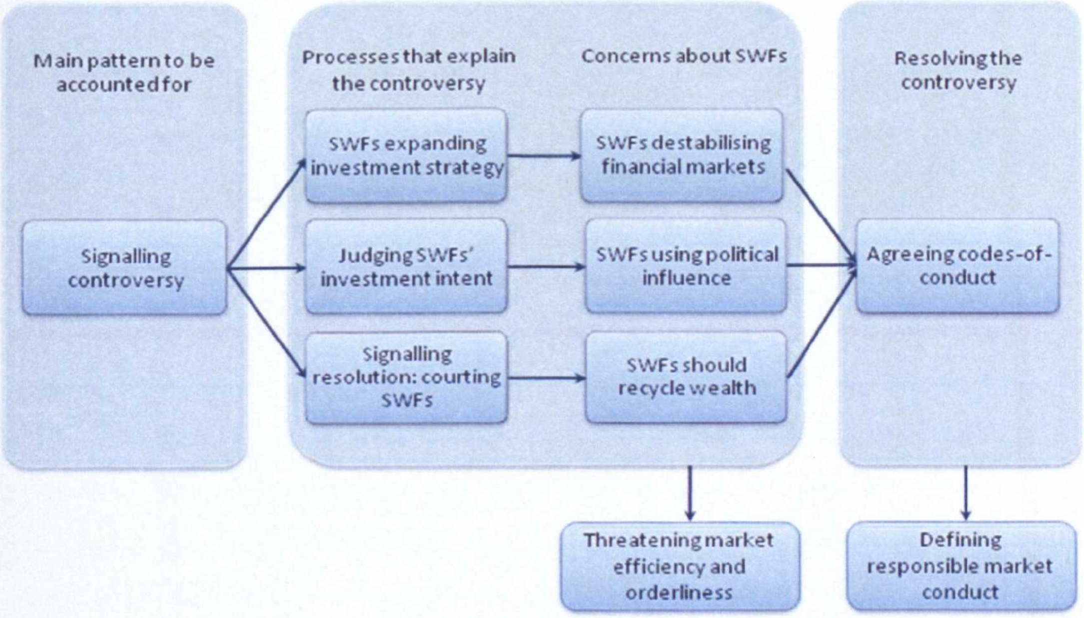
The chapter's main contribution is to offer a concept of 'corporate market responsibility' (CMR), and a set of propositions that continue to answer the question of how firms are responsible for ensuring orderly financial markets. I argue that the central process for CMR is to establish strong management systems and controls, and set out what the protocols are, how they are implemented, by whom, when, and with what consequences, based on the two episodes. The propositions about CMR in this chapter also provide a theoretical framework to assess the post-Credit Crunch regulatory debate, in the next chapter.

4.1.2. Outline of chapter

This chapter begins in Section 4.2 by recounting the rise to prominence of sovereign wealth funds, and by analysing the signals of controversy that emerged. Then, it outlines the key processes that motivated it: (1) sovereign wealth funds *expanding their investment strategies and risk exposure*; (2) governments and commentators ***judging SWFs' investment intent***; and (3) *signalling resolution: Western governments courting SWF investment.* Each of these processes is strongly associated with a particular concern about SWFs, as the figure below illustrates. I argue that these processes amount to a concern that SWFs would fail to ensure orderly financial markets – much like the Citigroup controversy.

Section 4.3 conceptualises the US, EU and IMF codes-of-conduct, which ended the controversy, and identifies good management controls as the central issue facing SWFs. Section 5.4 then compares the emerging propositions in this episode with those from the Citigroup case and builds tentative generalisations about CMR. Section 5.5 concludes.

Figure 4-1. The SWFs episode as a controversy about orderly markets and responsible market conduct: Summary of key concepts

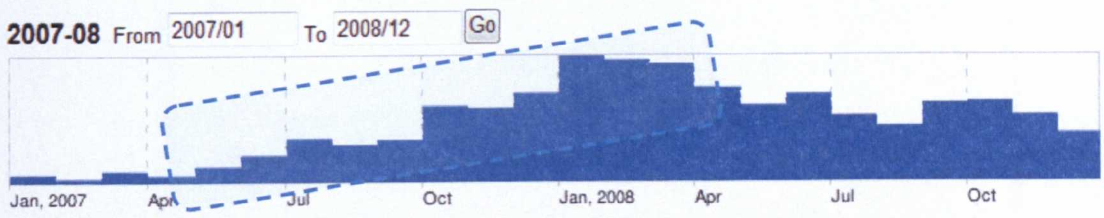


4.1.3. Sampling and analytical approach

The sampling strategy for SWFs was underpinned by the same grounded theory principles as the Chapter 3, but took a slightly different turn operationally. The central principle was theoretical sampling; sampling data that can uncover new properties and dimensions of the main concepts. Technically, the core concept I am working with is the *expectation that companies will help ensure* *market stability and confidence* (drawn from the Citigroup episode). However, in this chapter instead of sampling for said *expectation* immediately, I sampled instead for the controversy around SWFs more broadly. The motive was to understand the broader context for SWFs because the episode involved more actors and markets than the Citigroup case. Perhaps, there were other more significant drivers for the SWF controversy and I did not want to obscure them.

The first step was to establish a baseline sample of reports about SWF controversy. The baseline sample contained all references to SWFs and controversies in the same publications where I had analysed Citigroup.[5] It spanned the period May 2007 to April 2008 because this period represented the funds' rise to public prominence, as measured by volume of news reports globally (see Figure 4-2 below). During this time period, reporting grew steadily and SWFs entered international markets and the political lexicon. Expectations about SWFs were formed and public controversies emerged. At the end of the period, the first codes-of-conduct were written, signalling closure, and reporting declined. The period was an appropriate launch-pad for identifying (and then re-sampling for) the issues most central to the SWF controversy.

Figure 4-2. Historical volume of news reporting on sovereign wealth funds, and sampling period circled[6]



The baseline sample consisted of 117 reports across the eight publications. I sought reports that were directly relevant to the controversy, and searched for the terms 'sovereign funds' and 'sovereign wealth funds', with variants of the word 'controversial/controversy' or 'political/geopolitical'. The searches were conducted on each publication's website and cross-checked using Google News Archive. The reports were fairly evenly spread across the publications, with some emphasis in British rather than American media, as shown in Figure 4-3.

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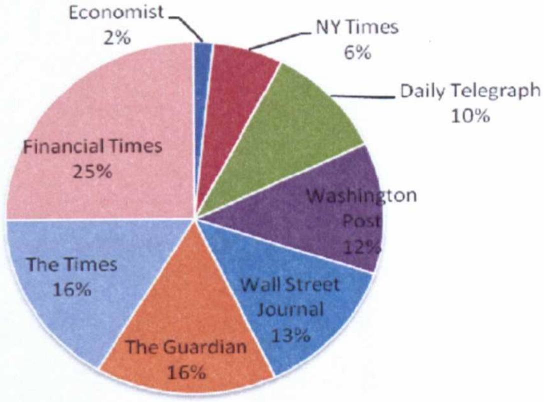
[5] The *Daily Telegraph* (DT), *The Financial Times* (FT), *The Guardian* and *Guardian Unlimited* (GU), *The Times* (TT), *The Economist* (TE), *The New York Times* (NYT), *The Wall Street Journal* (WSJ), and *The Washington Post* (WP). The selection criteria for these data sources are detailed in Chapter 2.

[6] Graph reproduced from Google News Archive in May 2009.

This data set was supplemented with reports from corporate reports that drove numerous headlines. Morgan Stanley's (2007a, 2007b, 2007c) early reports "guesstimating" (2007b: 1) the size and future growth of the funds were widely cited and a central frame of reference for the debate in the media. McKinsey's (2007) report characterised the funds as new "global power brokers" and became another key reference in the debate, particularly because it reported fears that SWFs might invest politically. Standard Chartered's (2007) report was influential because it compared SWFs to each other and furthered the idea that, despite being state-owned, they were "capitalist", profit-maximising investment vehicles.

Figure 4-3. Distribution of SWF/controversy reports in sample, by publication



The second dataset comprised regulatory and policy-documents related to SWFs, specifically the codes of conduct. An early code-of-conduct was published by the US Treasury (UST1), based on an agreement with the SWFs of Singapore and Abu Dhabi. This was particularly interesting because its principles are very similar to what had been expected of Citigroup. It suggests that key lessons from the episodes are generalisable across the two settings. Secondly, the European Commission published "inputs" to the discussion on a global code-of-conduct for SWFs (EC2, EC3, EC4), outlining the principles that it judged SWFs should abide by. The US and EU initiatives culminated in a global code-of-conduct, which was drafted under the auspices of the IMF by SWFs and government representatives (IMF2). Known as the Santiago Principles, the code set out a "user manual" for responsible market conduct by SWFs. I analyse these codes and compare them with the Citigroup episode in the second part of the chapter.

4.2. Enter Sovereign Wealth Funds

"Wanted: managers to run $200bn portfolio.
Pay not commensurate with market rates.
Controversy (virtually) guaranteed."

Lex, Financial Times, 2007[7]

For the best part of 60 years, sovereign wealth funds were both conservative and peripheral to the global economy. One report places their first incarnation in the Gilbert Islands, Micronesia, in 1953. The British administration at the time "used money raised from the sale of bird poo – which was used in fertiliser – to set up a fund that is now worth more than $500m" (GU7). Another SWF emerged in 1956 in Kiribati. The Revenue Equalization Reserve Fund was set up to manage the government's phosphates export revenues in support of the exchange rate and fiscal budget. The US state of New Mexico also created an SWF that decade, the Investment Office Trust, with revenues from land leasing, natural resources, and tobacco. For a North American venture, its investment objective remains surprisingly timid today ("growing the funds at a rate at least equal to inflation"[8]), but typical of most sovereign funds. Alaska's Permanent Fund Corporation, a mid-ranking SWF with $27 billion in assets, aims only for a 5% return after inflation, which is less than some retail savings accounts were offering customers earlier this decade. "We're trying to turn non-renewable mineral wealth into renewable financial wealth," said its Executive Director, "and we've been at it for quite some time" (FT118).

Today, sovereign wealth funds exist in primarily two forms (IFSL 2008). Stabilisation funds manage earnings from commodity exports, to protect the economy when commodity prices fall. If prices fall and economic growth slows, the government has these funds to stimulate domestic enterprise. Stabilisation funds also protect the country from shortages of foreign exchange reserves, since most commodities are traded in hard currencies like the US dollar. The second type is savings funds, which manage pensions and government savings destined for future generations. Other kinds of sovereign investment vehicles, particularly development funds (for socio-economic projects), and state-owned companies (like a national oil company), are distinct from SWFs (ibid), although they are also frequently invoked in SWF debates (e.g. IMF 2007).

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[7] Refers to the China Investment Corporation (FT129).
[8] See http://www.sic.state.nm.us/permanent_funds.htm.

The 1970s oil shocks created the first surge of new sovereign funds,[9] as oil producers like Abu Dhabi, Alaska, Canada, and Saudi Arabia – followed by minerals exporters like Botswana (diamonds) and Chile (copper) – profited from high commodity tax revenues and began investing their cash in bond markets, to help hedge against inflation and exchange rate fluctuations. High commodity prices also account for most of the SWFs established in the 2000s. China's SWFs, in contrast, were funded by a nominal 1000-fold increase in the country's foreign exchange earnings, from $2 billion in 1977 to $2 trillion in 2009, owed to strong exports. China established four SWFs from the late 1990s onwards. Some countries created SWFs to invest in international capital markets in order to earn finance for national pensions. Ireland, for example, established its National Pensions Reserves Fund ($31 billion) in 2001. For most of their history, these civil-servant-staffed investment vehicles relied on safe, fixed-income instruments, primarily US Treasury bills, to beat inflation. As the former head of one of Singapore's two SWFs wrote in his memoir, "Investing is a hazardous business. My cardinal objective was not to maximise returns but to protect the value of our savings and get a fair return on capital" (FT116).

Figure 4-4. Number of SWFs, 1953-2009

Sovereign funds' risk appetite increased in the mid-2000s, when they began *diversifying their portfolios*[10] into investments in equities and real estate. This change was motivated by a combination of necessity and ambition. At an individual level, many funds were exceeding their conservative growth objectives as new export earnings accumulated quickly, driven by the commodity price boom, and therefore had surplus capital to invest in riskier ventures. Collectively, the doubling in the number of funds in the early 2000s meant that many were chasing the same investments, thus depressing returns. Coupled with a roughly 33% depreciation of the US dollar in 2003-07 (which many felt would be prolonged due to the yawning US trade deficit), US Treasury bonds had also become a less reliable option for reserves, and this drove many funds to look at

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[9] See Figure 4-4, based on data from the SWF Institute; http://www.swfinstitute.org.

[10] As in other chapters, phrases in italics refer to conceptual categories (or their properties and dimensions); that account for the empirical data.

alternative investments with higher returns. Another motive for setting up sovereign funds was that countries, like Algeria, Brazil and Kazakhstan, repaid multilateral debt obligations and were no longer bound to fiscal restraint conditions in exchange for development finance. They were therefore able to pursue new state spending, and wanted higher yielding investments in order to fund it. Together, these trends and the advent of SWFs heralded what some political economists have called "state capitalism"[11] – governments as investors.

With higher risk appetite came visibility. Equities (and real estate) are much more visible investments than bonds because they give shareholders a degree of influence in the acquired company's investment strategy. High profile equity investments helped propel SWFs to prominence. On 23 July 2007, in one of the first such investments, Singapore's Temasek and the China Development Bank announced that they would take stakes in Barclays Bank. In September, Dubai acquired 20% of the US Nasdaq stock exchange, and 28% of the London Stock Exchange (LSE). Another 20% of the LSE was purchased by Qatar, which also took a 25% stake in the third largest UK supermarket chain, Sainsbury's. Abu Dhabi, Kuwait, Saudi Arabia and others provided sorely needed liquidity to major American banks caught up in the subprime lending crisis – Bear Stearns, Citigroup, Merrill Lynch, Morgan Stanley, and UBS – in exchange for shareholdings. The irony that these iconic global banks sought rescue from non-Western governments lay behind much of the attention devoted to SWFs from late 2007 onwards.

However visible, these bids cannot fully explain the emerging controversy afflicting SWFs because the controversy began earlier, in April 2007. My interpretation, based on the language and content of many of the early news reports, is that the initial political and intellectual debates were inspired primarily by two publications. First, Morgan Stanley published two research notes in March and May (2007a, 2007b), which "guesstimated" (2007b: 1) that the value of SWFs could increase from $2.5 trillion that year to $12 trillion in 2015, thus exceeding the size of the world's official government reserves (see e.g. FT108, GU8). The bank concluded that the "longer-term implications for financial markets are immense" (2007a: 2), but did not, or could not, specify what they would be. The estimates in these reports became 'received wisdom', cited very frequently in media and government reports. Also influential was the IMF's April 2007 "Global Financial Stability Report", which said of sovereign funds, "A single institution could make sudden portfolio adjustments that could have significant price effects on certain asset classes ... In some cases, assets may be shifted

[11] See e.g. Jeffrey Garten in FT137, and Bremmer (2009).

for political-strategic reasons" (p. 85; FT107, FT110). SWFs' potential political motives became a major source of express concern.

Before these publications, media reports that mentioned SWFs had been more technical and their tone less inflamed. These media reports, in the first quarter of 2007, had been about new trends in central bank reserve management, and more specifically, whether the US dollar would remain the major world reserve currency, a well-studied question since at least the establishment of the euro in 1999. In the absence of any controversial acquisitions by SWFs in the first quarter of 2007, it is possible that Morgan Stanley's and the IMF's reports were catalysts for the political controversy that began in the spring of that year. In the following paragraphs, I outline the conceptual properties of this controversy.

4.2.1. Signalling controversy

The controversy surrounding the rise to prominence of SWFs is an interesting problematique because, a priori, there was no clear motive for it – no misconduct by SWFs, or evidence that misconduct was imminent. The *Oxford English Dictionary* defines controversy as a "debate or disagreement about a matter which arouses strongly contrasting opinions". Controversy also thrives on uncertainty, as I argued in Chapter 3. When the debate has some features of uncertainty – for example, whether or not a political decision will be taken – the debate/controversy intensifies. Uncertainty about SWFs' impact helped to fuel debates about their proper role in the global economy.

Before contextualising and explaining the controversy, I outline its signals in this section (see Figure 4-5). The first and strongest signals of controversy arose with *politicians reviewing their policies* towards foreign investors. There were initial calls in Europe to establish a policy of 'defence' against sovereign wealth funds. Germany's Angela Merkel and France's Nicolas Sarkozy were particularly forceful in this regard. In July 2007, Merkel called SWFs "a completely new conflict situation that one must respond to adequately" (Bloomberg 2007), and Germany set up a new agency mirroring the US's Committee on Foreign Investment in the United States (CFIUS) to vet foreign investment. France's President Sarkozy stated: "We've decided not to let ourselves be sold down the river by speculative funds, by unscrupulous attitudes which do not meet the transparency criteria one is entitled to expect in a civilised world. It's unacceptable and we have decided not to accept it"

(GU13).[12] The Dutch government expressed similar reservations, and when discussions moved to European forums in June 2007, they were resisted by the UK and Italy. The British Chancellor, Alastair Darling, argued that "calls for the EU to adopt a common approach to vetting corporate acquisitions by foreign state investors" should be resisted (FT110). Italy's international trade minister, Emma Bonino, took a similar position, saying in respect of the country's national airline, Alitalia, "I don't care who buys it, it can be the Chinese, or the Eskimos, so long as they turn it around" (ibid). In the data, there was widespread sentiment that the risk of a political backlash against SWFs was significant. "And this," wrote a *Bloomberg* columnist in July (2007), "is happening without anyone having made any offers recently".

Figure 4-5. The category *Signalling controversy*: properties and (dimensions)

Politicians reviewing policy
(EC, France, Germany, Italy, UK, US, Australia)
(Protectionism, own SWFs)
Unions expressing concern
Being related to private equity
(private equity controversy)
(investment partnerships)
SWFs lacking transparency
(investment strategy)
(management controls)
(risk management)
Size of SWF sector
(number of players, funds under management)
Symbolising wealth transfer
Improving the global economy
(providing liquidity, increasing market confidence)
(correcting global imbalances)
(protecting emerging markets against shocks)
SWFs managing political risk
(making small investments)
(lobbying, PR)
(resisting code-of-conduct)

In the US, the debate was similar. In March 2006, the US Congress had successfully persuaded Dubai Ports World, a port operator subsidised by Dubai's sovereign fund, to disinvest from port facilities in six major US cities. The company had acquired control over the ports by purchasing their previous owner, Britain's P&O, months earlier. Some US lawmakers argued that Dubai Ports World could not be relied on to secure US infrastructure. Senator Charles Schumer, who led the opposition, described the Emirate of Dubai as having a "nexus with terrorism" (FT169). CFIUS, the US watchdog emulated by Germany, had not objected to the deal, prompting several Congressmen to "re-examine laws governing" it, according to a *Wall Street Journal* report (WSJ34): "Some proposed to vastly expand the definition of investments that could pose a threat to national security". A year later, in June 2007, the "US position on sovereign funds was clarified ... in a largely unnoticed speech [by a Treasury official]," according to *The Times*:

> "Identifying the potential '*impact on financial market stability*', [the official] said that because so little was known about the funds' investment policies, minor comments or rumours could spark volatility. 'It is hard to dismiss entirely the possibility of unseen, *imprudent risk management* with broader consequences', he said..." (TT15, italics added).

[12] Sarkozy eventually urged France's own sovereign fund, Caisse des Dépôts (CDC), to "defend and promote the essential economic interests of the nation" against SWFs (GU18).

SWFs' *transparency* and ability to *move markets,* both raised in this statement by the US Treasury, were key properties of the controversy, which I address below. On the other side of the debate in the US, American banks and a range of economists (WSJ25) pressed the government "to keep the [policy] reviews narrow enough to encourage foreign investment" (WSJ34).

Elsewhere, Australia, Canada and Japan also began reviews of their investment policy regimes in July 2007, and by February of the next year, Australia became the first country to adopt a new policy in direct response to SWFs. Australia argued that "Foreign governments may not operate solely in accordance with normal commercial considerations and may instead *pursue broader political or strategic objectives*" (GU31, italics added). Australia's Foreign Investment Review Board emphasised that it would scrutinise whether "an investor's operations are independent from the relevant foreign government" (*Financial Times* 2008). It examined a bid by the Aluminium Corporation of China (Chinalco) for equity in the mining giant Rio Tinto, even though the bid was for less than 15%, the threshold that would normally trigger a review (ibid). It was not without irony that, one year later, Australia's Securities and Investment Commission would launch an investigation against Australia's own SWF, the Future Fund, after it sold shares in Telstra Corp, weeks before the government threatened to split up Telstra on competition grounds (Opalesque 2009a). The suspicion is that the fund had received inside information from government. Overall, most governments' political reviews ended with relatively mild encouragements for SWF transparency, particularly in relation to investment in sensitive industries, rather than outright blocks or quotas on foreign investment. In 2009, the Australian government actually proposed tax breaks for SWFs in order to encourage their investment in the Australian economy (Opalesque 2009b), tempering the government's earlier scepticism.

The public debate on SWFs was partly fuelled by domestic political groups, particularly *trade unions*. In the UK, the Trade Union Congress, which represents all unions, *expressed concerns* about the impact of SWF investments on pensions and jobs (GU10). Unions were forceful in California, where, in April 2008, the legislature nearly approved a trade-union-sponsored bill to bar either of its state pension funds from investing in private equity funds that were part-owned by SWFs (DT46).

Sovereign funds' *relation to the private equity industry* was widely noted as a property of the controversy. Private equity funds bypass stock markets to acquire control of privately owned companies, restructure their management, and resell them as more profitable concerns some years later. They grew significantly in 2005-06, courting disrepute over a lack of transparency, their large size, and negative effect on jobs. A UK parliamentary inquiry in spring 2007 centred on the concern that "buy-out firms [i.e. private equity funds] were profiteering by taking over iconic companies, stripping them of value, and laying off employees" (FT124). In November, the industry agreed its own code of conduct, stipulating more disclosure regarding investment strategies. The code was significantly "watered down" under pressure from the industry, according to a *Financial Times* report (FT123), and, in some cases, private equity agreed to disclose only industry-wide, rather than company-specific, data about their investments. The British Private Equity and Venture Capital Association said that it hoped SWFs would also adopt the code (ibid), which they did not. Sovereign funds worked closely with private equity companies, often using them to help *maintain a low profile*, such as by entering a joint venture to invest under the private company's brand name (see FT116). "Perhaps the mutual love of secrecy explains the attraction" between the sectors, said a *Guardian* editorial (GU7).

> *"I think we were certainly guilty of telling our story badly. [We need to] get out there and say it is not about fat cats – it is about pensioners."*
>
> Simon Walker, head of private equity industry association, regarding its code of conduct (FT136)

Sovereign funds' *lacking transparency* is an ubiquitous source of concern, throughout the data, in relation to their *corporate governance* more broadly. Transparency was important along several dimensions. One was SWFs' governance structure, namely the potential political affiliations of individuals on the board. Identifying these individuals, and their *management systems* more generally, would help distinguish between *being government-owned* versus *being government-directed* (FT112). Secondly, transparency was lacking in relation to SWFs' *investment strategies.* Because many new deals were being concluded through private equity, the extent of SWFs' interest in specific industries was unknown. This obscured an assessment of potential ulterior (political) motives related to the specific investment, and created problems from a systemic perspective. Coupled with a lack of information about *risk management and control systems*, it meant that SWFs might accumulate very high exposure to sectors or asset classes, eventually posing a risk to the system. This ability of SWFs to *move markets* concerned the US Treasury and IMF, as noted above. In its April 2007 report, the IMF (2007) stated:

> "A single institution could make sudden portfolio adjustments that could have significant price effects on certain asset classes. Market rumours of such adjustments may lead to volatility as previous announcements by central banks have shown. Furthermore, if raw material and energy prices fall ... countries may intentionally run down their funds and international reserves, reversing past flows" (op cit: 85; FT107).

This threat was significant by virtue of the SWF sector's *burgeoning size* (both the rising number of funds, and total funds under management). In the first quarter of 2007, SWFs controlled between

$2.5 and $3.5 trillion (Morgan Stanley 2007a, McKinsey 2007). They grew rapidly, by roughly 18% in 2007 (FT160) and 24% in the year to April 2008 (DT49). Growth was sometimes owed to shrewd investment (for example, the Government of Singapore Investment Corporation, GIC, claimed to have achieved a 9.5% average annualised return in dollar terms since 1981; FT116), but it was also in great part due to the commodity price boom, which earned exporters additional foreign exchange (IFSL 2008). SWFs were widely projected to quadruple by around 2015, based on reports by Morgan Stanley (2007a, 2007b). While sovereign wealth funds were larger than the hedge fund industry ($1.9 billion) and private equity ($0.8 billion) combined, they still comprised a small share of all institutional investor funds – including pension, mutual, and insurance funds – which controlled a total of $75 trillion (IFSL 2008). This growing size was ubiquitously associated with the political disquiet because it raised macroeconomic and strategic uncertainties.

Key among these uncertainties was a perceived *transfer of economic power* away from the West. A frequently cited report by McKinsey (2007), the management consultancy, classed SWFs alongside hedge funds and private equity funds as "the new power brokers" in international finance. SWFs were deemed "the most controversial" of the group (FT119) because of their lack of transparency and "the possibility that they could use their financial heft for political purposes" (FT119, citing McKinsey). On this basis, the G7 discussed SWFs for the first time (TT15) at their October 2007 summit. The funds were also the main topic of discussion at the World Economic Forum in Davos in January 2008, according to the *Wall Street Journal* (WSJ35). The "new world order" that SWFs represented (ibid) troubled many, but it reassured others.

SWFs' potentially *positive impact on the economy* was the main argument counterbalancing calls for more protectionist policies in the West. The reinvestment of their foreign exchange reserves were a means to *correct global imbalances* – the growing trade deficits and declining savings in the West, matched by opposing trends in Asia particularly. As the *Wall Street Journal* put it, "For those living in the developed world, there are clear benefits ... Capital from SWFs will cushion the blow of the current financial crisis on businesses and consumers. And continued growth in emerging countries will soften the effects of a possible recession elsewhere" (ibid). *Providing liquidity* to cash-strapped global banks was strongly associated to *restoring market confidence* (e.g. FT138). This rationale lay behind the UK's bullish stance on sovereign wealth (GU25, DT33). It was also, of course, a key motive for investment banks to lobby in favour of SWFs in the US, and a reason why Australia, which initially adopted laws to limit SWFs, eventually proposed tax incentives for them.

The ways in which sovereign funds *managed the emerging political risks* also signalled controversy. Their central strategy was *making small investments to avoid regulatory review* (e.g. FT138, WSJ26, WSJ30, WSJ34). For example, when the China Investment Corporation (CIC) bought a stake in the private equity group Blackstone in July 2007 – one of the highest profile acquisitions – it trimmed its investment to 9.9% because 10% would have given it a seat on the company's board (WSJ34). Board representation would bring political scrutiny (ibid). Similarly, "After Abu Dhabi's investment arm bought a 4.9% stake in Citigroup [in September 2007] ... officials went out of their way to stress how uninvolved they would be in Citi's affairs," said a *Wall Street Journal* report (WSJ26), "They would get no board seat, or have any ongoing say in the bank's operations". These negotiations were fine-tuned with the assistance of a well-funded *lobbying campaign* in the US. For example, the UAE created a US-Emirates alliance, headed by a former aide to Hillary Clinton, to organise roundtables and other projects to promote mutual understanding, notably with Jewish interest groups (ibid). Singapore's Temasek, one of largest and less secretive SWFs, also launched an appeal with the *Financial Times* in defence of its reputation, with Simon Israel, its executive director, saying that "our reason to exist is purely to produce shareholder returns" (FT112). According to the *FT* report, Israel "said Temasek's corporate governance is 'almost the mirror of what exists on a publicly-listed company'" (ibid). "That may seem to be stretching the point," continued the report, "when five of its board members are current or former members of the Singapore state apparatus" (ibid).

By March 2008, a consensus had emerged that a global code-of-conduct for sovereign wealth funds would be drawn up, but the Kuwait Investment Authority, among other funds, initially *resisted the idea*. Its managing director, Bader al-Sa'ad, argued:

> "It's time to call a spade a spade. Recipient countries are placing handcuffs on SWFs in the form of regulations termed, in the best tradition of George Orwell's 'newspeak', codes of conduct, principles of operations or best practices. ... The American economy today faces the 'mother of all crises'. This crisis will drag Europe down and, subsequently, the rest of the world.
>
> The cause was the creation of funds which permitted entities to borrow 30 to 40 times their capital without any regulation. Based on public information, these funds apparently grew geometrically without any governance or oversight" (GU39).

Drawing these parallels with large private institutional investors, al-Sa'ad suggested that SWFs were being treated unreasonably, given that they had – now in the *Guardian* reporter's words – "acted responsibly and swiftly during the financial turmoil" (ibid). Russian, Saudi and Norwegian officials echoed the sentiment that SWFs had been, throughout their history, "responsible long-term investors" (GU25).

Having outlined the signals of controversy, I turn now to data that contextualises and explains it.

4.2.2. Explaining the Controversy: Potentially destabilising markets, judging SWFs' investment intent, signalling resolution

The disquiet in sovereign funds' rise to prominence took place against three overlapping dynamics: the funds *potentially destabilising markets*, the *judging of SWFs' investment intent*, and finally, the *signalling of resolution*, or possible compromise. The first shows which investment behaviours drew attention to the funds; the second embodies the tone and intent of the scrutiny; and the third illustrates what brought closure to the debate. Analysing these processes together, we are led to a broader explanation for the controversy, which centres around the *judging of SWFs investment intent* – specifically their potentially political investment motives. Below, I contend that the debate on SWFs entailed an effort to define responsible market conduct for these new, untrained market entrants.

Potentially destabilising markets

SWFs' rapidly increasing investment drew much of the scrutiny. Specifically, the funds *diversified into equity and real estate markets*, away from bonds, ***taking "more aggressive" risks,*** as many commentators called it. This was a much more visible investment strategy than they had pursued previously and, as statements from the US Treasury (TT15) and IMF (2007) noted, it raised concerns about SWFs' potential to destabilise markets.

Figure 4-6. The category *Expanding investment strategy*: properties and (dimensions)

Diversifying investments
(bonds, equities, real estate)
(higher risk appetite)
Increasing investment flows into West
(rapid acceleration)
Size of SWF sector
(number of players)
(funds under management)
Potentially destabilising markets
(sudden portfolio movements)
(correlation with commodity prices)
(passive/active fund management)
SWFs lacking transparency
(management systems)
(risk management)

It is difficult to identify the specific parameters of SWFs' expansion because the funds are in many cases untransparent. According to a report by International Financial Services London (IFSL 2008), a thinktank, SWFs "are usually not constrained to certain asset classes or currency exposures as some institutional investment managers such as pension funds may be" (p. 6). Moreover, much of the diversification occurred through private investment managers, including hedge funds and private equity houses. Norway's $300 billion Government Pension Fund is known to have increased their equity exposure from 40% to 60% of their overall portfolio in 2007 (FT107), although nothing suggests that these proportions would be representative of other SWFs. Nevertheless, a persistent shift away from bonds would have the effect of raising borrowing costs for the US and European governments in particular (see DT18), which is likely to have figured in their political reaction. The most visible investments **fuelling SWFs' rise to prominence were** direct equity purchases. In 2007-08, virtually all of their largest equity deals were for stakes in Western financial institutions (see table below).

In addition to diversification and SWFs' burgeoning size, already noted, SWFs' expansion was also part of a broader trend of *rapidly increasing investment flows* from developing economies into advanced ones. According to Dealogic, the value of deals that companies from developing countries made in advanced economies rose from $14 billion in 2003 to $128 billion in the first three quarters of 2007 (WSJ 25). That value was roughly the same as the amount of capital going in the other direction, $130 billion (ibid). This represented the *shift in economic power* away from the West, as some called it, and helps to explain alarm in Western capitals.

Largest SWF acquisitions, 2007-08 (IFSL 2008: 2)

Target	Target country	Value ($bn)
Citigroup	US	12.5
UBS	Switzerland	11.5
Citigroup	US	7.5
Merrill Lynch	US	6.6
Merrill Lynch	US	5.6
Morgan Stanley	US	5.0
Laureate Education	US	3.7
OMX stock exchange	Sweden	3.6
Barclays	UK	3.0
Budapest Airport	Hungary	2.6
London Stock Exchange	UK	1.6
Related Cos	US	1.4
Carlyle Group	US	1.4
Och-Ziff Cap Mgmt Group	US	1.3
Alliance Medical	UK	1.2

Together, diversification into riskier assets and rising investment values could contribute to *destabilising financial markets*. Large funds might make large adjustments to their holdings (*value*), trading large amounts of similar securities (*range*), in a short time-frame (*speed*), thus destabilising liquidity for those asset classes (IMF 2007).[13] In addition, as the IMF noted (ibid), extraordinary portfolio adjustments might be highly correlated with commodity prices. If sovereign funds' revenues from commodities exports were to fall sharply, then they might be compelled to exit riskier equity markets, driving down values there. (Energy and minerals companies would be doubly hurt by falling prices and falling equity values.) Finally, even in the absence of extraordinary transactions or commodity price shocks, the extent to which sovereign fund managers might begin trading actively, rather than passively, could be a source of concern, according to UK Chancellor Alastair Darling (TT14).[14] In fact, the movement into equity had not yet led to more active management by SWFs themselves. Most SWFs remained long-term passive investors, and handed their riskier capital to private managers like hedge funds. SWFs' stated objectives included "risk diversification, avoiding domestic equity and commodity exposure, long-term returns and investments into strategic sectors" (FT161, IFSL 2008). They therefore intended to address two of the destabilisation concerns implicitly, just not the extraordinary portfolio adjustments issue.

Invariably, media reports associated the potential for market destabilisation to a *lack of transparency* about sovereign funds' corporate governance systems, as I discussed earlier. In particular, the metrics and processes for risk management, and the professional backgrounds of key individuals, were unknown. As a result, the market risks associated with SWFs rise to prominence became central to the controversy.

If these processes reflected the SWF behaviours that drew scrutiny, the tone and intent of that scrutiny centred on SWFs' underlying investment intent.

Judging SWFs' investment intent

The rapid ascent of any new kind of financial actor on the international stage would generate extensive coverage, but sovereign funds' state ownership fuelled the controversy. The similarly quick rise of (opaque) private equity funds (WSJ35) two years earlier was controversial, but far less so. The main expressed concern about SWFs was that <u>their investments would have political, rather than commercial, objectives</u>. This concern was raised universally, by every influential report cited in the press (including Morgan Stanley's, the IMF's, and McKinsey's), as well as by the official US, EC, German and Australian policy documents. "After all," summarised a *Guardian* editorial, "commercial

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[13] Note similar dimensions to this kind of transaction – value, range, and speed – and those cited in Citigroup's MTS trade. They are metrics for an '*extraordinary transaction*'.

[14] Active trading seeks to outperform the markets, whereas passive trading seeks to emulate market performance.

implications are unlikely to be paramount for totalitarian regimes" (GU17). However, I would argue that the deeper underlying concern about SWFs, if we assume some rationality on the part of the actors involved, was less about SWFs having political objectives than it was about using political influence to further commercial objectives. I will develop this argument as a premise to my broader contention that the controversy was about establishing good market conduct for SWFs.

It has always remained unclear what it would mean, in practice, to invest for political objectives. No SWF investment was ever cited as suspicious or suggestive of non-commercial intent. As a *Financial Times* editorial put it, "The main flaw in the argument [that SWFs might invest for political reasons] is the absence of any proof to back it up" (FT138). A *Wall Street Journal* report added, "That leaves even the most articulate sceptics confined to hypotheticals" (WSJ30). The sceptics advanced few hypotheticals, according to my data. A helpful 'straw man' was presented by non-sceptic John Kay, in an FT column:

> "The City of London appears at the mercy of sovereign wealth. Its electricity is supplied by a company controlled by the government of that ancient enemy, France. Perhaps, as one of those interminable discussions among the ministers of Europe reaches deadlock, President Nicolas Sarkozy could order the lights to flicker. That would remind everyone that the source of power is in Paris.
>
> But the scenario is absurd. The switches are in London, and it is their location, not that of the share certificates, that matters. France does derive some minor influence but this is the result of French physical supplies through the cross-Channel interconnector, not French ownership of British electricity companies: trade not investment. Similarly President Vladimir Putin's influence on European energy comes from Gazprom's control of assets inside Russia, not its ownership of those outside Russia" (FT149).

Kay's analysis is valuable because it highlights the distinction between SWFs, which make portfolio investments, and state-owned industrials, which are involved operationally. This is important because industrial investors can exert concrete operational pressure more readily. For example, as both an investor and a counterparty to British energy company, Russia's Gazprom would be able to manoeuvre politically much more quickly by altering contracts and supplies, than a purely portfolio investor (Gomes and Balin 2007). This distinction is of course porous in both directions, but helps bind SWFs more closely to financial markets, and might help explain why ultimately the resolution of the controversy rested on voluntary codes-of-conduct for portfolio investors. US Senator Charles Schumer also made this distinction in justifying his acceptance of Abu Dhabi's investment in Citigroup, after having resisted Dubai's stake in P&O ports (see WSJ26).

Other hypothetical scenarios for political investment, advanced by Peer Steinbruck, the German finance minister, were:

- "if a sovereign wealth fund out of a non-democratic society took over a big media company in Germany in order to try and influence public opinion;
- "if one tried to systematically siphon off technological know-how;
- "Or took possession of highly sensitive networks and critical infrastructure" (FT126, italics added).

Larry Summers, the former US Treasury Secretary, highlighted others:

- "a fund took a large stake in a western airline and then insisted that airline begin direct flights to its capital city, even if it were not profitable" (GU25)
- "a SWF makes an investment in a major bank of another nation [and the investment] goes bad. 'Is there anybody in the world that can assert that, with billions of dollars on the line, their head of state and foreign minister are not going to get involved in the negotiations?'", he asked (WSJ30).

As one tries to make sense of these concerns, in order to get to the root of what was expected of the funds, we can see four dimensions of *investing politically*, based on the range and intensity of concerns reported throughout the data (not only in the hypotheticals above), and assuming some rationality on the part of those that expressed them:

- Investing on commercial grounds; that is, to maximise investment returns
- Investing on political grounds; that is, to maximise political returns
- Investing occasionally on commercial grounds and occasionally on political grounds
- Investing on commercial grounds, using political tactics (politics as process, not as objective)

The fourth dimension, using political tactics, is the one that best fits the data. Consider the alternatives. It is safe to say that some SWFs invest purely on commercial grounds; such as Norway, Ireland, and Singapore's Temasek, often cited as a 'best-practice' example (see FT155, FT109). Indeed, what drove SWFs to prominence in the first place was diversification in pursuit of higher investment returns, so it is also arguable that virtually all SWFs have invested on commercial grounds until now, and thus the second dimension – purely political investments – may be dismissed by assumption. Regarding investing occasionally on purely political grounds, inference is

Figure 4-7. The category *Judging investment intent*: properties and (dimensions)

SWFs investing on political grounds
(purely commercial motives; purely political motives; sometimes political motives; commercial motives with political influence)
SWFs lacking transparency
(investment strategy)
(management controls)
(risk management)
Threatening efficiency
(degree of state-ownership; state-effectiveness as a shareholder)

difficult. There are no precedents, and in fact the data points in a different direction. Two of the most worrisome SWFs for Western policymakers were Russian and Chinese funds,[15] but these funds were precisely the ones under highest scrutiny domestically to meet economic objectives. For example, one of the high profile SWF purchases was the China Investment Corporation's stake in private equity fund Blackstone, which subsequently lost 33% of its value. The CIC endured "especially sharp" criticism from its government because of the loss (WSJ26) and subsequently lowered its risk exposure and profile (WSJ26). Similarly, in 2008 Russia's National Wealth Fund was "operating like a central bank rather than a strategic investor. The wealth is being held in liquid assets such as government bonds because the managers suspect that Moscow might recall the funds at any time" (DT50). Therefore in both cases, while the funds were clearly accountable to governments, their investment stance was far from geostrategic.

The fourth dimension of investment intent – investing on commercial grounds whilst using political tactics – is more fitting to the controversy. This possibility would explain residual concern about the Chinese and Russian profiles just cited, but also match other explicitly expressed concerns, such as Larry Summers' bank scenario, above, and the following point by US Senator Evan Bayh regarding Saudi Arabia's stake in Citigroup: "Does he [Prince Alwaleed bin Talal] have a controlling interest in the company? Most people would ordinarily say at 4%, no. But it's hard to say he didn't exert some significant influence" over the ouster of the bank's chief executive (WSJ26). The point Bayh makes here is that Saudi Arabia had lost confidence in Chuck Prince's ability to lead Citigroup and had political tools at its disposal, which private shareholders might not have had. One tool was providing the acquired banks access to the SWF's home market. For example, Morgan Stanley saw CIC as "a strong ally to help its own expansion plans in China" (DT29). An SWF government could exert pressure on the bank by closing off that access to that market through economic policy – thus making political tactics a credible threat.

Investing on political grounds, versus using politics to further commercial objectives, is an important distinction because the latter is not new. Government delegations from every country use state visits to help secure contracts for their domestic business groups. Indeed, favours also flow the other way, with companies offering preferential contracts to foreign governments aligned with their own.

[15] These two countries were consistently cited as primary concerns. E.g. "What worries Berlin, Paris, and Brussels are mega-funds under the control of Russia and China" (DT23).

The problem with SWFs was less about political objectives, and more whether governments could be legitimate, or effective, shareholders.[16]

This re-interpretation of the concern about SWFs resonates with how frequently the resistance to SWFs was based on resistance to so-called "cross-border nationalisations" (e.g. GU31). The concern here is that SWF posed a threat to their acquired companies' operating efficiency, rather than their geopolitical positioning. Recall Larry Summers's aviation scenario, where an SWF with a controlling stake influences a company to open an unprofitable route. "For decades, Mr. Summers and like-minded US officials have travelled the world preaching the virtues of privatisation," wrote a *Wall Street Journal* reporter, "So it's jarring for them to see businesses suddenly selling sizable stakes in themselves to government-controlled funds" (WSJ30). Many economists welcomed SWF liquidity but maintained reservations about their impact on efficiency.[17] The progress that had been made to develop liberalised and efficient markets could be overturned by the market-entry of state-owned investors.

On this basis, I would argue that the central concern about SWFs may be summarised as: owners of SWFs 1) using political influence to further their commercial objectives and 2) doing so at the expense of corporate and economic efficiency. This is the most faithful rendering of *judging SWFs' investment intent*, in my view. Significantly, this also made the problem reconcilable, because it meant that the solution lay partly in corporate governance. Therefore this is also a possible explanation as to why the chosen resolution was to adopt codes-of-conduct rather than outright prohibitions on SWF investment in strategic industries. More evidence for this argument appeared with the *signalling of a resolution*, to which I now turn.

Signalling resolution: courting SWF investment

No sooner had the controversy erupted than contours of compromise emerged. Whilst calling for more transparency on the part of SWFs, Western politicians sought assurances of *reciprocity in investment policies*; that is, assurances that SWFs' home governments would also allow Western companies into their markets. This was particularly the British position: "free trade is just that", wrote the Chancellor (FT110). Western governments also *requested a code-of-conduct* for the funds. This signalled that a compromise was possible. It is notable, however, that no visible efforts were made to agree new, reciprocal investment policy regimes at intergovernmental level – such as

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[16] See Catá Backer (2008) on political views of the legitimacy of SWFs as shareholders.

[17] According to the *WSJ*, "Economists say this cross-pollination is healthy, because it injects new capital into often-mature industries and helps to knit the global economy closer together" (WSJ25).

quotas on the amount, industry or influence that foreign investors could have in their target companies. Instead, political efforts focused on creating codes-of-conduct for SWFs. This suggests that it was more important (perhaps cheaper or more effective) to ensure that sovereign funds learned good market conduct, than it was to achieve a binding governmental policy agreement.

In no uncertain terms, Western economies, struggling through a liquidity crunch, *needed sovereign wealth*. And insofar as necessity begets compromise (beggars can't be choosers, as the saying goes), this also signalled that a resolution or compromise would emerge. "The influx of capital to bolster balance sheets has been welcomed by regulators and governments, which have seen the SWFs as white knights," said an *FT* columnist, "But if future growth accelerates ... the controversy may well return" (FT161). In the US, Senator Schumer, who had associated Dubai with terrorism in the context of the 2006 ports deal (FT169), welcomed Abu Dhabi's 4.9% stake in Citigroup, stating, "My general inclination is that foreign investment here [in banking] is good. We need to be careful when national security is at stake as in a ports deal" (WSJ26). At face value, Schumer's distinction is questionable. Terrorist financing had been a motive for the US government's insistence on international financial reforms as part of the War on Terror. Terrorism was not anathema to finance. Moreover, if Dubai had a "nexus with terrorism", as Schumer had alleged, then its parent emirate, Abu Dhabi, might at least be suspect. Yet, the Abu Dhabi investment in Citigroup was welcomed: necessity bred compromise.

Figure 4-8. The category *Signalling resolution*: properties and (dimensions)

Western governments proposing resolution
(requesting reciprocal investment policies)
(requesting code-of-conduct)

West needing SWF funds
(liquidity crunch, low market confidence)
(widening global imbalances)

SWFs managing political risk
(making small investments)
(lobbying, PR)
(engaging with code-of-conduct)

Absence of SWF misconduct

The second dimension of the West's need for capital was macroeconomic, not specific to the banking sector. SWF investment in Western economies would help to contain *widening global imbalances*. Major Western countries have growing trade (current account) deficits with Asian economies particularly, many of which in turn have surpluses. In addition, high savings rates and growing currency reserves at consumer and country levels contributed to the imbalances. If countries like China were to reinvest their export earnings (particularly in non-financial industries like manufacturing) in the West, this could support economic growth and sustainability in Western countries.

For their part, the funds' *political risk management* (e.g. *taking small, non-strategic stakes*), noted above, also suggested that they did not intend to ride roughshod over political sensibilities. Some state-owned companies became more overtly commercial. Dubai Ports World, for example, offered 23% of its shares to private investors on the Nasdaq Dubai stock exchange in November 2007.

So long as *evidence of SWF misconduct* remained notable for its absence, the factors above seemed to imply that a resolution to the controversy was imminent. Sovereign funds had been driven to prominence in search of higher investment returns (perhaps with latent political force), and Western economies needed their capital, so the sole remaining challenge was to ensure that SWF conduct did not undermine financial markets. It was this challenge that the codes-of-conduct were designed to overcome.

4.2.3. Unifying theme: Defining responsible market conduct for orderly financial markets

Is there a single core category, a unifying theme, for the processes in the controversy? How do we reconcile sceptical *politicians reviewing investment policies* with their *courting of SWF investment*? The negative ***judging of SWFs' investment intent*** with the evidence that SWFs were *having a positive impact on the global economy*? The *signalling of controversy* with the *signalling of resolution*? As the perennial grounded theory question puts it: what is going on here?

Let us return to the three express concerns about SWFs, found in *signalling controversy* and *judging SWFs' investment intent* – that SWFs might:

- Destabilise financial markets
- Use political influence in the market
- Hoard reserves (EC3: 5) and not provide liquidity to redress imbalances.

If we were to frame these concerns in the lexicon of the Citigroup chapter, we would say that they relate to the <u>efficient and orderly functioning of financial markets</u>. First, the "destabilisation" concern clearly relates to "orderliness". Second, the use of political influence reduces allocative efficiency if, for example, an acquired airline were forced to establish an unprofitable route to its owner-SWFs' country, as hypothesised by Larry Summers. SWFs would also threaten market efficiency if they signalled a new wave of "cross-border nationalisations" (GU31). Finally, "accumulating reserves for its own sake" (EC3: 5) could threaten both efficiency and orderliness. It could threaten efficiency because global liquidity would continue to tighten, increasing the risk that markets would fragment into varying levels of liquidity and prices. This would also threaten orderliness because tightening liquidity was increasing the risk of widespread financial sector insolvencies, particularly in the West.

Accepting that the concerns about SWFs were concerns about their impact on financial market efficiency and orderliness, then <u>the controversy may be understood as an effort by governments and other actors to define SWFs' responsibilities to help maintain efficient and orderly markets</u>. Controversies entail debates, by definition. The debate in this case was whether SWFs could be relied on to act responsibly – with commercial objectivity, transparency, market discipline – or whether they would require new laws and regulations. This controversy reached closure when a consensus emerged, both from governments and SWFs, in support of voluntary codes-of-conduct that would define the requisite SWF responsibilities to markets. The central category, or unifying theme, for this episode is therefore *defining responsible market conduct for orderly financial markets*.

Before elaborating, I consider an alternative interpretation that also emerged from the data.

'Investing politically' as a red herring: the protectionism argument

Much of the data situated the SWF controversy within a broader trend of classical protectionism (a good example is DT21). Instead of saying that Western governments were concerned about SWFs' political manoeuvring, one could say that they simply wanted to restrict foreign investment – the age-old, yet unfashionable practice of protecting domestic industries from competition. In this view, Western governments used SWFs' government-ownership as a pretext for their protectionist tendencies. Interviewed on the US government reaction to SWFs, an American lawyer expressed this succinctly: "It's just political – similar to the outcry against Japan back in the late 80s. Obviously security concerns make for some differences now, but there are regulations in place in the US to deal with that" (WSJ27). Thus, this argument would hold, the SWF controversy was not about disciplining SWFs' market conduct and political instincts; it was about keeping them out of financial markets where they could compete with Western financial institutions. While this resonates with much of the data, it is an inadequate explanation for the controversy. Indeed, one could argue that the controversy turned the classic notion of 'protectionism' on its head, because 'protecting' banks like Citigroup meant welcoming, not restricting, SWFs.

Among the signals of controversy that support the protectionism argument is the fact that the biggest reservations regarding SWFs came from the US and France, often highly protectionist countries, plus Germany. By contrast the biggest welcome came from the UK, a financial liberal (see especially DT33). In addition, some anti-SWF initiatives arose due to trade union initiatives (GU10, DT46), suggesting that governments' resistance to SWFs were driven by traditionally protectionist domestic political actors. On this basis, one could argue that resistance to SWFs was similar to resistance to other powerful foreign investors – fuelled by *raison d'etat* or domestic interests.

However, this explanation would not account for the European Commission's reaction to SWFs, which was, perhaps surprisingly, not protectionist. The EC is reputed for its protectionist and interventionist instincts; low-income countries often point to its Common Agricultural Policy as an obstacle to trade liberalisation, and the UK government is perennially fearful that new EC financial regulation might affect the City of London. One could reasonably have expected the EC to adopt a protectionist stance against large foreign financial investors like SWFs. Yet three key Commissioners welcomed sovereign wealth funds in emphatic terms. "Let's be brutally frank about this, sovereign wealth funds have been positive and long-term investors," said Internal Market Commissioner Charley McCreevy, "There is no, as far as I am aware, no instance of sovereign wealth funds acting in any manner other than responsibly up until now" (BBC 2008). He added that the EU would not restrict any SWFs investments, but would propose "some common principles on transparency and governance" (ibid). EU Trade Commissioner Peter Mandelson said, "We don't need new laws. What we need is reassurance that the benign conduct of funds in the past will remain a useful and consistent guide to the future" (FT155). This is very different language to that employed by German politicians to describe SWFs ("giant locusts", DT50), or by US Senator Schumer in relation to Dubai ("nexus with terrorism", FT169). At European level, SWFs were seen neither as predatory investors nor as national security threats, oft-used justifications for protectionism. EU Monetary Affairs Commissioner Joaquin Almunia described SWFs as offering "useful investment", adding that they "<u>must acknowledge that their growing weight in global financial markets brings responsibilities</u>" (BBC 2008, underlining added). It was on this express basis that the EC supported the creation of a global code-of-conduct at the IMF.

A protectionism-based account for the controversy would also not fit with CFIUS's (Committee on Foreign Investment in the United States) continued sanctioning of foreign investment into the US; before, during, and after SWFs' rise to prominence. If protectionism accounted for most concerns about SWFs, and given that CFIUS came under Congressional pressure to scrutinise more foreign investments from early 2007, after the Dubai ports deal, one could have expected a more protectionist CFIUS. Yet, in 2006, 2007, and 2008, CFIUS served notices to review or investigate 404 proposed investments, and only two of those investments were referred to a presidential decision, both in 2006; all others were permitted (CFIUS 2009).

Proponents of the protectionism explanation could also invoke counterfactual hypotheses. For example, Western governments may be waiting until liquidity and growth improve, and resuscitate protectionist policies when SWF liquidity is no longer required. Or, perhaps governments' motives were originally protectionist but they had to succumb to SWFs' higher economic advantage; that is, politicians supported the codes-of-conduct in order to save face. Both of these possibilities are moot. We know that the codes-of-conduct now feature in the political economy, and they have been established as the key criteria for allowing SWFs to operate. They mitigate the threat of protectionism because they give SWF owners a pretext to retaliate.

Ultimately, the protectionist argument is most unfitting because the present episode turned protectionism on its head. The *shift in economic power*, severe *structural imbalances,* and *liquidity crunch* that contextualised this controversy created a new protectionist mandate. 'Protection' for domestic industries could no longer accrue from avoiding foreign investment, as it does in the classical sense. Protection would accrue instead from *welcoming sovereign wealth funds.* "What would the average American say if Citigroup is faced with the choice of 10,000 layoffs or more foreign investments?" asked Senator Schumer, rhetorically (WSJ34). The move to a code-of-conduct might therefore be seen as a response to the inadequacy of classical protectionism to protect domestic industry under new structural and historical conditions.

Defining responsible market conduct

The controversy reported in the media foreshadowed what might be in these codes. The main processes – *signalling controversy, SWFs potentially destabilising markets, judging SWFs investment intent,* and *signalling resolution* – all shared a common property: SWFs lacking transparency. In addition to corporate governance standards, many of the recommendations advanced in reports (both by quoted officials and columnists) centred on sovereign funds *taking minority stakes* in companies and, in any case, *not seeking operational control* of their investment targets. Carrying out *long-term investments, being predictable* and *accountable*, also featured. *Competing fairly* with the private sector was raised by Peter Mandelson (FT155) and then reiterated in the US Treasury's code-of-conduct (UST1). Neither expanded on what this means, but a credible inference is that SWFs should not use political influence to attain better investment conditions than their private counterparts. Finally, a few context-specific suggestions emerged. Gerard Lyons, lead author of Standard Chartered's influential report on SWFs, said that the funds might help to promote democracy locally: "what one can say is that good economics is normally good politics, and if SWFs can be used, for instance, to invest in economies in the Middle East, say, then this will help them to diversify and generate jobs" (FT122). In Russia in February 2008, Herman Gref, a former finance minister who heads Sberbank, the country's largest, called for the government to use sovereign wealth to bail out domestic midsized banks that were experiencing liquidity difficulties (DT38).

4.3. "Users' Manuals" for Capitalism: The codes-of-conduct

"Producing a voluntary code of conduct should simply be a question of formalising existing investment practice."

Peter Mandelson, then EU Trade Commissioner[18]

In spring 2008, one year after the sovereign wealth funds controversy emerged, Western governments and SWFs began developing a global code-of-conduct, which would be confirmed by October. The majority of Western governments provided input to those codes, including those that were reviewing their domestic investment laws (of which Australia and Germany implemented reforms). Between March and April 2008, the US, EU and IMF acted more-or-less in concert. The US Treasury agreed the first, trilateral code-of-conduct for SWFs with the governments of Singapore and Abu Dhabi. This would be an input to the multilateral initiatives underway at the IMF (UST1). The EU Council of Ministers, which represents national governments at EU level, agreed to take a Europe-wide stance toward sovereign wealth funds and channel their input to the IMF (EC3, EC4). The IMF hosted representatives from sovereign wealth funds and national governments for a meeting where "Participants agreed that SWFs invest on the basis of economic and financial risk and return related considerations" (IMF1, underlining added). The meeting established the International Working Group of Sovereign Wealth Funds (IWG-SWF), comprising representatives from 25 SWF countries, which would proceed "to agree on a common set of voluntary principles for SWFs, drawing on the existing body of principles and practices, to help maintain the free flow of cross-border investment and open and stable financial systems" (ibid, underlining added).

The issue of investing on political grounds, which had dominated much of the political controversy over the preceding 12 months, had by this time become a subtler question of operational nuance. Most official policy papers emphasised that legal safeguards already existed to protect strategically important industries in case a proposed SWF investment were perceived to have political motives (e.g. EC4). In addition, governments jointly declared that SWFs were primarily commercial vehicles (IMF op cit; UST1). The priority was instead to ensure that SWFs had operational policies and processes which would mitigate the risks that they would (1) destabilise financial markets, (2) use political influence to advance their investments, or (3) not recycle their currency reserves into the global financial system to help redress macroeconomic imbalances.

[18] Cited in FT155, referring to a code of conduct for SWFs.

To this end, the IMF's Santiago Principles established global guidelines for SWFs' establishment as coherent institutions. A *Guardian* editorial referred to the imminent US and IMF codes as "users' manuals" (GU17) to help sovereign funds' integration into the political economy. Sceptics like the Kuwait Investment Authority (initially) and US Senator Evan Bayh referred to them derisively as "best practice" (GU30, WSJ39).

As data, the codes and inputs illustrate the high-level principles – theoretical principles – that would underpin responsible conduct by SWFs. Each of the IMF's Santiago Principles is supplemented with an explanation and commentary on why it is important. The principles supplement national legislation, and provide a basis for establishing new laws. (That is, while representing good conduct for SWFs, they would also guide national jurisdictions in determining their individual responses to the funds.) For example, the European Commission (EC3) stated that its "Member States have national instruments which could be used to control and condition SWF investments or any other investors and they can also develop new measures suitable to tackle specific needs if these arise, as long as those measures are compatible with the Treaty [on European Union], are proportionate and non-discriminatory, and do not contradict international obligations" (p. 7). Against this background, the codes merit analysis not only because they resolved the controversy but also because their nature as consensual voluntary guidelines gives them greater theoretical resonance than the alternatives, such as context-specific national-level legislation.

Accordingly, the analysis in this section begins by outlining the key features of the US, EU, and IMF principles for SWFs, and then identifies the commonalities between then. From this analysis, stem four overriding principles for good market conduct by SWFs.

The next section then compares the principles for SWFs with those identified for Citigroup, discussed in the previous chapter. That comparison, and integration, helps us to crystalise the notion of a 'corporate market responsibility' across these two substantive contexts, as we continue to explore the central research question, 'how are firms responsible for ensuring orderly financial markets'.

4.3.1. The US-Singapore-Abu Dhabi Agreement

The US Treasury was the first institution to publish a sovereign fund code-of-conduct, through a short press release on 21 March 2008. The express intent of the agreement was to provide a set of "basic principles" to feed into the upcoming multilateral initiatives. The principles governing sovereign wealth funds were as follows:

1. "SWF investment decisions should be based solely on commercial grounds, rather than to advance, directly or indirectly, the geopolitical goals of the controlling government. SWFs should make this statement formally as part of their basic investment management policies.

2. "Greater information disclosure by SWFs, in areas such as purpose, investment objectives, institutional arrangements, and financial information – particularly asset allocation, benchmarks, and rates of return over appropriate historical periods – can help reduce uncertainty in financial markets and build trust in recipient countries.

3. "SWFs should have in place strong governance structures, internal controls, and operational and risk management systems.

4. "SWFs and the private sector should compete fairly.

5. "SWFs should respect host-country rules by complying with all applicable regulatory and disclosure requirements of the countries in which they invest" (UST1, underlining added).

This code-of-conduct attends to the criticisms of SWFs cited earlier, either explicitly, such as their lack of transparency, or implicitly – better governance structures should mitigate the negative risks associated with SWFs' growing size, such as sudden portfolio movements.

The code is not without implications outside of SWFs; it has broader relevance for other investors. Consider an assessment of Citigroup's Eurobond trade against these five criteria (table below), on the premise that this code, like the international one, sought to "formalise existing investment practice", as EU Commissioner Peter Mandelson put it (FT155).

Figure 4-9. Testing Citigroup on criteria for SWFs

Test	Result	Observation
Basing investment decisions solely on commercial grounds	Fail	While financial returns were central to Citigroup, German investigators concluded on the basis of a Citigroup memo some aspects of the trade were "not investment driven" (WSJ18).
Full information disclosure, esp. purpose and investment objectives, to build trust	Fail	Non-disclosure of purpose and objectives was essential to Citigroup's prepositioning in the futures market; trust was diminished.
Strong governance structures and internal controls	Fail	Poor controls were the main shortcoming cited by the FSA in its punishment of Citigroup.
Fair competition between public and private sectors	Inconclusive	No public sector competitors were trading on the MTS, but government stakes in MTS were criticised.
Comply with applicable regulation of the countries in which they invest	Inconclusive	Technically Citigroup broke no market abuse laws, but failed to comply with FSA regulatory principles.

The analysis in Figure 4-9 shows where the conduct requested for SWFs was similar to the issues raised by Citigroup. It reveals that what lay behind much of the Citigroup controversy was that it did not meet the basic tenets of this code-of-conduct. Although clearly motivated by financial returns, the Citigroup trader who initially proposed the strategy noted additional 'benefits' in his memo, including: decreasing the attractiveness of the German bund market, and "turning the European government bond market into one that more closely resembles the US government bond market" (FT53). The German regulator "criticised the strategy outlined in [the memo] as '<u>not investment driven</u>' but instead aimed at harming Eurex's reputation", according to a *Wall Street Journal* report (WSJ18, underlining added). The *Financial Times* criticised the bank in an editorial titled "Citi takes on Europe", where they claimed that "When US banks venture overseas, they often do so under the banner of spreading American capitalism", which in that case meant transforming the European market from a quote-driven system to a (less transparent) order-driven system. The second criterion, transparency, was not met insofar as the purpose of ancillary trades (pre-positioning in the futures markets) was obscured in order to extract maximum effect from the main trade.

Third, strong governance and risk management controls were inadequate – even at the world's leading private bank – the main irregularity cited by the FSA. The criterion on fair competition between private and public sectors does not apply neatly because Citigroup faced no government competition. However, it is notable that those who absolved Citigroup made their arguments on the grounds that the MTS's rules gave European governments (which have stakes in the MTS) an unfair advantage because a minimum liquidity for their debt was guaranteed (e.g. FT7). Finally, Citigroup complied with the letter of the law, and was not charged with criminal misconduct, but did violate good business principles, according to the FSA.

What this tells us is that the US position on sovereign wealth funds is interesting beyond its idiosyncratic context. Citigroup would arguably not have carried out the Dr Evil trade if it had abided by those guidelines. It would have judged the operation purely on its investment merits, which were modest in absolute terms (i.e. independent of the short time-frame); abstained from sending un-transparent signals in its ancillary trades; operated better governance and risk management systems; and observed "all applicable regulatory requirements". This strengthens the argument, already advanced, that the SWF codes-of-conduct may represent a guide to responsible market conduct, on a broader ideational plane. It is important, however, to look at the international code, which is both more detailed and intentionally global. Beforehand, I review the EU's input, which was published the same week at the Treasury code.

4.3.2. The European Recommendations

European Union countries converged on a common approach to sovereign funds in March 2008, reconciling Germany and France's scepticism with the UK and Italy's cautious acceptance. Initially the Commission (EC), a supranational body, recommended that all Member States agree a common approach, and published "contributions" to a global code of conduct (EC3, EC4). The European Council, which represents national governments, approved those recommendations shortly after (European Council 2008).

In a review of its concerns, the EC noted, first, that "The accumulation of reserves for investment by SWFs should not become an end in itself. SWF owners need to show that they are not holding back appreciation in their currencies to accumulate more foreign assets for their SWFs" (EC3: 5). This was important due to growing macroeconomic imbalances. Second, "there is unease that – whatever the motivation – SWF investment in certain sectors could be used for ends other than for maximising returns" (ibid). Finally, sovereign funds, due to their size and the nature of some investments, would need to adopt systems to help maintain stable financial markets.

Like in the US, Europe's recommendations were concise, based on two overriding principles: governance and transparency. Governance aimed for "clarity about the degree of possible political interference in the operation of a SWF ..." (EC3: 9). Transparency, in turn, "promotes accountability. In the case of SWFs, transparency not only serves to foster market discipline, but also reduces the incentives for any government intervention" (ibid). The input was as follows:

> "Principles of <u>good governance</u> include:
>
> - "The clear allocation and separation of responsibilities in the internal governance structures of a SWF;
> - "The development and issuance of an investment policy that defines the overall objectives of SWF investment;
> - "The existence of operational autonomy for the entity to achieve its defined objectives;
> - "Public disclosure of the general principles governing a SWF's relationship with governmental authority;
> - "The disclosure of the general principles of internal governance that provide assurances of integrity;
> - "The development and issuance of risk-management policies.
>
> "[...] <u>Transparency practices that could be considered</u> would include:
>
> - "Annual disclosure of investment positions and asset allocation, in particular for investments for which there is majority ownership;
> - "Exercise of ownership rights;
> - "Disclosure of the use of leverage and of the currency composition;
> - "Size and source of an entity's resources;
> - "Disclosure of the home country regulation and oversight governing the SWF" (op cit: 9-10).

This input centres on the same issues as the US Treasury code, offering more specific, if tentative, criteria for transparency. (Notably, the sub-criteria related to disclosure of asset allocation and size and source of resources were the ones that the private equity industry resisted in their own code-of-conduct; FT124.) In a more qualified presentation of EU principles, Commissioner for Monetary Affairs Joaquin Almunia (EC4) said:

> "So, what is the substance of the EU's position? In essence, the EU is calling on sovereign wealth funds to commit to good governance practices, adequate accountability and a sufficient level of transparency. In particular, we ask for a clear division of rights and responsibilities between managers and their sponsor governments and an effective system of checks and balances in respect of investment decisions. <u>It should be clear that funds are aware of their weight and of their ability to impact on markets with large shifts in their positions</u>" (p. 4).

The treble objective of the EU initiative was to therefore to discipline SWFs' governance, ensuring that they are (1) aware of their potentially destabilising impact on markets, (2) independent of political influence, and (3) not accumulating reserves for their own sake, but recycling them in the global economy. Thus *stabilising liquidity* – that is, providing it to correct global imbalances, but not so sharply that it distorts markets – was a noted responsibility to ensure orderly markets as it had been with Citigroup.

This treble objective of the EU mirrors precisely the three concerns expressed in the broader controversy as reported in the media (see section 2.3). It tells us that the EU policy discussion on SWFs closely reflected the broader debate involving market actors, public intellectuals, etc.

4.3.3. The IMF's Santiago Principles (GAPP)

As the US and EC published their codes, the Fund established a Working Group with representatives from 25 SWFs and SWF governments to elaborate what became known, in October 2008, as the Generally Accepted Principles and Practices (GAPP), or Santiago Principles (finalised at a meeting in Chile). The IMF's discussions on SWFs had begun a few months earlier, in November 2007, where a Roundtable of Sovereign Asset and Reserve Managers focused on the issue of transparency as an emerging concern. The Fund then began a survey of existing practices in SWFs, in preparation for developing a set of best practice guidelines (EC3: 6).

The Santiago Principles were, in the IMF's words, "underpinned by the following objectives for SWFs:

1. "To help maintain a stable global financial system and free flow of capital and investment;
2. "To comply with all applicable regulatory and disclosure requirements in the countries in which they invest;

3. "To invest on the basis of economic and financial risk and return-related considerations; and

4. "To have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability" (IMF2: 4).

A reading of the principles gives a clear sense that they aimed to provide a blueprint for establishing and operating a sovereign wealth fund, as if these were brand new entrants into the economic sphere. The recommendations begin with extremely basic issues. For example, Principle 1 is that an SWF should have a clear legal status, regardless of its form. It may be a state-owned corporation governed by company law, or a special purpose vehicle subject to ad hoc regulation, or an asset pool with no independent legal identity at all. Principle 3 recommends simply that SWFs should coordinate their activities with the countries' central authorities, something that one might think was presupposed, given the concerns about political influence. Principle 22 outlines basic types of risk that SWFs should attend to, along the categories of financial, operational, regulatory, and reputational risks. Thus, the Santiago Principles effectively start from scratch.

My own focus in analysing this data is narrower and deeper. It is to understand how the principles attempted to redress the controversy: that is, SWFs' potential to destabilise markets, to wield political influence, and to hoard capital. Those principles would constitute how SWFs were expected to contribute to orderly and efficient markets. To arrive at that point, I took three steps. First, I coded the GAPP document (IMF2) and reconceptualised its recommendations as generic processes. This 'long-list' of SWF activities is presented Figure 4-10 on the next page. The table captures every principle (denoted by the numbers 1 to 24), occasionally in some detail, although some nuance is lost particularly in respect of their variants for different types of sovereign funds, like state-owned companies versus simple asset pools. The second step was to identify which principles aimed explicitly to assuage the aforementioned concerns about SWFs (rather than simply establish them as legal entities, for example). These are the processes that help to answer the question of how sovereign wealth funds were expected to help govern markets. The third step was to return to the GAPP document and re-code the properties and dimensions of each of the latter principles. This analytical sequence is represented in the following pages.

gure 4-10. The Santiago Principles codified as generic processes (author developing IMF 008b)

he column below lists the generic processes, or conceptual categories, that appear in the code-of-conduct. The ght-hand columns denote the structure of the document, its three Sections A, B, and C, and subsections. Each umber in the table is corresponds to a Principle. Its intersection indicates where a generic process appears in the ocument (IMF 2008b). For example, the generic process 'Giving managers an independent investment mandate' nd row below) can be found in Principle 1.1 (Section A), and in Principle 16 (Section B).

	A. Legal Framework, Objectives, and Coordination with Macroeconomic Policies				B. Institutional Framework and Governance Structure			C. Investment and Risk Mgmt Framework	
	Legal basis and form	Objectives and macroecon linkages	Funding and withdrawal rules	Statistics compilation and withdrawal rules	Governance framework	Accountability	Assurance of integrity of operations	Investment policy	Risk & performance management
TABLISHING GOVERNANCE STRUCTURE AND MANDATES									
fining the fund's owners and beneficiaries	1.1								
ving managers an independent investment mandate	1.1						16		
to act in the best interests of the SWF					9				
to make both financial and operational decisions					9				
clearly defined in charter					9				
viding owners/governing bodies from operational management					6		16		
fining a clear accountability framework for the owner, governing body, and management						10	16		
fining procedures for appointments to governing bodies and management					7, 8				
fining the SWF objective (e.g. saving v stabilisation v returns)		2							
to ensure professional management and commercial agenda		2							
to ensure consistency with an investment strategy		2						18	
TABLISHING TRANSPARENT OPERATIONAL POLICIES AND PROTOCOLS									
fining an investment policy/strategy consistent with Fund's objectives								18, 19	
to guide appropriate financial risk exposure and use of derivatives and leverage								18.1, 19	
to guide employment of external managers and consultants (esp. their purpose and skills)								18.2, 19.2	
ublicly disclosing non-financial investment objectives and decisions (e.g. social, environmental)								19.1	
ublicly disclosing source of funding			4.1						
promotes accountability			4.1						
ealing with third parties on an economic basis, using defined guidelines							14		
eing clear about linkages with related institutions	1.2								
to ensure professional management	1.2								
fining and disclosing a policy on funding and withdrawals			4						
helps clarify government fiscal and monetary position			4,4.1						
aving a framework to identify, assess and manage risks and a strong risk management culture									22
four major categories: financial, operational, regulatory, and reputational									22
tablishing clear reporting procedures that give owner a fair picture of performance and risk					7				23
efine and disclose policy for exercising ownership rights								21	
"SWFs' demonstrated ability to contribute to the stability of global financial markets results in part from their ility to invest on a long-term, patient basis" (p. 22)								21	
declaring approach to board representation ex ante								21	
declaring approach to voting rights ex ante								21	
protecting financial value of the securities (citi and bund market ?)								21	
OCESS AND EXECUTION									
ercise "care, skill and due diligence" in decisions, and accepted asset management practices								19.2	
in delegating authority								19.2	
assessing assets in respect of whole portfolio, not in isolation								19.2	
accruing reasonable fees and costs								19.2	
ublicly disclosing risks management terms in qualitative terms									22.2
"to help maintain a stable, transparent, and open investment environment" (p. 24)									22.2
ublicly disclosing investment policy, using qualitative terms (e.g. Active/passive, financial/strategic)								18.3	
to give an indication of risk appetite and exposure								18.3	
isclosing financial information, typically asset allocation, benchmarks, rates of return							17		
to give guidance on risk appetite							17		
to build trust in recipient countries							17		
"meeting the intent of theGAPP to contribute to stability in financial markets" (p. 20)							17		
ublishing annual accounts according to international standards						11			
eing subject to internal and external audit						12			
regularly reviewing implementation of the GAPP									24
raining staff in professional and ethical standards							13		
establishing a code of conduct for governing bodies, management and staff							13		
establishing guidance on conflict of interest							13		
ompeting fairly, without using inside information (sovereign tax treatment optional for host countries)								20	
enabling risk management processes, incentives, codes of conduct, BC, audit									22.1
ommunicate and coordinate investments with own central authorities		3							
to ensure consistent action - e.g. SWF exchanging currencies can affect exchange and domestic demand		3							
eporting assets and investment performance to owner, using ex ante benchmarks									23
eporting statistical data on a timely basis to owner				5					
omplying with all applicable laws							15		

In theoretical terms, the table above lists the best practices for SWFs to bring gains to the world economy. The principles guide how funds' owners and management may define their incorporation, their objectives or raison d'etre, and basic activities such as accounting, audit, and recruitment. I organised these processes into more abstract, higher principles in different ways before settling on *structure, policies,* and *execution* as the three principal categories. For example, I initially asked how each Principle related to one of the three headline concerns about SWFs. Should *destabilisation, political influence,* and *re-investing capital* be the main categories? I found, first, that the Principles were fundamentally about incorporating and recognising SWFs as market entrants – a more fundamental objective than 'simply' resolving the controversy. Second, and consequently, I had to understand the Principles in their entirety before analysing which were most closely related to the concerns about orderly and efficient markets. On some level, they are all related to the controversy because they were born from it. This was the rationale for the coding summarised in the Figure above.

For theory-building it is important to identify which combination of these generic processes are unifying themes (core categories) that lead to robust propositions about SWFs' market responsibility. This also implicates the processes in the other international frameworks – not only the IMF's but also the US' and EU's. A comparison of the three will yield the most salient expectations of SWF conduct across political jurisdictions. Accordingly, the first table below outlines which generic processes were explicitly related to orderly and efficient markets in the text of the Santiago Principles. Then, the second table outlines which ones were present in the other international codes-of-conduct.

Figure 4-11. Santiago Principles aimed specifically at maintaining orderly and efficient markets (author developing IMF2)

Key process and subprocesses	GAPP	Expressed benefits
Defining and disclosing and independent corporate governance framework	16	"Such public disclosure would support an open and stable investment climate [and] assist in reassuring recipient countries that SWF investments area based on economic and financial considerations and employ sound operational controls and risk management systems." (p. 19)
Dividing owners/governing bodies from operational management	6, 16	
Giving managers an independent investment mandate	1.1, 9, 16	
Defining a clear accountability framework for the owner, governing body, and management	10, 16	
Defining and disclosing a corporate objective, an investment strategy, and financial performance benchmarks		
Defining the SWF objective (e.g. saving v stabilisation v investment returns)	2	Five principles that "aim at meeting the intent of GAPP to contribute to stability of international financial markets and build trust in recipient countries" (p. 22)
Defining and disclosing a policy on capital funding and withdrawals	4	
Disclosing financial information, typically asset allocation, benchmarks, rates of return	17	
Publicly disclosing investment strategy qualitatively (e.g. active/passive, financial/strategic)	18.3	
Define and disclose policy for exercising ownership rights ("long-term, patient investment" p. 22)	21	
Having a recognised and trusted risk management system		
Having a framework to identify, assess and manage risks and strong risk management culture and controls	22	"will also help achieve the aim of preserving international financial stability as well as maintaining a stable, transparent and open investment environment" (p. 23)
Publicly disclosing risk management framework in general terms	22.2	"will help achieve the aim of maintaining a stable, transparent, and open investment environment" (p. 24)
Regularly reviewing implementation of the GAPP	24	"may contribute to stability in international financial markets and enhance trust in recipient countries" (p. 25)

Figure 4-12. Commonalities in US, EU, IMF frameworks (adapted from UST1, EC3, IMF2)

Defining and disclosing an investment policy	
US	Basing investment decisions solely on commercial grounds; part of formal investment policy
EU	Development of an investment policy that defines the overall investment objectives
IMF	Development of an investment policy that defines the overall investment objectives
Disclosing investment positions and asset allocation	
US	Full information disclosure, esp. purpose, investment objectives, asset allocation, benchmarks
EU	Disclosure of investment positions, including asset allocation and leverage
IMF	Disclosure of investment positions, asset allocation, leverage, and benchmarks
Defining and disclosing governance controls	
US	Strong governance structures, controls, and risk management systems
EU	Separation of responsibilities in governance, disclosure of internal governance, risk management
IMF	Strong governance structures, controls, separation of management responsibilities; strong risk

These two tables show that the issues emphasised by the US and EU, and those highlighted by the SWFs themselves (under the aegis of the IMF), are very closely related. Namely, the key processes for helping to maintain orderly and efficient markets entail *defining* and *disclosing independent governance structures, an investment policy, investment positions,* and *risk management systems*. The codes do not stipulate how definition and disclosure should occur. They focus on content. In the following paragraphs, I conceptualise each one, based on the how the codes describe them.

Having independent governance structures

Much of the GAPP's emphasis is on incorporating and institutionalising SWF, with the aim of ensuring that they operate according to economic incentives. The first principle is that SWFs should have a *defined legal form*, and the code outlines three possible dimensions of this. One is a state-owned corporation (such as Singapore's Temasek or the China Investment Corporation), subject to common company law. Another is also an independent legal entity, governed by special purpose laws (e.g. the Abu Dhabi Investment Authority, and most other Gulf SWFs). The third is an asset pool with no independent legal entity, which is owned by the government or central bank directly (e.g. Botswana, Norway) (IMF2: 11). Although none of these forms necessarily presuppose a better or worse performance, they do condition other requirements like the hierarchical structure and *accountability framework,* which I discuss below. The Santiago Principles emphasise the importance of separating the fund management function from governance of the fund and from its owners (see GAPPs 1.1, 6-9, 16). The governing bodies – effectively a board of directors – may be a government institution like a ministry, or independently appointed. Regardless, it is important for fund managers to "have the authority to make individual investment decisions, as well as to make operational decisions related to staffing and financial management (subject to strategic direction and accountability to the owner or the governing body(ies))" (op cit: 17). The necessary *accountability frameworks* also depend on the funds' overall legal form. For example, if a fund is established as an independent legal entity, then "the governing body(ies) is accountable to the

Figure 4-13. The category *Having independent governance structures*: properties and (dimensions)

Defining the fund's owners and beneficiaries in a legal entity
(state-owned corporation)
(special-purpose vehicle)
(asset pool without separate entity)

Giving fund managers an independent mandate
(ensuring managers are motivated only by investment returns)
(establishing a separate governing body)
(providing extensive powers to senior staff)
(giving management responsibility to a statutory agency like central bank)
(contracting external service providers)

Defining the SWF's objective
(savings v stabilisation v investment returns)

Defining accountability framework for owner, governors, and fund management
(owner being accountable to legislature; governors accountable to owner; management accountable to governors)

owner, and management is accountable to the governing body(ies) for the SWF's operations, including its investment performance" (ibid). In funds without a separate legal identity, managers are accountable to the owner, and the owner is accountable to the legislature or the public, for the SWF's objectives (ibid).

Establishing a policy objective is another core property of the funds' incorporation and governance. The policy objective clarifies the ultimate goal that each governance structure should aim towards. For example, stabilisation funds (e.g. Russia, Chile, Mexico) aim "to insulate the budget and the economy against price swings" (op cit: 12). Savings funds (e.g. Libya and Kuwait) "aim to convert non-renewable assets into a more diversified portfolio", particularly for pension purposes (ibid). Investment corporations (e.g. Korea, CIC) aim for returns on capital. Whatever the primary objective, it conditions consequent investment policies; for example, savings funds have longer time-horizons than stabilisation funds, and the latter will almost always look for assets that are negatively correlated with national income (ibid).

Having and disclosing an investment policy

Having an investment policy was perhaps the most important management protocol required for SWFs from the point of view of abating the controversy. Market participants, regulators, and politicians wanted to know what SWFs intended to do, and how, and the investment policy would reveal it. The concept of an investment policy is very closely related to each of the three concerns about SWFs. First, it would provide benchmarks about what kind of assets the SWFs would invest in, and establish the level of risk tolerance, thus going some way to illuminating dimensions of the funds' potential to *destabilise markets*. Second, an investment policy would set some boundaries for SWFs' ability to *exercise political influence,* such as under what conditions they would take up seats on the boards of acquired companies and how they would deploy their voting rights as shareholders. Moreover, if the SWFs did have political objectives, such as social or

Figure 4-14. The category *Having an investment policy*: properties and (dimensions)

Matching SWF investment objectives

Establishing a benchmark portfolio
(performance targets and time-frames)
(permissible asset classes)
(concentration risk of asset classes, liquidity, sectors, etc)
(correlation with source of SWF's funding)

Establishing risk tolerance
(size of manageable declines in portfolio)
(acceptable size of performance uncertainty)
(acceptable use of derivatives, leverage)

Using external investment managers
(skills required, costs, monitoring)

Exercising equity ownership rights
(board representation)
(voting rights)

Disclosing the policy qualitatively
(active/passive)
(financial/strategic)
(benchmark portfolio)
(non-financial considerations)

Monitoring performance and reviewing policy periodically

environmental mandates, the policy would clarify what those were. Finally, the existence of an investment policy would promote investment, thus mitigating the concern that SWFs might simply *hoard capital* in reserve and contribute to the problem of widening global macroeconomic imbalances and falling liquidity in the West.

Central to the investment policy would be a *benchmark portfolio*, which is "a reference portfolio or an index [that] serves as a basis for comparison of the performance of the actual portfolio" (IMF2: 20*n*). It is the fund's aspirational asset allocation strategy, *specifying time-frames for investments* in different asset classes, and ***how correlated the investments would be with the SWFs' funding***.[19] Another core property of the investment policy would be to ***establish the fund's risk tolerance***, including the extent of recourse to *derivative products and leverage* (borrowed capital). The GAPP also stipulated that the investment policy should be disclosed, at least in qualitative terms.

Disclosing investment position

Public knowledge of where SWF capital has been allocated would increase knowledge of which markets increasingly relied on sovereign liquidity. These were, on one hand, healthier markets given that global liquidity was tightening in 2007-08. On the other hand they were also more vulnerable to a sudden shift in SWF domestic priorities or risk aversion. Given the emphasis put on *establishing an investment policy*, the disclosure requirements were simple by comparison. Both the EU and the IMF employed cautious language, aware that disclosure was a sensitive subject. In the West private financial companies must disclose this information as a matter of course, but imposing the requirement on other governments would be difficult. Santiago Principle 17, the only one on this specific issue, reads, "The financial information referred in this principle would normally be asset allocation, benchmarks where relevant, and rates of return over appropriate historical periods" (IMF2: 20). "Disclosure of these items," it continues, "will help to give guidance on risk appetite" (ibid).

Figure 4-15. The category *Disclosing investment position*: properties and (dimensions)

Disclosing investment position
(Asset allocation)
(Benchmarks)
(Rates of return over investment horizon)

[19] The advice is that funds should invest in assets whose value has a negative correlation with their source of funding.

Operating risk management systems

The imporntance of highlighting risk management in the principles owed itself primarily to SWFs relative inexperience, rather than their links to government, or their size. Risk-based governance is a prime issue for any new market entrant because of how interdependent market actors are in modern financial markets. The issue also features highly in the Financial Services Authority's Principles for Business, where Principle 3 is "Management and control: A firm must take reasonable case to organise and control its affairs responsibly and effectively, with adequate risk management systems" (FSA 2009a).

Figure 4-16. The category *Operating risk management systems*: properties and (dimensions)

Establishing framework
(identifying, assessing, managing risks)
(financial, operational, regulatory, reputational)
(clear lines of responsibility)

Risk monitoring and management
(control and incentive mechanisms)
(codes of conduct)
(reliable reporting)
(business continuity planning)
(tracking regulatory changes)
(independent audit)

Conducting stress-tests
(model-risk measurement)
(economic and financial shocks)

Training staff in professional and ethical standards
(establish code of conduct)
(conflict of interest, integrity)
(offering legal indemnity)
(extending this to external contractors)

Disclosing general framework

Three Santiago Principles are devoted to "Risk Management and Performance Measurement", covering the establishment of a risk management framework (GAPP 22, 22.1, 22.2), accurate and reliable reporting of risk information to the SWF owners (GAPP 23), and reviewing implementation of the GAPP itself (GAPP 24). Other principles also provide valuable inputs to risk management, however. GAPP 12 stipulates that operational systems and controls "should be internally audited on a regular basis" (op cit: 18). GAPP 13 states that all persons involved with the SWF should follow "professional and ethical standards", based on clear policies and training. The positive impact that training in ethical conduct could have on risk management had also been highlighted in the FSA's punishment of Citigroup, and in Citigroup's own pre-emptory response to the controversy. The remaining properties of *operating risk management systems* are set out in Figure 4-16. It is evident from the level of granularity of these Principles that these controls are central to good market conduct by SWFs.

4.3.4. Preliminary conclusions

I began analysing these codes-of-conduct on the premise that they embodied the types of behaviours that were expected of SWFs to help ensure well-functioning markets. My grounds for this premise were based on the deduction that (1) the SWF controversy was an attempt to define good market conduct for SWFs and (2) the codes-of-conduct resolved the controversy. Hence, (3) the codes-of-conduct defined good market conduct. I made two discoveries that were material to the episode's broader relevance. To what extent do the Principles for SWFs apply more broadly? The first thing to note is that the GAPP sought to recognise SWFs are market entrants, and legitimise by setting out effectively a 'how to' manual for operating one. Secondly, in my analysis of the US Treasury code-of-conduct, I found that Citigroup's mistake was largely to fail to abide by those principles. As a result, these principles have a broader market significance. In this episode the four essential features of good market conduct were given by:

- *Having and disclosing independent governance structures*
- *Having and disclosing an investment policy*
- *Disclosing investment positions*
- *Operating risk management systems*

To understand the broader implications of these responsibilities, I compare them with those invoked for Citigroup in the next section.

4.4. Defining 'corporate market responsibility': Integrating the episode into theory

The Citigroup and SWF episodes both suggest that market actors have special responsibilities towards markets; that is, responsibilities beyond maximising profits and complying with the law. Citigroup was punished for failing to meet these responsibilities, and SWFs were led, under a threat of regulatory sanction, to codify responsibilities of their own. In the Citigroup episode, the existence of special responsibilities was evident because Citigroup was punished despite not breaking the law. In the SWFs episode, we found that even though legal safeguards existed to prevent SWFs investing in strategic industries for political purposes, markets needed additional protection from the potential that SWFs would inadvertently destabilise them. Beyond compliance and investment returns, sovereign funds had to be responsible market actors. Given this similarity in the conceptual trajectory of the two episodes, we can begin to integrate and establish relationships between the concepts that emerged in each. Each episode has its own set of interrelated concepts that explain the controversies and their resolution. Together, they continue to answer our original research question: how are firms responsible for helping to ensure orderly and efficient financial markets?

In the following paragraphs my analysis establishes the concept of 'corporate market responsibility' in the form of a proposition affirming its existence, and describes CMR's role as a core category that explains the main patterns of behaviour in these episodes. Then, the various manifestation of CMR are extended, in three related propositions.

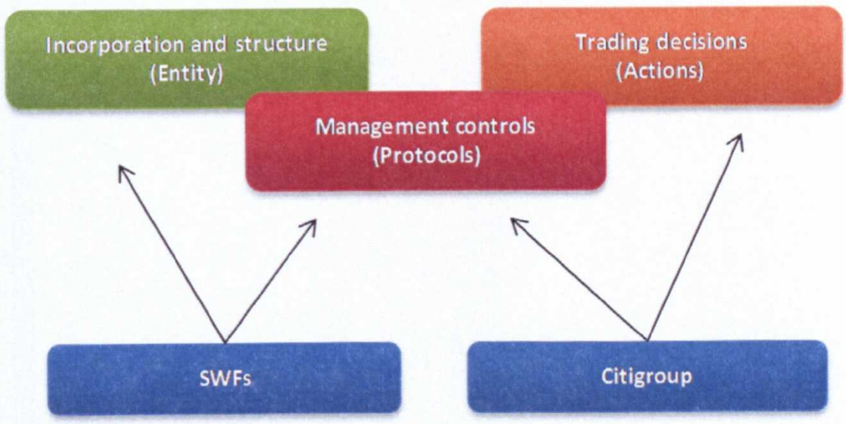
4.4.1. Defining CMR: The core proposition

We can begin with some generalities, or what grounded theorists call "coding families" (Glaser 1978: 72-8), meta-codes. At a general level, the recommendations invoked for Citigroup and SWFs organise into a coding family that I would entitle *entity, protocols,* and *actions*. Let:

- *Entity* stand for corporate structure: how a firm divides into hierarchies and mandates
- *Protocols* stand for rules: management systems and controls such as risk tolerance
- *Actions* stand for financial transactions and enabling activities

In general terms, the responsibilities invoked for Citigroup focused on actions; and protocols that would support those actions. Those for sovereign funds focused on corporate structure; and protocols that reinforce that corporate structure (see Figure 4-17 below). Citigroup's punishment held that the bank's trade disrupted the market unduly, its managers failed to exercise due skill, and ultimately its systems and controls had been weak. Although the bank was faulted at corporate level, rather than at the level of individual traders, the emphasis was not its corporate structure; it was on its activities and protocols. The inverse appears to have held for sovereign funds. The recommendations that brought closure to the SWF controversy focused on SWFs' overall incorporation and structure (i.e. division of labour, objectives, policies) rather than the funds' practical activities. To address market risks arising from transactions, the focus is on ensuring that SWFs are clearly incorporated and structured, and have protocols to support that structure. Specifically, a range of fully disclosed protocols should ensure that fund managers maintain an independent mandate from the fund's owner. For balance, I note that the Citigroup sanction also addressed entity and the SWF principles also addressed actions.[20] But the one issue that cuts equally across both controversies is how effective management systems and controls are. For Citigroup, they relate to better trading, and for SWFs, to better corporate structure.

Figure 4-17. *Management controls* as a central feature of market responsibility in the two episodes



On these grounds, 'corporate market responsibility' is based, first and foremost, on management controls, rather than, for example, being a certain kind of corporation or engaging in certain kinds of activities. For the purpose of theorising firms' responsibilities towards financial markets, the centrality of management systems and controls is not deductively surprising: if an entity has a responsibility that pre-determines its activities, then that responsibility would be expressed as a protocol. We must now establish **what** the requisite protocols are, **why** they matter, **who** is responsible, **when**, and **with what consequences**. Let us present the core category of CMR first, and then the propositions that follow.

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[20] For example, the FSA pointed out that Citigroup *strengthening its compliance department* pre-emptively had mitigated further sanction; SWFs signed the GAPP 20 on *competing fairly*, i.e. not seeking inside information.

We deduce from the regulatory and reputational controversy that emerged in both episodes that a corporate market responsibility exists. **'Corporate market responsibility' refers to an expectation by regulators and other political, economic and social actors that companies will help to maintain orderly and efficient markets by helping to ensure market confidence and stability through certain management protocols.** In the case of Citigroup, *market confidence* means actors trusting that the market's rules and its implicit norms will be observed. In the case of SWFs, trust, which is referenced in several of the Santiago Principles (see Figure 4-11), meant that SWFs would be good commercial partners. 'Confidence' and 'trust' were largely conceptually synonymous in the data, as they are in many languages. Market stability in both cases is based on the protagonists providing liquidity reliably – as a trusted market participant in Citigroup's case, and as an investor (not merely a holder of capital reserves), in SWFs' case. The episodes dictate that certain protocols should be observed, and that they mitigate regulatory and reputational risk.

Figure 4-18. Core CMR proposition

	Theoretical Proposition	Annotation	see Fig:
What	**Companies have a responsibility to help maintain orderly and efficient markets.**		
How	**Specifically CMR entails:**		
	Ensuring market confidence and stability by establishing a set of protocols (as follows)		
	Operating a sound risk management system that anticipates the impact of investment transactions	*Risk management protocols were central recommendations in both episodes. This was important for Citigroup to anticipate the impact of transactions, and important for SWFs to reassure host countries that they would not be a destabilising force.*	3-13,4-16
	Operating a transparent investment policy based on commercial objectives.	*Central for SWFs, significant for Citigroup. The German regulator criticised Citi's strategy for not being entirely "investment-driven" (WSJ18), as did the FT (see below).*	3-9,4-14
	Improving CMR shortcomings proactively	*This holds because standards are fluid and may not be well-established; secondly, because proactive mitigation increases trust and reduces regulatory and reputational risk.*	3-18,4-8
Why	*This is important because:*		
	Compliance with only minimum standards may not suffice to maintain efficient and orderly markets. The boundaries of acceptable market conduct are moderated by porous and implicit principles and agreements that change quickly and may not be known by every actor. In the event of market instability, compliance with only minimum standards increases regulatory and reputational risks.	*Compliance with minimum standards (i.e. the 'letter of the law') was given in both episodes, but did not prevent controversy. In the Citigroup episode, the market-making rules had to be moderated by sound judgement. (Although intended to increase liquidity, too much liquidity would also be problematic.) In the SWFs episodes, acceptable market conduct was frequently redefined; for example, when Schumer condemned Dubai World's investment and accepted Abu Dhabi's.*	3-9,4-5,4-7
Who	*Responsibility falls primarily to:*		
	Large, liquid market participants.	*Media and regulatory data frequently singled out the particular responsibility of large firms.*	3-7,4-5
	Senior management is held accountable externally, and junior management internally; junior staff have most implementation responsibility.	*The occasional differences are noted in the tables below.*	3-17,3-15,4-13,4-16
When	*This matters most when:*		
	Making or assessing extraordinary transactions	*Large, fast, unprecedented transactions are more likely to impact market confidence and liquidity, thus courting regulatory scrunity. Citigroup's trade and SWFs' high-profile equity acquisitions were examples*	3-6,3-7,4-5,4-6
	Entering new markets	*The geographic dimension of new markets was key in both episodes, where the controversy emphasised the investors' national origins. However, entry into new financial product markets is also significant*	3-9,4-6
	Being a market-maker	*In a market-making system, the potential to contribute to too little or too much liquidity is more acute.*	3-10
	Liquidity is rapidly rising or falling at market- or economy-level	*Citigroup's trade was a reaction to high amounts of existing liquidity, and it ultimately led to liquidity tightening. SWFs brought welcome liquidity. The goal is liquidity stabilisation.*	3-6,3-10,4-5,4-6
Conse-quences			
	Establishing independent governance structures with clear mandates	*Impact on* entity.	3-14,4-13
	Restricting certain kinds of investments	*Impact on* actions.	3-13,3-7,4-14
	Collaborating with regulators and political bodies	*Collaboration increased market confidence and curbed regulatory risk in both episodes.*	3-18,4-8

The table above sets out the core proposition of CMR, and how CMR is manifest. The left-hand column sets out the theoretical propositions that emerge from the data. These are answers to the research question, and building blocks of the emerging theory. The 'Annotations' note how the proposition fits differently with each of the episodes, or notes theoretical implications, or clarifications. The right-hand references are to Figures where the related conceptual categories are more fully described. For example, Figure 3-6 is *signalling controversy* in the Citigroup example, and it notes that the MTS market operator *reigned in liquidity* as a response to Citigroup's trade. Thus the references enable further clarification and substantiation of each theoretical proposition.

4.4.2. Propositions on risk management, investment policy, & improvement

The core CMR proposition points to three sets of management systems and controls – risk management, investment policies, and proactive improvement – that represent CMR in practice. These protocols help to discipline the corporation as an entity, as well as its actions. The protocols differ from the core proposition in **what** they are, but not in **why** they matter or **when** they should be used. Theoretically, there may be differences as to why different protocols matter, and when, but the data does not present this level of granularity. All of the protocols matter **because** they contribute to market confidence and stability. They are particularly important **when** making or assessing extraordinary transactions, entering new markets, being a market-maker, or when liquidity is unstable (rapidly rising or falling) at market- or economy-level. There are small variations related to **who** is responsible for each protocol, and what its **consequences** are, as I outline below.

Figure 4-19. CMR proposition on Risk Management

	Theoretical proposition	Annotation	see Fig:
What	**A company has a responsibility to operate a sound risk management system that anticipates the impact of investment transactions.**		
How	**Specifically it should:**		
	Establish a risk management framework (incl risks and lines of responsibility)	*Both episodes noted that some risks, including reputational risk and the impact on market risk, may be underestimated.*	3-13,4-16
	Implement risk monitoring systems (rules, incentives, reporting, ...)	*Using well-structured analysis and monitoring risk exposure were highlighted specifically by the FSA, and other systems were noted extensively in the GAPP.*	3-13,4-16
	Anticipate the impact of its activities on the market	*This ex ante analysis was central for Citigroup. For SWFs, it related only to reputation risk, but figured also in the investment policy (see below)*	3-14,4-16,4-14
	Escalate strategies to senior management	*Reliable information and decision reporting is emphasised in both cases*	3-13,3-14
	Conduct stress-tests	*For SWFs, this is in the GAPP. For Citi, the FSA limited its punishment, saying (like others) that Citi's competitors should have prepared for the scenario in advance.*	3-15a,4-16
	Train staff in professional and ethical conduct (incl market conduct)	*Both cases emphasised broad stakeholder groups, and Citigroup's also noted attendance levels.*	3-13,4-16
	Disclose this framework for external monitoring	*Disclosure figures highly in the SWF GAPP. It is part of conventional audits of private companies.*	4-16
Who	*Responsibility falls to:*		
	Lower management is responsible for implementation and *escalation of key decisions* to senior management. Senior management is held accountable by external parties.	*Both cases emphasise that accountability and reporting requirements (e.g.to independent risk functions) should be clearly delineated. Individual Citigroup traders were not held accountable by the FSA.*	3-15,4-13
Conse-quences	*This may lead to:*		
	The firm may need to abstain from certain profitable transactions that exceed risk tolerance or whose impact cannot be reliably assessed.		3-6,3-15,4-6

The second protocol, below, is to operate an investment policy based on commercial objectives. Here, comparing the two episodes was particularly useful for helping to clarify the boundaries of being 'investment-driven'. In Section 4.2.2, I argued that the underlying concern about SWFs is that, whilst investment-driven, they could use political influence to help achieve their aims. In the Citigroup case, controversy had emerged partly from a Citigroup memo revealing that the bank had intended, in its own words, to "turn the European government bond market into one that more closely resembles the US" market and "decrease the attractiveness of the [German] Bund" (FT53). Consequently, BaFin, the German regulator, accused Citigroup of not being "investment-driven". Similarly, a *Financial Times* editorial claimed the bank was operating "under the banner of spreading American capitalism" (FT61). Both episodes showed that being "investment-driven" is important, and yet ambiguous. Comparing the two, I would define it as: *seeking returns on <u>invested</u> assets*. The fact that Citigroup's ultimate motive for transforming the European bond market was commercial did not make it ok. The important issue is whether it was generating returns on the assets it was transacting, or looking primarily to impact on the market architecture.

Figure 4-20. CMR proposition on Investment Policy

	Theoretical proposition	Annotation	see Fig:
What	**A company has a responsibility to operate a transparent investment policy based on commercial objectives.**		
How	*Specifically, the policy should...*		
	Be driven by financial returns on invested assets	*Central for SWFs, significant for Citigroup. The German regulator and FT criticised Citigroup for looking to re-shape the European bond market into US-style market.*	*3-9,4-7,4-13*
	Be based on a well-accepted level of risk tolerance, and clear parameters for transactions (acceptable uncertainty levels, including external uncertainty)	*Both episodes show strong conceptual cross-over between investment strategy and consequent risk requirements.*	*3-15,4-14*
	Have a benchmark against which the strategy can be evaluated.	*Explicit for SWFs. Citigroup suggests that if a planned trade is unprecedented - has no possible benchmarks - then other CMR responsibilities are more acute.*	*3-13,4-16*
	Establish systems to monitor asset allocation/concentration and trading positions/exposure	*Ensuring that the investment policy is compled with.*	*3-15,4-14*
	Be generally disclosed and regularly audited and reviewed	*Disclosure may be solicited after perceived wrong-doing particularly.*	*3-9,4-14,4-15*
Who	*Responsibility falls primarily to:*		
	The policy is implemented by operational management and defined by the owner or governing body(ies).	*In private companies, the owner's responsibility may fall to shareholders.*	*3-15,4-13*
Consequences	*This may lead to:*		
	Adjusting corporate hierarchy and mandates	*Impact on* entity.	*3-15,4-13*
	Establishing new systems of accountability, transaction analysis and information escalation		*3-14,3-15,4-13*
	Disclosing investment positions in times of audit or scrunity	*Disclosing investment position was central for SWFs as a matter or course. For Citigroup it was more situational - other banks needed to understand Citigroup's position and intent during the trading itself*	*3-7,3-9,4-15*

The third proposition, below, relates to the importance of proactive, continuous improvement in respect of CMR. In both episodes, protagonists were held accountable for proactive action to implement CMR. For Citigroup, the FSA mitigated its punishment on the grounds that, since the trade, Citigroup had begun to implement more robust CMR-relevant systems proactively (outlined in Figure 4-21 below). Indeed, "inaction" is vis-à-vis regulatory principles is a proscribed behaviour under UK financial regulation (UKP1). For SWFs, taking action to draft and adopt a code-of-conduct – proactively attempting to correct their shortcomings – is what resolved the controversy.

Figure 4-21. CMR proposition on Proactive Improvement

	Theoretical proposition	Annotation	see Fig:
What	**A company has a responsibility to correct its shortcomings proactively, even if they are not in breach of regulation or their perceived cost is limited to the company.**		
How	**Specifically, it should:**		
	Cooperate with regulatory and political authorities, including to understand and codify its responsibilities, as well as to investigate past transactions	*The SWFs cooperating on a code-of-conduct, and Citigroup with regulators, were cited as increasing market confidence and curbing regulatory risk.*	3-18,4-8
	Emphasise its values from the level of owner, or governing body(ies) or CEO, downwards	*In private companies, the owner's responsibility may fall to shareholders.*	3-18,4-13
	Re-train its staff in professional and ethical standards	*As noted under 'Risk'.*	3-18,4-5,4-16
	Invest in surveillance and information-reporting quality		3.13,4-16
	Strengthen its compliance department and systems	*Citigroup moved compliance staff to trading floor.*	3-18,4-13,4-14
Who	*Responsibility falls primarily to:*		
	Senior management should express and cascade value messages, and are held accountable externally. Junior management implements the various processes, and must report and escalate known shortcomings.	*Regulatory and media data did not highlight the role of specific individuals, but tended to hold the entity accountable at corporate level. Senior staff have a more active role in Improvement processes than other CMRs.*	3-15,4-13
When	*This is particularly important when, in addition to other CMR conditions:*		
	The company is perceived to pose or have posed a risk to orderly and efficient markets.	*For Citigroup, these initiatives mitigated the FSA punishment. For SWFs, drafting and signing the GAPP was the first thing they were expected to do.*	3-18,4-8
Conse-quences	*This may lead to:*		
	New management structures, systems, and expenditure	*This shows that CMR has central governance implications, and cannot be effective at the margin.*	

In the end, my analysis of the two episodes suggests that having sound management systems and controls – that aim, among other things, to help ensure market confidence and liquidity – may be more important than merely abstaining from wrong-doing (like SWFs) or being a well-structured corporate entity (like Citigroup). These management protocols are the (at this stage tentative) answers to the question of how firms are responsible for helping to ensure orderly and efficient markets.

4.5. Conclusion

In 2009, two years after SWFs' rise to prominence, the idea that they posed a threat to the global economy had become sufficiently outdated to seem almost quaint. In November 2009, the IMF, a driver for global financial liberalisation and privatisation for best part of 50 years, encouraged Angola to establish a SWF in order to manage its foreign reserves on international markets (IMF 2009).

Western governments actively court SWFs as buyers for their sovereign debt, and as investors in slowly growing industries. SWFs have become mainstream. My analysis in this chapter suggests that SWFs became accepted at the same time as they learned how to be responsible actors, adopting management protocols that safeguarded orderly markets. While they did so, the public perception of SWFs matured. Western policy-makers acknowledged that SWF investment had become one of the few means available to them to protect domestic industries from insolvency within a 'free market' paradigm – that is, without fiscal intervention.

Early on in the analysis, I recognised similarities between the SWF and Citigroup episodes: controversy in the absence of clear-cut wrongdoing; concern for the financial system despite legal compliance; and increasing regulatory risks for the firms. Notwithstanding these general similarities, I had not expected to find so much resonance between the two episodes within the very detailed prescriptions for SWFs. The reason for the Citigroup controversy was effectively that Citigroup failed the US Treasury test for 'responsible' SWFs. Systematically coding the SWF codes of conduct as generic processes, and comparing these conceptual properties with the earlier episode's, I built propositions that explain and frame both controversies. Figures 4-18 to 4-21 detail those CMR propositions, noting their roots in each empirical setting and their occasional variations. These are the key contributions of this chapter, to provide a conceptual account of the SWF controversy, and to provide a set of propositions that explain and frame both controversies.

During this research, I noticed that a new public debate had emerged about firms' contributions to the financial system. As the global financial crisis that began in late 2007 gathered pace in 2008, large banks and bank-like institutions were blamed, among others, for an "age of irresponsibility" that resonated with the proposition of corporate market responsibility. Poor risk management that provided the wrong incentives; bad investment policies that spawned misleading product innovations; and a lack of proactive improvement in compliance practices, were all emphasised in the debate among regulators, policy-makers, and other market stakeholders, following the collapse of Lehman Brothers investment bank in September 2008. Again, firms' responsibilities for orderly markets were invoked. This became the subject of the following chapter.

Chapter 5: The post-Credit Crunch regulatory debate

My daughter called me up from school and said, "Daddy, what's a financial crisis?" And without trying to be funny, I said, "it's something that happens every five to seven years". And she says, "so why is everyone so surprised?" So we weren't – we shouldn't be surprised.

Jamie Dimon, Chairman of JP Morgan, testifying to the Financial Crisis Inquiry Commission, 13 January 2010

The biggest mistake we made, somehow in mortgage underwriting, we just missed that home prices don't go up forever.

Dimon, same testimony[1]

5.1. Introduction

The financial crisis that began in 2007, often described as the most significant since the Great Depression, has brought to the forefront of public debate a number of ideas that contribute to this thesis. In this chapter, I explore what the debate contributes to our understanding of firms' responsibilities for orderly financial markets. The regulatory fallout from the Credit Crunch is a contemporaneous problematique, complicated by many overlapping themes. Its breadth was first conveyed by Britain's then-Prime Minister Gordon Brown, in a speech at the UN General Assembly in September 2008, when he described the run-up to the crisis as an "age of irresponsibility":

> "The current era has been one of global prosperity. It has also been an era of global turbulence, and while there has been irresponsibility, we must now say clearly that the age of irresponsibility must be ended. We must now build that new global financial order, founding it on transparency, not opacity; rewarding success, not excess; and responsibility, not impunity. That order must be global, not national" (Brown 2008).

Months later, Barack Obama lent his weight to the concept, making "a new era of responsibility" the central theme of his presidential inauguration and the title of his first budget. Obama (2009) wrote:

> "Wall Street threw caution to the wind, chased profits with blind optimism and little regard for serious risks—and with even less regard for the public good. Lenders made loans without concern for whether borrowers could repay them. Inadequately informed of the risks and overwhelmed by fine print, many borrowers took on debt they could not really afford. And those in authority turned a blind eye to this risk-taking; they forgot that markets work best when there is transparency and accountability and when the rules of the road are both fair and vigorously enforced. For years, a lack of transparency created a situation in which serious economic dangers were visible to all too few. This irresponsibility precipitated the interlocking housing and financial crises that triggered this recession.
>
> The time has come to usher in a new era — a new era of responsibility..." (p. 1, underlining added).

[1] FCIC (2010) video, minutes 02:34:00 and 01:53:00.

Both leaders extended the blame for the crisis to a wide constellation of actors. Bankers had acted with excessive risk tolerance, improper incentives structures, and inadequate knowledge of their products. Regulators had been insufficiently sophisticated or intrusive, even occasionally negligent of their mandate. Borrowers were frequently over-optimistic to borrow against expensive homes, especially when many had misrepresented their income in mortgage applications. More broadly, there was "a failure of the collective imagination of many bright people ... to understand the risks to the system on the whole", according to a letter from the British Academy (2009: 2-3) to the Queen.

The crisis began in a specialised part of the banking system in 2007, and quickly spread to the real economy in countries worldwide. Initially, banks experienced large losses from defaults on subprime mortgages[2] that they held on their trading books (FSA6: 93).[3] Many of these mortgages had been packaged and sold throughout the banking system as re-structured, derivative products that became exceedingly difficult to value. "[U]ncertainty over the scale of the losses created a crisis of confidence which produced severe liquidity strains across the entire system," wrote the FSA in 2009 (ibid), "As a result, a wide range of banking institutions now suffer from an impaired ability to extend credit to the real economy, and have been recapitalised with large injections of taxpayer money". The Credit Crunch put many companies and individuals in bankruptcy. "Trillions of dollars in wealth have been destroyed," wrote the Securities and Exchange Commission (SEC11: 1), adding that the crisis "challenged the faith of many in our system of capital formation and allocation – a system for creating wealth that has proved over the long term to be the greatest the world has seen".

Banks and regulators now find themselves in a substantial and wide-ranging review of how to govern financial markets. In the US, UK and at European levels, financial ministries, legislative committees, and regulatory institutions have published white papers to analyse what led to the crisis and propose new approaches for financial regulation. There is broad agreement that regulation should be more "robust", although both among researchers and practitioners there is significant disagreement about what it should look like.[4] The UK's Financial Services Authority wrote that the future requires "a combination of better regulation <u>and market response</u> to the crisis" (2009b: 10, underlining added). Research on this market response has taken a backseat relative to regulatory

[2] 'Subprime' refers to the relatively low creditworthiness of the house-buyers who took out mortgage loans, relative to the size and cost of the loans.

[3] As in previous chapters, stylised referencing is applied to data documents, which are listed in Part 1 of the bibliography.

[4] Research on better post-crisis regulation is already extensive (e.g. Davies and Green 2008, FSA 2009d, Goodhart 2009) and likely to grow rapidly for years. In the US, the Congressional Financial Crisis Inquiry Commission (FCIC) is due to report in December 2010, setting the stage for further US policy debate.

reform, although some references to it have emerged. For example, Commissioner Byron Giorgiou of the US Congressional Financial Crisis Inquiry Commission, stated at a hearing:

> "I'm a strong believer in the strength of the market system. And although regulation of the financial services industry is proper and necessary, despite their best efforts, governments and regulators often lack the resources and expertise to monitor adequately activities that create undue systemic risk. So it is important for us to focus on creating market mechanisms that reduce the likelihood that risk-taking practices will get out of hand and threaten the stability of the entire financial system" (FCIC 2010: minute 02:02:00).

Jamie Dimon, head of JP Morgan, also stated at that hearing that, because regulatory oversight may be too slow to adapt to financial innovation, "perhaps some of this oversight is the [bank] managers' responsibility, not the regulators'" (ibid).

Managers' responsibility for oversight is of course a central theme in this thesis. In the last chapter, I established four propositions on the subject, which emerged from the Citigroup and sovereign wealth funds episodes (Figure 5-1).

Figure 5-1. CMR working propositions

Title	*Financial companies are expected to...*	see Figure:
Core proposition	Help maintain orderly and efficient markets by ensuring market confidence and stability through certain management protocols. Failure to observe this 'corporate market responsibility' increases regulatory risks.	4-18
Risk Management	Operate a sound risk management system that anticipates the impact of investment transactions.	4-19
Investment Policy	Operate a transparent investment policy based on commercial objectives.	4-20
Proactive Improvement	Correct their shortcomings proactively, even if they are not in breach of regulation or the perceived cost of the shortcomings is limited to the company.	4-21

In this chapter, I develop these propositions further, on the assumption that the current regulatory debate already has something to teach us.

The debate marks a departure from decades-worth of conventional wisdom about how and when financial markets self-correct (UST3: 2, FSA6: ch. 1). Now, the question of how firms must help to ensure orderly markets is discussed much more broadly in society. The ongoing debate includes a major re-alignment of responsibilities for regulation (including new regulatory institutions and mandates). In many cases, as I discuss throughout the chapter, regulators plan to intensify supervision while also calling for companies to comply with the spirit of the law, to share a common objective with regulators, in tacit recognition that prescriptive rules cannot always deliver adequate solutions in such a fast-paced and complex environment. Regulatory reviews and proposals are grounded in indictments over 'irresponsible' banking practices, such as poor risk assessments, inadequate compensation structures, and predatory lending. These data provide granular insight into discretionary decisions that financial institutions make daily, with implications for financial stability. At this level of granularity, the fact that the debate has not yet concluded is a strength. It gives a platform to minority views that may not ultimately be codified in regulation, but are shaping new expectations about corporate behaviour.

The debate presents ideas that contribute to the propositions outlined in earlier chapters. First, the notion that companies have a responsibility to adopt risk management systems that anticipate the impact on their market is pervasive. Much of what caused the crisis was a failure of risk management. Companies failed to assess and diversify the risk of certain credit products appropriately. Now the proposed reforms to risk management practices are based primarily on reducing risks to the financial system on the whole, rather than to individual companies (FSA6: ch. 2). Specific properties of risk management that the Citigroup and SWF episodes highlighted, such as *stress-testing* or *ethical conduct*, are again emphasised in this episode.

A second area of resonance is investment policy, where the previous episodes suggested that business practices should be part of an auditable, legitimate policy, benchmarked against broader corporate objectives. The Credit Crunch debate highlights specific business practices, such as short-selling (betting that the price of shares will fall), which regulators have partly prohibited because of the possibility that the bets become abusive or self-fulfilling, destabilising markets. More generally, the benefits of financial innovation are questioned based on their impact on the wider system. "Not all innovation is equally useful", said the FSA's Chairman, Lord Turner, in a speech (2009b: 15), "If by some terrible accident the world lost the knowledge required to manufacture one of our major drugs or vaccines, human welfare would be seriously harmed. If the instructions for creating a [derivative like the] CDO-squared have now been mislaid, we will I think get along quite well without". In the highly discretionary area of business innovation, new limits and considerations based on market stability have emerged.

Third, the proposition that firms have to correct their shortcomings proactively – even if they are not in breach of regulation and their perceived cost is limited to the company – is further substantiated.

This may be surprising because this episode is largely about tightening regulation and compliance. One might infer that the space for proactive improvement would be narrowed. On the contrary, the data suggests that even highly numerate and ostensibly 'precise' areas of new regulation, like accounting, require sound, responsible judgement in order to work. Regulators are actively encouraging companies to implement technical regulation responsibly. Indeed there may even be a positive relationship between the specificity of regulation and the amount of discretionary judgement that it requires. This is because the more specific the regulation, the more important it is to determine how to apply it to idiosyncratic products and processes.

The data also suggests that CMR is underpinned by a special role that banks have in the wider economy. All of the regulatory authorities and the heads of certain banks, like Goldman Sachs's Lloyd Blankfein, affirm that financial market stability is not only an objective in its own right, but a strategy for wider economic development. As Blankfein put it, investment banks are doing "God's work" (*Sunday Times* 2009).

5.1.1. Purpose and contribution of chapter

The purpose of this chapter is to conceptualise what the response to the biggest financial crisis for generations says about companies' responsibilities for regulating financial market stability. The episode conveys expectations of economically responsible corporate behaviour among more actors and across more markets. In such a broader context, it increases the credibility, resonance, and usefulness of the emerging CMR theory. Insofar as the financial crisis may herald a new regulatory era, the episode also helps the theory of CMR incorporate uncertainty about the future.

To this end, the chapter contributes a stylised conceptual account of the regulatory and public indictments of corporate conduct in the run-up to the Credit Crunch. It analyses what practices are legal and by some rationale worthwhile, but ultimately damaging to the market. It adds variation and density to the CMR propositions by illuminating new properties of responsible risk management, investment policies, and improvement. In particular, it develops two conceptual categories – *responsible compliance* and *humanising technical activity* which serve as unifying themes for the regulatory debate. Because this episode occurs in a new setting, this chapter demonstrates how expectations, responsibilities, and behaviours vary under different conditions. To what extent did market conduct in this episode differ conceptually? How did conditions differ? What were the effects? By drawing these boundaries through and between the episodes, I establish a basis then to integrate all the propositions on corporate market responsibility – from the Citigroup, sovereign funds, and the Credit Crunch episodes – in the next chapter.

Finally, this chapter demonstrates that the CMR propositions have contemporaneous significance. The emergence of CMR concepts at the centre of the current regulatory debate, particularly the 'discovery' of systemic risk as a pivotal issue of regulatory concern, suggests that CMR has historical significance. This sets the stage for a better understanding of the diffusion of private authority in financial governance. While CMR reinforces that trend, it also represents a reassertion of societal authority over market governance. For example, CMR may represent a conditionality framework for financial market de-regulation, and thus illustrate limits for the diffusion of authority. These issues are taken up for discussion in the next chapter.

5.1.2. Chapter outline

The chapter begins with a factual baseline about the economic and financial trends that led to the crisis. This narrative in Section 5.2 explains the most contentious financial practices and products and contextualises their emergence. Then it examines how the regulatory data conveys 'systemically responsible' risk management, investment policies and proactive improvement. Section 5.3 analyses the traction that this debate had among other market participants, observers and regulators, based on news reports in the financial press, and outlines several concepts that press reports contributed. Section 5.4 integrates the regulator and media analyses and Section 5.5 concludes.

5.1.3. Sampling and analytical approach

The analysis continues to draw on regulatory and media data to convey expectations of market conduct. In this episode, however, the epistemological significance of regulatory data is different. Previously, regulation served to resolve the controversies, to codify a set of expectations that would become accepted practice. In the Citigroup episode, market participants cited in news reports were explicitly waiting for the regulators' reaction in order to assess Citigroup's transaction. In the SWFs case, several politicians cited referred to the public controversy as an input to the codes-of-conduct that would emerge. In both cases, regulation signalled the end of extensive news reporting. Here, the regulatory data does not resolve the controversy, it prolongs it and helps to set broader stakeholder expectations. As a result, I inverted the sampling sequence, beginning with regulatory papers and moving on sampling news reports subsequently to understand the extent to which regulatory ideas found wider traction. This sequence also had the value of reinforcing the direct relevance of news data. This relevance would otherwise be very difficult to achieve because in the vast and 'noisy' (Taleb 2004) depository of new reports on the financial crisis, many reports are only tangentially related to CMR issues. Starting with regulatory reports reinforces my focus on the core theme and disciplines the use of media data, whose value is to convey broader social reaction to the regulatory fallout.

The sampling strategy entailed several criteria. Data is made up of white papers and similar publications that propose a new approach to financial regulation or review the existing approach. These papers analyse which banking practices may have undermined the system, and give an indication of where new regulatory thinking is headed. Their authors were finance ministries, legislatures, central banks, and financial regulators.[5] As in previous chapters, I narrowed the sample to UK, US and EU data. Because the data also contained significant references to work done at the Bank for International Settlement's Financial Stability Board, particularly its input to the G8 governments, their white paper was also included.

The temporal limit for sampling was September 2008 to September 2009. The episode begins in September 2008 because it was then that the fall-out from the Credit Crunch began, after Lehman Brothers investment bank collapsed. This was the largest catalyst for regulatory intervention in the financial system and the point at which point the crisis fully matured, and therefore the time to begin capturing the public stakeholder response to it.[6] The one-year time-limit was chosen because it includes a very robust set of regulatory reviews from all the relevant stakeholders; equals the sampling period for each of the two episodes in the preceding chapters; and, not unimportantly, fit the practical constraints of this doctorate. As I have acknowledged, the debate is still ongoing and relevant new data emerges weekly. I proceed on the assumption that there is plenty to learn from what has already been written and the claims that I make for the resulting theoretical propositions acknowledge the ongoing nature of the episode. On a few occasions, based on the principle of purposeful sampling (Charmaz 2006), I sampled documents whose publications exceeded the time-limit, because the other data suggested that they would significantly influence the terms of the debate.

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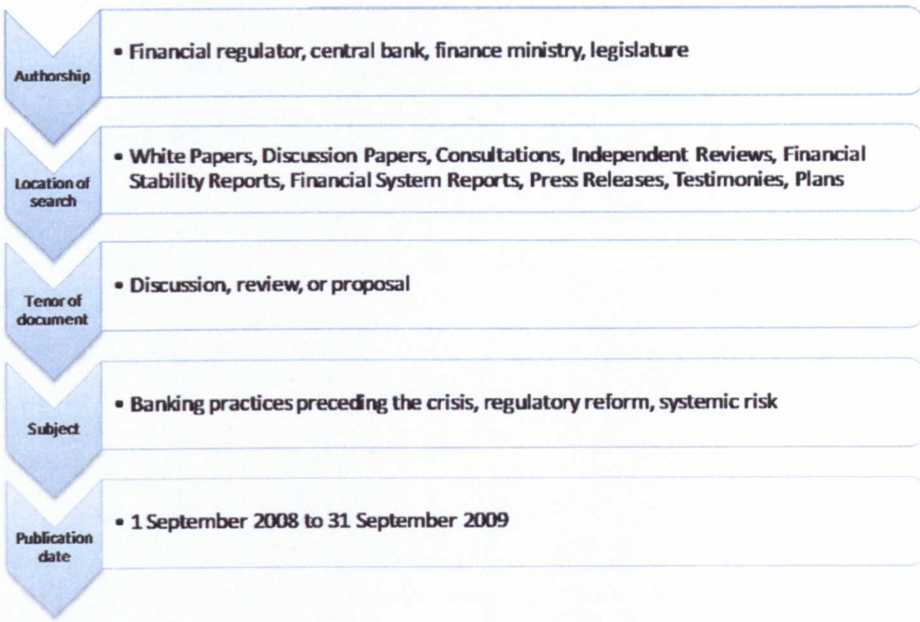
[5] The UK regulator is the Financial Services Authority. The US has several regulators with overlapping mandates, but the Securities and Exchange Commission (SEC) is the primary oversight institution for securities trading and describes its mandate almost identically to the FSA: "The mission of the U.S. Securities and Exchange Commission is to protect investors, <u>maintain fair, orderly, and efficient markets</u>, and facilitate capital formation" (SEC 2009, underlining added).

[6] The US Treasury called September 2008 "the most devastating month in modern financial history"; see http://www.financialstability.gov/roadtostability/faq.html.

These various sampling criteria narrowed the universe of regulatory publications into a specific data sample. The criteria are summarised in Figure 5-2 below. Some US institutions did not publish holistic reviews like their British counterparts. Instead the Securities and Exchange Commission (SEC) and Federal Reserve presented their analyses in a series of testimonies to Congressional panels. The SEC had 33 testimonies, 17 of which were selected for the sample on the grounds that they concerned pre-crisis banking practices, new financial markets regulatory reform, or systemic risk.

Figure 5-2. Regulation data collection scheme



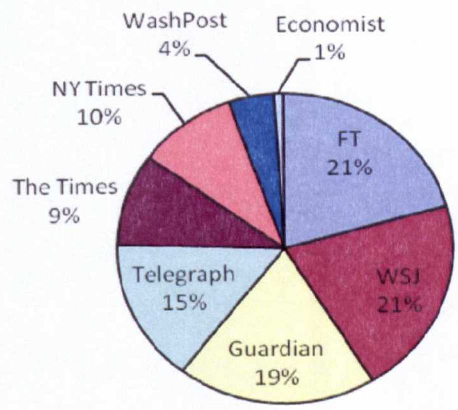
The dataset that resulted from these criteria is listed in Figure 5-3 below.

Figure 5-3. Regulation data sample

UK			
Treasury	Reforming Financial Markets	08 July 2009	UKT1
	Walker Review	01 October 2009	UKT2
Bank of England	Financial Stability Report: Safeguarding stability	01 December 2009	BOE1
	Financial Stability Report: Global Instability and Policy Response	01 June 2009	BOE2
	Financial Stability Report: Building a more resilient financial syste	01 June 2009	BOE3
	Financial Stability Report	01 October 2008	BOE4
	Role of Macroprudential Policy - Discussion Paper	21 November 2009	BOE5
UK Parliament	House of Commons Treasury Committee: Banking Crisis: Dealing v	24 July 2009	UKP2
	House of Commons Treasury Committee: Banking Crisis: Reformir	24 July 2009	UKP3
	House of Commons Treasury Committee: Banking Crisis: Regulatic	31 July 2009	UKP4
	House of Lords: Future of EU Financial Regulation	20 August 2009	UKP5
FSA	Turner Review: A regulatory response to the financial crisis	15 March 2009	FSA6
	Chancellor's response to Turner Review	27 March 2009	FSA7
US			
Treasury	Financial Stability Plan	01 March 2009	UST2
	Financial Regulatory Reform: A new foundation	17 June 2009	UST3
	Systemic risk legislation	22 July 2009	UST4
	Legislative text on OTC derivatives	11 August 2009	UST5
Federal Reserve	Cole Submission to the House (Risk mgmt in banks)	18 March 2009	FED1
	Bernanke Testimony to the House (Regulatory restructuring)	24 July 2009	FED2
	Bernanke Testimony to the House (Regulatory reform)	01 October 2009	FED3
US Congress	Senate: Restoring American Financial Stability Act of 2010	15 March 2009	USC1
	Senate: DODD: HOW DO WE PROTECT MAIN STREET FROM WALL ST	23 July 2009	USC2
	House: Corporate and Financial Institution Compensation Fairness	30 July 2009	USC3
	Senate: HEARING ON STRENGTHENING BANK REGULATIONS	04 August 2009	
SEC	Testimony Concerning Turmoil in U.S. Credit Markets: Recent	23 September 2008	SEC1
	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	SEC2
	Testimony Before the Subcommittee on Financial Services and Ge	11 March 2009	SEC3
	Testimony Concerning Mark-to-Market Accounting: Practices and I	12 March 2009	SEC4
	Testimony Concerning Lessons Learned in Risk Management Over	18 March 2009	SEC5
	Testimony Concerning Securities Law Enforcement in the Current	20 March 2009	SEC6
	Testimony Concerning Enhancing Investor Protection and Regulati	26 March 2009	SEC7
	Testimony Concerning Strengthening the SEC's Vital Enforcement	07 May 2009	SEC8
	Testimony Concerning the Oversight and Regulation of Executive	11 June 2009	SEC9
	Testimony Concerning Regulation of Over-The-Counter Derivative	22 June 2009	SEC12
	Testimony Concerning SEC Oversight: Current State and Agenda	14 July 2009	SEC13
	Testimony Concerning Regulating Hedge Funds and Other Private	15 July 2009	SEC14
	Testimony: "Regulatory Perspectives on the Obama Administratio	22 July 2009	SEC15
	Testimony Concerning Regulation of Systemic Risk	23 July 2009	SEC16
	Testimony Concerning "Protecting Shareholders and Enhancing Pu	29 July 2009	SEC17
	Written Testimony Concerning SEC Oversight of Credit Rating Age	05 August 2009	SEC18
	Testimony Concerning "Recent Innovations in Securitization"	24 September 2009	SEC19
EU			
EC	Report of the de Larosiere Group	25 February 2009	EC5
	Communication on 'Driving European Recovery'	01 March 2009	EC6
BIS			
BIS/FSB	Financial Stability Board response to Turner Review (Mario Draghi	27 March 2009	BIS1
	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	BIS2

After coding these documents and pinpointing how they analysed the concepts of CMR, I sought to understand the wider resonance of the regulatory debate. This had two stages. First I checked my coding log to identify which regulatory sources had provided the densest data – the most conceptual properties and dimensions. These publications could be said to be the most closely related to CMR because they contributed the most conceptual properties.[7] Then, I searched in the selected newspapers for all reports regarding those regulatory publications, within two weeks from their publication. The objective was to identify how the wider debate treated their ideas. The assumption behind this objective is that the financial media influences market expectations and behaviour over time (as discussed in Chapter 2, Section 2.4.2.1). Thus, media documents would help me understand which issues of CMR had become more salient throughout the sampling period.

Figure 5-4. Distribution of news reports, by publication.



The sample comprised 208 news reports regarding 11 regulatory publications, in the eight selected newspapers. The largest shares of data appeared in the *Financial Times* and *Wall Street Journal*, with British papers slightly more dominant (see Figure 5-4).

Analytical approach

As in previous chapters, it is useful to clarify the analytical approach because grounded theory methodology evolves at more advanced stages of research. At this point I have tentative propositions, and several working concepts. I now use selective, or focused, coding (Strauss and Corbin 1998: ch. 10; Charmaz 2006: ch. 3), to find new manifestations of these concepts. In grounded theory parlance, this means coding around the core concepts, aiming for "theoretical *completeness* – accounting for as much variation in a pattern of behaviour with as few concepts as possible thereby maximising parsimony and scope" (Glaser 1978: 95-6). I set out to recognise themes that previously emerged – both trends and contradictions – and then analyse how they differ from earlier episodes. For example, in this episode a concept or proposition may have entirely new properties than previous episodes. The role of remuneration and accounting for risk management are two examples.

[7] They were UKT2, BOE2, UKP3, FSA6, UST3, USC3, SEC2, SEC5, SEC16, EC5, and BIS2.

A particular analytical discipline was required for this chapter. The Credit Crunch brought a much broader controversy than the earlier episodes. Therefore it was important to ensure that coding focused on the right issues and that any new concepts "earned their way" into the theory, as grounded theorists put it (Glaser 1978; Charmaz 2006). In particular I focused on understanding banking practices that were directly related to orderly markets, or systemic risk. This meant downgrading data that referred only to institutional restructuring at regulatory organisations, for example, if this did not have direct implications for corporate practice.

Finally, a major theme in the regulatory debate fell outside the remit of my research, despite it relating both to systemic risk and corporate behaviour: capital adequacy reserves. It is a major issue of regulatory review that banks must hold much more (liquid) capital in reserve, and reforms are moving in that direction, under the umbrella Basel 2 process. The Bank for International Settlements, the lead institution in this process, identifies the key issues as follows (BIS2: 4-5):

- Increasing minimum capital requirements
- Establishing countercyclical capital buffers, requiring more reserves during good times, and fewer during bad
- The quality of the Tier 1 capital base, predominantly common shares and retained earnings
- Definition of various capital forms
- Appropriate leverage (debt) ratios
- Whether so-called "contingent capital" may be used as a 'shock-absorber' during crises

These highly technical discussions inhabit primarily quantitative finance studies rather than the political economy or sociological disciplines. My ability to interpret and analyse these issues critically is very limited. Accordingly, I leave liquidity standards to finance experts, but provide some input on responsible accounting practices as a higher-order management ethic.

5.2. Responding to the 'age of irresponsibility'

We need to encourage a tone and culture ... that mere compliance with the law, narrowly viewed, is not the highest goal to which we aspire, but the base from which we start.

US Securities and Exchange Commission[8]

For financial companies, many of which have returned to pre-crisis levels of profitability, the enduring fallout from the Credit Crunch is a slow and persistent regulatory re-think. Each of the four regulatory stakeholders in the US and UK – regulators, legislatures, finance ministries, and central banks – and the European Commission, has called for some form of regulatory tightening. The major investment banks have also offered to help fund an expansion of regulators' supervisory capacity, perhaps in the hope that this will ward off tough new rules.[9] Although the debate covers a wide range of specific and technical fields – reform of institutional mandates and institutions; capital adequacy standards; and business practices such as risk management – the myriad reviews, proposals, and theoretical ideas put forth to date all appear underpinned by the 'discovery' of systemic risk as a pivotal regulatory concern.

Before the crisis, regulators operated on the implicit assumption that regulating individual institutions' capital and systems mitigated generalised, multi-market risks. The interdependency of financial institutions did not figure highly in regulatory agendas. For the FSA, this is the main reason why regulators did not suitably address the issues that led to the crisis. "The reality of excessive risk can sometimes only be spotted at systemic level," it wrote (FSA6: 80). Pre-crisis definitions of systemic risk looked at the problem from individual institutions' point of view. Systemic failures were thought of as idiosyncratic concerns – losses to specific companies – and therefore the approach to systemic risk was vigilance at company level. By and large, regulators only addressed financiers' impact on market stability in isolated episodes such as the Citigroup and SWF episodes, or else criminal cases of market manipulation.

[8] SEC6: 14.
[9] The former head of Morgan Stanley, John Mack, told the Financial Crisis Inquiry Commission, "Well, I've said this and I think some of my colleagues have said this, that I think we need a regulator with bigger resources and a bigger budget to focus on that [financial complexity] and attract [experienced] people". See http://www.fcic.gov/hearings; video for 13 January 2010. Jamie Dimon concurred in a press conference later that day.

Systemic risk has become not only what the system does to companies, but also what companies do to the system. Now, "the future of banking regulation and supervision needs to be rooted" in a systemic approach, wrote the British regulator (FSA6: 52; also BOE5). A systemic risk is one that threatens the effective operation of the financial system as a whole (BOE5), or a core part of the system (FSA6), for example, when a failure by one institution leads to large losses for other institutions (IMF 2010).[10] As SEC Chairman Mary Shapiro wrote, "Throughout this crisis we have seen how traditional processes evolved into questionable business practices, that, when combined with leverage and global markets, created extensive systemic risk" (SEC11: 3). These corrosive activities are attributable to banks and similar institutions. The SEC and the UK Treasury write about the financial sector generally, with the latter's Walker Review of corporate governance employing the acronym BOFIs – banks or other financial institutions (UKT2). The FSA differentiates "institutions performing bank or bank-like functions" from those "performing non-bank financial activities, such as life insurance" (FSA6: 52). I follow the same conventions.

In this section I analyse how the corrosive practices that Shapiro referred to are now perceived, their potential regulation, and the implications for firms' responsibilities to the financial system.

The propositions about CMR developed earlier – on risk management, investment policy, and proactive improvement – structure the following analysis, and serve as section headings. I find that despite the intent to tighten regulation and the technical content of many of the key issues, regulators persistently raise importance of corporate employees exercising sound (subjective) judgement, and taking a share of responsibility for systemic risk maintenance. Accounting requires interpretation; independent committees need functional independence; systemic risk calls for shared responsibility. A distinction emerges between literal compliance and responsible compliance.

[10] The SEC also defines systemic risk as "the longer-term risk that our system will unintentionally favour large systemically important institutions over smaller, more number competitors, reducing the system's ability to innovate and adapt to change" (SEC14: 1).

5.2.1. Background: Pre-crisis economic and financial trends

"When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."

Chuck Prince, then-CEO of Citigroup, 9 July 2007, two months before Citigroup's liquidity crisis

For the purpose of contextualising the debate, the following paragraphs set out a factual baseline about the economic and financial trends that led to the crisis. The FSA's (2009b) summary of these trends is regarded as consensual (e.g. FSB2, EC5), and does not seek to assess the relative significance of the different factors in causing the crisis, merely to provide a narrative description.[11] As an economic explanation, the FSA account helps us to understand the crisis on its own epistemological terms.

The economic story begins at the turn of the 2000s, with global macroeconomic imbalances: yawning trade deficits in the US, UK and other large import-driven Western economies, matched by trade surpluses in China, oil-exporting countries and other export-driven Asian countries. These imbalances, driven in large part by high savings in China and low savings in the US, meant that foreign exchange reserves were accumulating very quickly in surplus countries' central banks. These reserves were invested mostly in very low-risk government bonds, rather than in equity, property or other assets (FSA 2009b: 2).

High demand for bonds led interest rates to fall to historic lows, with two major consequences. First, low interest rates fuelled the rapid growth of new borrowing in US and UK property/mortgage markets particularly. The credit standards of borrowers fell significantly, not least because the accompanying property price bubble "made those lower credit standards appear costless" (ibid). (I.e. it was thought that even if borrowers defaulted, their inflated properties would cover the cost of default.) Second, low interest rates fuelled "a ferocious search for yield" (investment returns); "a desire among any investor who wishes to invest in bond-like instruments to gain as much as possible spread above the [lowest-risk interest rate], to offset at least partially [that] declining rate" (ibid). This made "any products which appear to add 10, 20 or 30 basis points [hundredths of a percent] to that yield without adding too much risk look very attractive" (ibid).

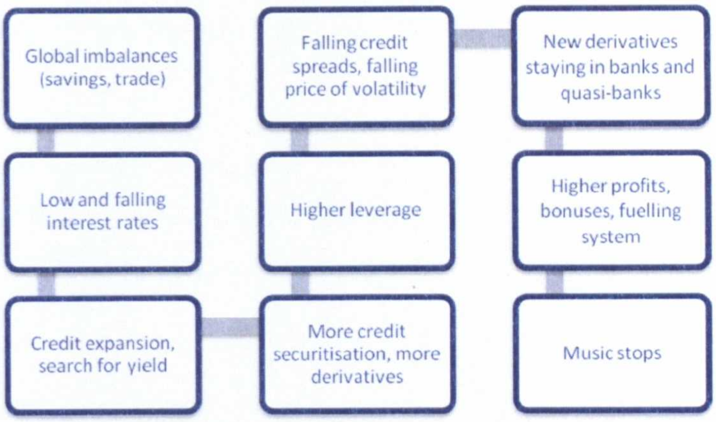
[11] The UK Treasury's Walker Review of corporate governance adopts a similar stylised approach (UKT2: 6). Literature attributing the crisis to specific issues is already extensive; see reviews in *Economist* 2009a, *Financial Times* 2009a, and *The Times* 2009a.

With this hunger for assets with higher yields, innovation in financial services became critical, particularly securitisation of credit assets, which led to new products. Banks and bank-like intermediators began "slicing and dicing" assets with different risk profiles and yields. They re-structured the various slices to create new assets whose value derived from the underlying risk exposure – assets known as structured credit derivatives. The underlying belief in banks was that derivatives could "'create value' by offering investors combinations of risk and return which are more attractive than those available from direct purchase of the underlying credit exposures" (op cit: 3). This led to an "alphabet soup" of credit products whose risks were defined by highly complex mathematical calculations that were not understood in many cases by the investors who bought the securities, nor even by senior management in the originating banks. The business model described here is referred to as the "originate and distribute" model for banks' credit business (ibid). However, it transpired that many risky securities were not distributed throughout the system but were held by the originating banks or their special purpose vehicles (shadow banks), resulting in a growing concentration of risk.

As a result of securitisation, the difference between yields of securities with very different risk profiles began to fall "to clearly inadequate levels" (ibid). In other words, even high-risk assets were offering the same low returns over time as lower risk assets; 'credit spreads' became narrower. One effect of falling credit spreads was to encourage even more securitisation of riskier (i.e. potentially higher yielding) assets and more complex derivatives whose underlying risk was difficult to account for. In addition, banks began to leverage investments (i.e. use borrowed capital) in historically high proportions. The median leverage ratio in UK banks was over 30-to-1 in 2007; that is, for every 30 units of capital they invested, banks borrowed 29 units. Deutsche Bank and UBS had leverage ratios of roughly 45-to-1 in 2007, rising to roughly 65-to-1 and 100-to-1, respectively, in 2008.

Across a range of instruments, credit risk appeared to be falling, "fuelling in turn higher apparent profits and higher bonuses, and as a result reinforcing management and traders' certainty that they must be doing the right thing" (ibid). This continued "Until", writes Turner, "we reached the point where people began to fear that the music was about to stop – but where others felt ... that they had to keep dancing until the band stopped" (ibid). That moment came in autumn 2007.

Figure 5-5. Trends leading to the financial crisis



This trajectory from macroeconomic imbalances to over-leveraging has a consensual description. Some, like Goldman Sachs's CEO Lloyd Blankfein (FCIC 2010), emphasise that a number of government policies encouraged higher home ownership and, by implication, were to blame for falling credit standards at banks, but the core processes described above are not in dispute.

5.2.2. Risk management

It is difficult to find a greater example of wishful thinking combined with hubris.

The British Academy, on pre-crisis risk management[12]

In many respects, the lead-up to the Credit Crunch is a story about risk management. Credit securitisation, derivative products, the use of leverage, and the retention of certain capital assets on the balance sheet, all relied on understanding the risks in the underlying assets. According to the FSA, there was a "misplaced reliance on sophisticated maths" (FSA6: 16). Complex mathematical formulas were assumed to be reliable and 'soft' subjective judgement was often considered unsystematic. This faith in hard maths and atomistic economic doctrine (whereby the system was assumed to be the sum of its corporate parts) eventually proved unreliable because markets failed. Reviewing data post-crisis regulatory debate, one finds frequent references to the importance of soft judgement in normally hard risk management. One might say that there was an abrogation of traditional management responsibility, because discretionary decision-making was transferred to 'automated' mathematical models. The data does not simply call for more subjective judgement over mathematical calculus, however. Rather it argues that a subjective ethic, or judgement principles, should run through even technical risk management processes – such as deciding which accounting rules to apply in particular situations, or which scenarios to stress-test against. What

[12] British Academy (2009: 2)

makes these principles relevant for CMR is the fact that they arise in discussions of how better to ensure orderly financial markets.

Below, I review how this debate contributes to our understanding of responsible risk management, in the areas of corporate governance, fair accounting, remuneration, and stress-testing, all of which were highly prominent in the data. This analysis then extends to the role of innovation and compliance.

5.2.1.1. Corporate governance

The impact of corporate governance on risk management was as significant a priority in the wake of the Credit Crunch, as it had been in the other episodes. The UK Treasury published a review of corporate governance standards (the Walker Review, UKT2) whose tone is similar to the other sources. The notion that specific prescriptions cannot wholly replace good discretionary judgment is pervasive. The Walker Review stated that,

> "Good corporate governance overall depends critically on the abilities and experience of individuals and the effectiveness of their collaboration in the enterprise. Despite the need for hard rules in some areas, this will not be assured by overly specific prescriptions that generate box-ticking conformity. So while some of [our] recommendations are relatively prescriptive ... most set parameters within which there is need for judgement and appropriate flexibility" (UKT2: 7).

The extent to which boards show good judgement and flexibility also determines potential changes in regulation: "the ability of the regulator to stand back and leave space for significant new initiative and enterprise will necessarily depend on a positive supervisory assessment as to the quality and capability of a board, in discharging its essential obligation in relation to risk" (UKT2: 92). A greater onus is placed on firms with higher systemic significance (UKT2: 91). Throughout, the data suggests that the balance of regulatory risk rests on the extent to which firms and regulators *pursue shared objectives.*

There is considerable overlap between discussion of risk governance in this episode and in others. This is to say, several issues are given the same prominence and level of granularity. One case is the need to *establish a risk management framework* that specifies risks to be monitored and lines of responsibility and is *disclosed* and *externally monitored.* This episode also emphasises *assessing market-relevant risks* (leverage, liquidity, interest rate and currency, etc) rather than several company-specific risks (IT, business continuity, and reputation risk), on the grounds that the former are the "'fundamental' prudential risks of the institution" (UKT2: 95). New dimensions also emerge in this episode. Although previous episodes emphasised *escalating risk strategies to senior management*, regulators in the post-crisis debate specify *boards being directly accountable* for risk decisions. In particular, *creating a risk committee, setting overall risk appetite, having a chief risk officer with enterprise-wide remit*, and *non-executive directors challenging 'groupthink'* (UKT2: 90-105) are boards' responsibilities. Therefore, the key process that was *escalating* lower-level strategies, evolves into *integrating high-level objectives with lower-level strategies*, in this episode.

Another new dimension that emerges is about the future. One of the propositions already established in earlier chapters is that a good risk management system should anticipate the (systemic) impact of investment transactions. A similar, forward-looking, hypothetical dimension emerges here. Several financial institutions had adopted a view of risk management as audit. That is, risk management involved assessing the risks posed by current (or past) investment decisions. In the UK, an explicit focus on future risks emerged (e.g. FSA6: 22, 44; FSA 2008b). The British government's review of corporate governance (UKT2) made several recommendations on *establishing a board risk committee* that would be separate from an audit committee. A "key priority" would be "to give clear, explicit and dedicated focus to current and future-looking aspects of risk exposure" (p. 95). *Taking a forward-looking view* of risk entails changes to a wide range of activities, including accounting and stress-testing, which I address below. In addition, it reinforces the need for discretionary judgement and challenging 'groupthink'. In this context, risk management expands to capture uncertainty, with financial institutions compelled to identify also which risks are unknown (see FSA6: 44).

Figure 5-6. New properties and (dimensions) of *Operating a sound risk management system*

Aligning high-level objectives with mid-level strategies

Promoting board's accountability
Creating a risk committee
Setting strategic risk appetite
Appointing enterprise-wide CRO
Appointing independent NEDs
(groupthink, forward-looking)
Establishing 'fitness' standards for directors
(honesty, competence)
Taking a forward-looking view

In the US regulatory debate, corporate governance was addressed in depth by fewer institutions. The Obama administration's white paper on financial reform (UST3) and the Federal Reserve data (FED1-3) had a strong focus on governance at regulatory institutions but not in corporations. The issue was taken on more extensively by the Senate and the SEC. The Senate's *Restoring American Financial Stability Act 2010* emphasised corporate governance requirements for firms involved in dealing derivatives. According to the bill, each firm should:

> "*establish governance arrangements that are transparent* in order to fulfil public interest requirements and to support the objectives of owners and participants [...]
>
> *establish and enforce appropriate fitness standards* for directors, members of any disciplinary committee, and members of the organization [...]

establish and enforce rules to minimize conflicts of interest in the decision-making process of the organization and establish a process for resolving such conflicts of interest [...]

ensure that the composition of the *governing board or committee* *includes market participants*" (USC3: 571-2, emphases added).

These succinct recommendations rely on corporate discretion to tend to the "public interest" and more specifically to other "market participants". This is notable both because it takes place in an American legislative environment, where regulation is based on prescriptive rules, but also because it applies to firms where mismanagement of risk was extensive. In that environment, the extent of this reliance on corporate responsibility for financial stability is notable.

The SEC addressed corporate governance in the context of accounting rules, to which I now turn.[13]

5.2.1.2. Fair accounting

Accounting methods featured prominently in the assessment of bad practices that led to the crisis and prolonged it. Accounting is a highly specialised discipline whose natural habitat is the study of finance rather than political economy or sociology, and one to which the latter can offer only limited insight. However, accounting is also an inexact process that requires frequent qualitative judgement (see Power 2004). To this end the SEC, itself a rules-based regulator, has published extensive guidance "about how accounting standards should be applied in particular situations" (SEC7: 4), "to assist those responsible for making fair value measurement judgements" (SEC3: 5). The balance of benefits and risks associated with 'fair' accounting is a delicate one. Insofar as accounting requires qualitative human judgement, because straightforward rules are not always available, and insofar as the purpose of accounting is to provide transparency to markets, then it stands to reason that finance companies have a responsibility to *strive to account 'fairly'*.

In this vein, the SEC advances several corporate governance protocols to support it. "Given [mark-to-market's] critical contribution to the integrity of valuation and books and records," it states, "[independent management] supervisors must engage fully in *understanding the price verification controls* at financial institutions, ensure that it is *well resourced*, has *independent authority* to push back on the business line valuations, and is in ready communication with and has the active support and *investment of firm senior management*" (SEC5: 5). In short, good accounting, however numerate, requires the discipline of sound, responsible corporate governance.

[13] Although the substance of CMR is management protocols, rather than corporate structure or actions (see Chapter 4, Section 4.4), note that regulators in this episode emphasised corporate structure in some depth, such as rules for electing directors to various governing bodies in firms (USC3: 895-900), accountability of non-executive directors (UKT2: part 2, UKP3: 10), and reporting lines to and from the Board particularly (EC5, UKT2, USC3, SEC5, SEC9).

Accounting and risk management practices generally have relied heavily on credit ratings for capital products, and the agencies that provide those ratings have come under scrutiny because they underestimated the risk of many credit derivatives that subsequently failed.[14] What I will address here are the risk management rules in financial institutions for the use of credit ratings. As the FSA put it, "The use of ratings-based investment and cash management rules by individual companies [...] is entirely rational at the idiosyncratic level and it is very difficult to imagine how many institutions could operate without such decision rules" (FSA6: 79). In principle, credit ratings systemise how institutions assess credit risk, and ratings were largely accurate before the advent of complex derivatives (FSA6: 43). The challenge is to ensure that internal (idiosyncratic) rules on the use of ratings do not increase procyclicality in the system unduly.[15] To this end, once again discretionary judgement is paramount. Companies should *limit reliance on credit ratings only for securities where a consistent rating is possible* (FSA6: 8). Moreover, in line with the SEC's recommendation above, companies' risk analysts should operate independently from "commercial revenue maximising objectives" (FSA6: 78), and *push back* on trading decisions based on credit ratings that may not be consistent. In addition, the BIS has agreed *good-practice due diligence* principles to reduce asset managers' reliance on credit ratings (BIS2: 3). Most of the issues arising from credit ratings in this episode relate to the agencies themselves, however, and their supervision by regulatory authorities (FSA6: 78-9, UST3: 45-5, 87-8; SEC7), who should themselves rely less on ratings (UST3: 45).

Figure 5-7. The category *Doing accounting fairly*, properties and (dimensions)

Understanding value verification controls
Having support of senior management
(resources, independent authority)
Limiting credit ratings to where they apply
(authority to push-back on transactions)
Monitoring risk over time (mark-to-market)

5.2.1.3. Remuneration and risk-taking

High levels of remuneration in the financial industry, particularly the *awarding of performance-related bonuses*, courted intense regulatory and political scrutiny because they could encourage excessive risk-taking. The FSA argued that while other factors like approaches to accounting were more important for risk management, "There is a strong prima facie case that inappropriate incentive structures played a role in encouraging behaviour which contributed to the financial crisis"

[14] There is a debate about how to regulate credit ratings agencies in their own right, but I focus here on how banks and other financial institutions use ratings in their risk management.

[15] Procyclicality in credits ratings occurs when, for example, a ratings downgrade for a certain institution then inhibits that institution from raising further capital, thus making default more likely. Thus the rating itself precipitates the default. The liquidity strain that AIG faced after a threatened downgrade in September 2008 is an example.

(FSA6: 80). "[Past] remuneration policies ... resulted in large payments in reward for activities which seemed profit making at the time but subsequently proved harmful to the institution, and in some cases to the entire system," it said (ibid). Regulators had not previously addressed this issue and firms had focused on the impact of remuneration on inter-firm competitiveness (attracting talent) but not on balance sheet risk (ibid). Like in Britain, the US regulator emphasised the importance of reforming executive compensation for *safeguarding companies' long-term interest*. As a result of the systemic failure, the SEC began considering "a broad package" of new compensation-related guidance and regulation (SEC9: 4). In Britain reform proposals arrived more quickly.

The FSA emphasised six principles for *aligning remuneration with risk management practices*. The first principle is that the alignment should happen. This became a formal rule for "systemically important companies", a designation that, as in the Citigroup and SWF episodes, emphasises the special responsibilities of large institutions. More specifically, the second principle holds that remuneration committees should *provide independent judgements* on the impact of company remuneration policies for the company's risk exposure. Thirdly, "remuneration should *reflect an individual's record of compliance with risk management procedures*", not only their financial performance (FSA6: 80). Fourth, the profit metrics used to determine compensation should *reflect the risk profile of the transactions* (ibid). The majority of performance-related bonuses should be *paid in a deferred form* and, finally, this deferment should *be linked to the transactions' financial performance* (ibid). As is typical with the FSA, this regulation took the form of principles that companies are expected to use to guide their risk and corporate governance policies. In addition to these principles, the Financial Stability Board (Bank for International Settlements) also called for *limiting guaranteed bonuses* (FSB2: 9).

Figure 5-8. The category *Alignming remuneration with risk management*, properties and (dimensions)

Assessing its impact on risk exposure
Aligning it with compliance record
Aligning it with risk profile of trades
Making deferred payments
(stock options, dates of maturity)
Limiting **guaranteed** bonuses

5.2.1.4. Stress-testing and moral hazard

In risk management, a firm's stress-tests assess whether the firm has enough capital to withstand a hypothetical crisis scenario. For example, a stress-test could measure how the company would fare in a deep economic recession, or following defaults by a cross-section of borrowers, or in the midst of a systemic failure. Stress-tests can also be used to design responses to operational issues, such as IT failure.

Goldman Sachs CEO Lloyd Blankfein told the US Financial Crisis Inquiry Commission (FCIC 2010) that moving stress-tests up the risk management agenda was one of the most important lessons that the bank had learned from the crisis. Stress-testing was not as extensive before the crisis, and when it happened it was often based on mild or wrong assumptions (EC5: 8). Instead, risk managers confided in techniques that measured the future value-at-risk (VAR) of their risk exposures. In VAR modelling, according to the FSA, "the underlying methodological assumption was straightforward: the idea that analysis of past price movement patterns could deliver statistically robust inferences relating to the probability of price movements in future" (FSA6: 44). Accordingly, banks thought that they had a good assessment of the likely risks they faced. However, the assumption that events in financial markets have a similar distribution of frequency/severity as other phenomena is not supported by evidence (see Taleb 2004, 2007). In financial markets, high-severity events may be more frequent than VAR calculations indicate. In addition, they appear to be characterised by randomness (Taleb 2004); that is, more unexpected, as well as more frequent. On this and other bases,[16] stress-testing 'what-if' scenarios emerged as a fundamental risk management activity.

I have found suggestions of negligence or moral hazard in banks' choices of *which* scenarios were modelled. In the opening quotation of this chapter, JP Morgan's Jamie Dimon states that crises are "unsurprisingly" cyclical and that the one scenario JP Morgan did not consider was falling house prices. Here is that second quotation in full:

> "The [risk management] process is very rigorous, if you look at risk we have a separate pricing group, internal audit, external audit, reviews by the OCC and the Fed, and if you had a chance to look at those things you'd be pretty impressed by the diligence behind that process.
>
> "As a company we always did some stress testing because history tells you that things go bad in the market and you have to be prepared. And looking back ... the biggest mistakes we made, somehow in mortgage underwriting, we just missed that home prices don't go up forever. ... We stressed [tested] almost everything else, but we didn't say 'home prices going down 40%'" (FCIC 2010: 01:53:00).

Brian Moynihan, head of Bank of America, which bought Merrill Lynch to save it from bankruptcy, stated something very similar:

> "If you ask what we thought we missed I think it would be similar to what Mr. Dimon said, which is ... we didn't do the kind of testing you actually do on a trading book, saying, what if housing goes down 40% and test what your thought would be, and how best you protect your firm, and I think that's the best lesson we've learned" (FCIC 2010: 01:56:00).

Both banks ostensibly missed the falling house prices scenario, even though, among others, the Bank for International Settlements (BIS), which oversees international banking policy coordination, warned in its 2003, 2004, 2005, 2006, and 2007 Annual Reports that a downturn in housing prices

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[16] See FSA6: 44-45, 58-59; SEC1; SEC5.

was a significant risk for the financial sector (see Chapter VII of each report). Yet the banks only stress-tested "almost everything else". One possible explanation is that they failed to *exercise due skill, care and diligence*, in contravention of the FSA's Principle 2. Another is that they perceived an implicit guarantee that the state would capitalise major banks in case of crisis, to prevent a systemic meltdown. In the latter interpretation, banks felt that they were 'too big to be allowed to fail'. A stress-test would have revealed significant vulnerabilities; the lack of a stress-test would create 'plausible deniability' and enabled senior managers testify, as they did, that they were unaware of these vulnerabilities. We could characterise either a lack of due skill or this moral hazard as irresponsible, especially given the various warnings and the magnitude of risk.

Regulatory proposals have now recommended almost uniformly that some stress-test scenarios should be provided by regulators (e.g. FSA6, UST2, SEC1, BOE1). This represents an increase in the regulatory risks faced by financial institutions. These tests will take into account the existing systemic position as well as how individual institutions might react in crisis scenarios. Regulators have also extended responsibility for best-practice stress-testing to companies (perhaps in the hope of deflecting criticism to companies if/when another crisis occurs). For example, the FSA now recommends a "reverse stress-testing" approach whereby firms explicitly identify the areas where they are most vulnerable and design scenarios that show how negative impacts would play out (FSA 2008b: Ch. 3; also UKT2: 97). Among some of the issues discussed are the expectations that banks and other financial institutions *promote imaginative thinking* when designing scenarios (BOE2); *contemplate complete systemic meltdown* (SEC1); *contemplate shocks not only to the firm but to other firms of which it is a group* (FSA 2008b); *assume no government bailouts* (SEC1); *incorporate short, sharp shock scenarios* (SEC1); *improve disclosure* (BOE2); and *inform firms' risk-appetite* (BOE2, UKT2), particularly *"pre-identification of trigger-points for review and revision of [business] strategy"* (FSA 2008b: 25). In the latter respect, stress-tests become an input for broader investment policy.

Figure 5-9. The category *Improving stress-testing*, properties and (dimensions)

Identifying vulnerabilities first and testing them, ie. 'reverse stress-testing'
Promoting imaginative thinking for new scenarios
(NEDs, internal departments)
Contemplating systemic breakdown
(length, intensity of shocks)
Contemplating shocks to peers
Assuming no government bailouts
Improving disclosure
Linking tests with risk appetite
(trigger points, reporting channels)

5.2.3. Investment policy: Choosing business activities

How a firm's choice of business activities might impact on systemic risk also emerged as a corporate responsibility issue in the previous episodes. Then, we saw the expectation that companies would operate an investment policy with transparent commercial objectives and risk tolerance. Citigroup was criticised for seeking to undermine the quote-driven Eurobond market and transform it into a US-style order-driven market, where there is less transparency, through their bond trading. The German regulator BaFin regarded that objective as "not investment driven" (WSJ18). A central public concern about SWFs was that they might have investment objectives or strategies that were not purely commercial. Best-practice for the choice and pursuit of business activities was coded as *operating a transparent investment policy* that was driven by returns on invested assets, had an acceptable risk tolerance, had benchmarks against which to evaluate transactions, systems to monitor asset allocation/exposure, and was disclosed and auditable (Figure 4-20).

This proposition evolves in the post-credit-crunch debate. The manner in which certain business practices and innovation were pursued was seen to have implications for broader market stability, and consequently led to higher regulatory scrutiny. The expectation emerged that a firm's impact on the wider system should influence it in *choosing business activities*. Short-selling, and innovation more generally, are two such activities.

5.2.1.5. Short-selling

"There are practices that are contrary to fair and orderly markets; abusive short selling, for example, would fall in that category," wrote the SEC (SEC7: 3). Short-selling means betting that an asset's price will fall. To short-sell company shares, for example, traders borrow the shares from shareholders, sell them on the open market, wait, re-buy them at a lower price (assuming the bet is successful), and return them to the original owners with a small premium. The difference between the sell price and the buy price, minus the premium paid to the original shareholder, is profit. In economic theory, there is merit to this practice because it enables markets to discipline asset prices quickly, gives the market liquidity, and provides a hedging tool for risk management. However, wrote IOSCO[17] in a statement to the G-20:

> "short-selling may be problematic in the midst of a crisis of confidence. For example, in a context of a credit crisis where some entities face liquidity challenges, but are otherwise solvent, a decrease in

[17] The International Organisation of Securities Commissions is an association of financial regulators from around the world, who together supervise over 90% of global securities trading. It works closely with the Bank for International Settlements, which is in effect an association of central bankers and was mandated by the G-20 to coordinate international research into crisis response.

their share price induced by short-selling may lead to further credit tightening for these entities, possibly resulting in bankruptcy. In addition, there are circumstances in which short-selling can be used as a tool to *mislead the market*. For example, short selling can be used in a downward manipulation whereby a manipulator sells the shares of a company short and then spreads lies about a company's negative prospects. This harms issuers and investors as well as the integrity of the market" (IOSCO 2008: 2; italics added).

In addition, *aggressive short-selling* by a group of funds can become a self-fulfilling bet without misleading rumours being spread. The practice became contentious during the crisis because bank equities came under extreme pressure from speculators.

Regulatory and political scrutiny focused on *"naked" short-selling*, where traders do not borrow the securities they are shorting, but instead look to acquire them after they have undertaken the sale. (Many trades are only settled at the end of the trading day, giving sellers some time to buy the traded security.) If the seller is unable to acquire the security, the transaction fails. It was therefore possible to sell certain shares non-stop, provided that one could demonstrate subsequent attempts to acquire the shares. These attempts would ostensibly prove that the motive was not market manipulation[18], but in many cases the damage was already done, from a regulatory perspective, because the price of the asset would have fallen as other traders observed a higher supply of those assets on the market.

There is a clear trade-off between responsible business and regulatory risk when it comes to short-selling. Regulators restricted the most threatening form of short-selling on the grounds that it threatened market stability, and there are grounds to suggest that conventional short-selling would also be restricted if it had a bad effect on market stability, particularly if it were driving down the value of bank shares. Short-selling was an established practice before the crisis, rather than a new discovery. In 2008, when Lehman Brothers and Bear Stearns went bankrupt, extensive short-selling of bank shares became seen as abusive and EU and US regulators temporarily suspended it. In 2009 most regulators internationally restricted naked shorting permanently by tightening requirements related to end-of-day transaction settlements, and increasing pre-trade borrowing requirements (IOSCO 2008, SEC7). The SEC considered proposals to reinstate the uptick rule, which stipulated that the price of a conventional short-sale had to be higher than the last traded price of the security. The FSA was given powers to suspend short-selling unilaterally and independently of any changes to the EU's market abuse directive (UKT1: 66). The German government banned certain forms of naked shorting outright in 2010. The trajectory here has been progressively tighter regulator driven by the threat that short-selling can pose to orderly financial markets, notwithstanding its benefits.

[18] See Chapter 3, Section 3.3.2 on market manipulation and other forms of market abuse.

This gives us grounds to hypothesise that conventional shorting could be more tightly regulated or banned if it disrupted markets further. The practical implication is that if financial firms witnessed a 'run' on the shares of another company (especially a bank), then they would be implicitly expected to *consider suspending shorting that asset*. Due to momentum effects, that suspension could mean *foregoing profits* whilst its competitors pursued the business opportunity, so this would be a very difficult decision for any company.

This is where transparent and auditable investment policies apply. Such a policy relates to the choice of investment activities and the way in which they are pursued. A policy that *stipulated the risk tolerance* and *clear parameters for transactions* (per my original definition of a responsible investment policy; Figure 4-20) could delineate a firm's attitude toward short-selling clearly. As a generalised practice, these policies could resolve the coordination problem where individual firms are reluctant to suspend short-selling because their competitors are continuing to profit from that opportunity. Thus investment policies that *defined clear parameters for short-selling* could both reassure regulators that this potentially healthy practice would stop in situations where it became detrimental to the system, and resolve coordination failure in the industry to help provide (market stability as) a public good. The latter is, after all, a purpose of many industry-led voluntary standards (Haufler 2000).

5.2.1.6. Innovation

One of the major strengths of a market economy is its capacity to incentivise innovation, which leads to economic growth and development opportunities. The market mechanism is generally assumed to promote good innovation and demote bad, with the state occasionally stepping in when the market fails. The key metric for distinguishing good and bad innovation is typically consumer demand. However, the post-crisis debate has brought a new dimension to the "two sides to innovation" (SEC14: 3). FSA Chairman Adair Turner summarised the debate thus:

> "Now of course, if you are an extreme Chicago school economic liberal [you will argue that] if the industry grew dramatically in the decade to 2007 that must be because it was performing value added services: if complex product innovations were able to sustain themselves economically, they must have been socially useful innovations. But after what has happened, I think we know that that is not the case. I think we know that imperfections and irrationality in financial markets which are not fixable just by disclosure, but are inherent, mean that financial innovation which delivers no fundamental economic benefit, can for a time flourish and earn for the individuals and institutions which innovated, very large returns.
>
> "Not all innovation is equally useful. [...] And in the years running up to 2007, too much of the developed world's intellectual talent was devoted to ever more complex financial innovations, whose maximum possible benefit in terms of allocative efficiency was at best marginal, and which in their complexity and opacity created large financial stability risks" (FSA 2009b: 14-5, underlining added).

Whereas Turner emphasised the societal utility of financial innovation here, his SEC counterpart Mary Shapiro made the point at a commercial level: "At their worst, the self-interests of financial engineers seeking short-term profit can lead to ever more complex and costly products designed less to *serve investors' needs* than to *generate fees*" (SEC14: 3). The UK Treasury emphasised the SEC's argument: "Innovation seems to have led to the development of *large ranges of subtly different products* rather than to *increasing market focus* on the types of products which consumers might reasonably be expected to want" (UKT1: 158). Firms' ability to create new mortgage products for subprime consumers and opaque structured credit derivatives was a major cause of the crisis (UKT1: Ch. 3). The negative aspects of innovation in this episode are not new. Citigroup's extraordinary transaction was controversial in part because it was so innovative, a property that featured in proposition regarding when CMR was most important (Table 4-18).

Pre-crisis innovations were closely associated with what the public debate termed *'irresponsible lending'*. The SEC's then-Chairman Christopher Cox was bullish on this point:

> "It is abundantly clear [...] that if <u>honest lending practices</u> had been followed, much of this crisis quite simply would not have occurred. [...] This is typified by the notorious no down payment loans and 'no-doc' loans in which borrowers not only didn't have to disclose income or assets, but even employment wasn't verified.
>
> "Securitisation of these bad loans was advertised as a way to diversify and thus reduce the risk. But in reality it spread the problem to the broader markets" (SEC1: 2-3, underlining added).

Cox stated that derivatives "fuelled" the crisis, but poor lending practices "created" it (ibid). The issue here is not only risk management, therefore, but rather how new products are developed and marketed. Many of these loan products were judged to be "unfair", "abusive", or "deceptive" (UST3: 58). One of the most contentious was so-called exploding mortgages, which had no or very low interest rates for the first years that subsequently 'exploded'. In order to lock in profits, some lenders *prohibited borrowers* from repaying any principal on their debt in the early years or imposed extremely high early repayment fees.

The problem with these consumer-facing products is the same as the inter-bank problem raised by Shapiro; that they do not serve consumer or investors' interests so much as generate income. This brings to mind Citigroup's apology for its transaction, where the head of global capital markets said, "We must *exercise sound judgement, know our markets and our clients well and act in their best interests*" (FT28). Knowing clients well and acting in their interests applies to *assessing their creditworthiness* and *selling them appropriate products*. Knowing markets and acting in their interest applies to *ensuring that risk is not misunderstood* and spread opaquely throughout the system. Exercising sound judgement is a general principle that is essential to *promote systemic stability* because there is a limit to how much responsibility regulators can take for regulating innovation, given that innovation is a driver of corporate growth and profitability. In fact, the problems of innovation have led to deeper regulation of derivatives, particularly the $58 trillion credit default swap market which, according to the SEC is "completely lacking in transparency and completely unregulated" (SEC1: 2; see BIS2). The enduring need for corporate responsibility, and its similarity to the Citigroup episode, are also clear from this analysis. Whatever regulation is enacted, it is unlikely to succeed without sound judgement.

Figure 5-10. New properties and (dimensions) of *Operating a sound investment policy*

Choosing business activities Establishing clear parameters for short-selling *(risk appetite, foregone profits)* Innovating for customers'/investors' true needs *(product differentiation, true demand)* *(consumer knowledge, freedom)*

5.2.4. Proactive improvement: Literal v. responsible compliance

The ethos of disciplined innovation is thus closely associated with the expectation that financial firms improve their shortcomings proactively. In the Citigroup and SWFs episodes, this expectation of proactive improvement was evident even though no specific regulation had been contravened and when the perceived costs of the shortcomings were limited to the company. In the Citigroup case, the FSA decreased its fine because Citigroup had, between the trade and the FSA investigation, taken steps to communicate its corporate values to staff, re-trained staff in ethical standards, invested in information-reporting quality, and strengthened its compliance department. SWFs, for their part, were encouraged to create a code-of-conduct proactively and stick to it rather than face new regulation. After the Credit Crunch, several dimensions of proactive improvement emerged in relation to risk management and compliance itself.

A regulator-driven imperative to strive continuously to improve is as surprising, from an economic perspective, as the principle that businesses should "demonstrate due skill", the FSA's second principle which I discussed in Chapter 3. One would infer from economic theory that companies who do not strive to improve – or demonstrate due skill – will succumb to greater competition. However, what emerges from a regulatory perspective is that companies who do not improve proactively put the entire system at risk, not only themselves. The Walker Review on Corporate Governance (UKT2: 92) made this point by writing, "A BOFI [bank or other financial institution] board that failed to *draw on the experience embedded in [best-practice risk management] techniques* to ensure that appropriate management and control processes are in place would be in breach of its responsibilities". More is at stake in corporate governance than the firm. The system relies on good practice.

In this vein, proactive improvement should involve *good judgement in complying with new regulation*. Throughout the thesis I have referred to CMR being a requirement above and beyond compliance, by definition. This is because the Citigroup and SWF episodes showed an expectation of CMR behaviour despite strict compliance having been observed. While that data helped me to define specific activities that comprise CMR, and in which situations they applied, the data did not specify how much the overall requirement of CMR varied with the overall specificity of regulation. We could have hypothesised that CMR requirements are constant however specific regulation is; or that that there is zero-sum trade-off between regulation and CMR. (There is a frequent assumption of zero-sum trade-offs between formal regulation and self-regulation, of which CMR is a form.) Data in this episode suggested that the requirements of CMR vary with the specificity of regulation, but do not amount to a zero-sum trade-off. In some cases, CMR may even rise with the specificity of regulation (although the data does not indicate when this would be most likely). The key point is that however specific and prescriptive new regulation is, it requires discretionary, and responsible, interpretation.

The more surprising data source to communicate this was the Securities and Exchange Commission, which is a rules-based, 'hard compliance' regulator. It concluded one of its testimonies on "Securities Law Enforcement" with the statement:

> "...we need to encourage a tone and culture, especially among those who make their livings from other people's investments, that mere compliance with the law, narrowly viewed, is not the highest goal to which we aspire, but the base from which we start. The securities industry as whole needs to *embrace this compliance culture*, and in each firm, the tone must be set at the top. We should all work toward a system where those who work in it are responsible stewards of the assets entrusted to them" (SEC6: 14-5).

The US regulator pointed to the importance of sound discretionary judgement in implementing new rules. "In order for markets to function properly", it stated, management must ensure they are providing shareholders with "*adequate information* about their companies" and allowing them to "*exercise effectively their rights to elect directors*" (SEC9: 1-2, formatting added). Disclosure and voting rights are strict regulatory requirements, but the added expectation is that senior management will tailor implementation to the company's particular situation and the good functioning of the market. For example, disclosed information must be "straightforward, understandable, and meaningful" (ibid). UK authorities, which tend to favour principles-based regulation, emphasised the point: "Despite the need for hard rules in some areas, this [good corporate governance] will not be assured by overly-specific prescription that generates box ticking conformity. So while some of [our] recommendations ... are relatively prescriptive, for example on the [role of the chief risk officer], most set parameters within which there is need for judgement and appropriate flexibility" (UKT2: 7). These statements are especially meaningful in the context of high pressure to tighten regulation under which they were written. If there were a

Figure 5-11. The category *Responsible compliance*, properties and (dimensions)

Pursuing shared objectives with the regulator
Pursuing best-practice techniques
Enabling a compliance culture
Setting tone at board level
Providing genuine adequate information
Demonstrating sound judgement
(literal compliance, responsible compliance)

context in which we would expect a hard regulatory approach looking to 'leave nothing to chance', this would be one.[19]

This analysis adds a new property to *proactive improvement* category – *demonstrating sound judgment complying with regulation*. It is tempting to label two dimensions of this property as *minimum compliance*, which seeks the lowest-cost compliance solution, and *responsible compliance*, which seeks to meet the goal of the regulation, within the parameters set by the latter. This would suggest that responsible compliance is nearly always more costly than minimum compliance, because it requires an additional judgment. That might sometimes be the case in the US, where the emphasis is on following specific rules (see, however, Ayers and Braithwaite 1992: 120-123). In European corporate governance (including some risk management and business policy rules), the minimum/responsible compliance dichotomy is less applicable because the general principle is "comply or explain" (UKT2: 38, EC 2006). If companies choose not to comply with a corporate governance guideline they can explain why, both to their shareholders and the regulator. The FSA has said it will be dedicating more time to assessing large banks' submissions on these points. As a result of "comply or explain", responsible compliance may be less costly than minimum compliance, if we define the latter as looking to follow the letter of the law. Therefore, the two dimensions of *sound judgment in compliance* could be termed *literal compliance* versus *responsible compliance*. This dichotomy integrates well with several existing theories, which I discuss in the next chapter.

[19] Indeed, then-SEC Chairman Christopher Cox stated in testimony that "We have learned that self-regulation does not work" (SEC2: 5).

5.2.5. Additional issues: Systemically important companies

Throughout this analysis, the primary actors in the CMR debate have been broadly defined, with a similar stylised approach as the UK government, which refers to "banks and other financial institutions (BOFI)" in its corporate governance review (UKT2). Many of the pre-crisis failures originated in "quasi-banks", as the FSA put it, or the "shadow banking system", in the US government's language. These institutions were sometimes special purpose vehicles where banks deposited their risk; other times they were mortgage brokers who effectively acted as lenders (WP35); some marketing companies had such long-standing contracts with banks that they were effectively an extension of their bank clients; hedge funds were involved in short-selling. The key differentiator in the regulatory debate, for which companies merited special attention, became their "systemic importance".

Figure 5-12. List of BIS-designated systemically important companies (FT 2009b)

US
Bank of America Merrill
Citigroup
Goldman Sachs
JPMorgan Chase
Morgan Stanley
Canada
Royal Bank of Canada
UK
Barclays
HSBC
Royal Bank of Scotland
Standard Chartered
Switzerland
Credit Suisse
UBS
France
BNP Paribas
Société Générale
Spain
BBVA
Santander
Japan
Mitsubishi UFJ
Mizuho
Nomura
Sumitomo Mitsui
Italy
Banca Intesa
UniCredit
Germany
Deutsche Bank
Netherlands
ING
Insurance groups
Aegon
Allianz
Aviva
Axa
Swiss Re
Zurich

Under US legislative proposals, the degree to which a company is systemically important depends on its size, degree of interconnectedness, and degree of leverage (debt) (UST4). Tier 1 financial holding companies (FHCs), as they are called, are set to be supervised specifically by the Federal Reserve, in the US, and face higher regulatory rules and standards. The US Treasury wrote, "These standards will be set with a focus on the risks that these firms could pose to the financial system as a whole, not just the risks to each institution" (ibid). The *Financial Times* (2009b) reported that it had obtained a confidential list of the 30 most systemically important companies, as designated by the BIS, reproduced in Figure 5-12. They are mostly banks.

The BIS takes the view that "regulation needs to focus on the economic substance of financial activities, rather than the legal form assumed by institutions. We have learned that the activities of large, highly leveraged institutions of all kinds have significant systemic impacts and potentially pose critical systemic risks" (BIS1). The US and UK agree. American definitions of Tier 1 FHC's will include banks, broker-dealers, investment companies, investment advisors, insurers, commodities pools, and others (KPMG 2009: 4). In the UK, Adair Turner, head of the FSA, referred to the "'duck factor' –

if something looks and sounds like a duck, it will be treated as if it is one" (FT172). This is a lesson I take forward to the next chapter, on theorising corporate market responsibility: that generic principles of CMR may be tentatively generalisable among a wider set of financial actors, insofar as they are grounded in maintaining systemic stability and in the experiences of large, interconnected financial institutions.

5.2.6. Preliminary conclusions

In review, this data illustrates two balances that are needed for regulating systemic risk. One is the balance of hard analysis and soft judgment. Hard risk mathematics required soft corporate governance standards. Dry accounting techniques required good discretionary judgement. Economic scenario stress-testing required imagination and broad participation. Competitive innovation required a systemic perspective. Compliance was less meaningful without shared objectives. In this vein, finance appears to acquire an endogenous socio-political dimension. We can anticipate some theoretical implications. Non-economic, or non-maximising, behaviour does not appear to be restricted to the non-market domain, nor even to inter-firm negotiations within the market domain. Regulating systemic risk requires non-economic behaviour within companies. As part of the daily grind of lending and trading, a wide range of management systems needed to be subjectively tailored to mitigate potentially corrosive impacts on the wider system.

The second balance is of responsibilities, between regulators and companies. Regulators acknowledged that systemic risk cannot be identified idiosyncratically from within companies; hence, much of the debate was about how to restructure regulatory authorities, particularly in the US. However, financial stability would not be achieved without firm-level reforms to risk management and trading, as regulators could not be expected to provide all of the requisite mechanisms prescriptively. Further, it emerged that a literal reading of regulation would not suffice to meet the regulators' objectives. This was evident even at the SEC, which describes itself as a "law enforcement agency" (e.g. SEC6). Orderly markets required shared responsibilities, implemented via improved management protocols.

5.3. Resonance: The wider debate in the press

"We don't know much about financial regulation, but we know what we don't like."
The people have spoken [...]

Andrew Hill, *Financial Times*[20]

"Financial news may have great human interest potential to the extent that it deals with the making or breaking of fortunes," wrote Shiller (2002: 85). Much in line with this idea, the press reports of the regulatory debate disproportionately emphasised the issue of remuneration. This subject received far more emphasis in the news than other topics, despite regulators having discussed it less than accounting or lending standards, for example. The media's emphasis brought its own pressure to bear on banks, independently of regulators'. Some banks took steps to improve risk-based remuneration proactively. In 2009 Goldman Sachs paid a higher share of bonuses in stocks and deferred payments, "in a bid to quell public anger", according to the *Financial Times* (2009c). The issue became important also for shareholders. According to the *Wall Street Journal*, Goldman Sachs set up a number of meetings with major shareholders in December 2009 to explain the rationale behind their high executive compensation (WSJ56). Excessive remuneration has become an explicit and widespread "red flag" that investment companies seek out in due diligence investigations of potential investment targets, because it may signal reputational or investment risks. This example helps to illustrate why it is useful, epistemologically, to analyse the news. Taking as a given that news reports influence market actors' expectations and actions, even distorted media emphasis acquires ontological significance. In this case, media emphasis became synonymous with "public anger", which made remuneration reform a larger regulatory risk than it was solely on the basis of regulatory documents.

In this section, I review how news reporting introduced new nuances to the conceptual categories developed on the basis of regulatory documents. One example of new conceptual properties is the relationship between ethics and technical analysis. Regulators had emphasised that new structured credit derivative products had been "socially useless" or not in clients' interests. News reports questioned the ethical standards of senior staff at banks and credit ratings agencies, and their potential impact on the wider system. If we accept the logic that news reports can elevate a relatively secondary issue to a prime regulatory risk for companies, then we are likely to find

[20] Cited in FT175.

humanising technical activity, as I would call it, an increasingly relevant component of corporate market responsibility. The new analytical layer from media data is set out in the following paragraphs, where I detail news reports' contributions to our propositions on risk management, investment policy, and proactive improvement.

5.3.1. Risk management, investment policy, and improvement

News reports about the regulatory documents did not go into detail on the whole scope of risk management issues, but focused on the more accessible components of remuneration, corporate governance, and stress-testing.

5.2.1.7. Remuneration and risk-taking

"How many boats have I bought? It's not a good time to answer that."

Michael Sherwood, Goldman Sachs, in 2009[21]

A central controversy regarding remuneration in the banking system was the perception that *governments* were *underwriting bonuses at banks*. Many banks had relied on direct government investment, particularly Citigroup, Lloyds, and Royal Bank of Scotland (RBS), in order to remain going concerns. All had benefitted from very cheap, sometimes free, credit from central banks under the monetary policy known as quantitative easing. The "public" therefore perceived these fortunes to be funded by governments while at the same time unemployment and bankruptcies were rising steeply in other economic sectors. According to a *New York Times* report, "public fury over bonuses has spilled into the regulatory effort" (NYT27). The Conservative shadow chancellor in the UK said, "It is totally unacceptable for bank bonuses to be paid on the back of taxpayer guarantees" (TT50). Public perceptions were so emphatic that it was even reported that the head of RBS, Stephen Hester, had been criticised for his remuneration by his mother (Financial Times 2010). Barclays and several government-backed banks followed Goldman Sachs's lead in reforming their compensation structures, at least temporarily.

Against this background, the debate in news reports (whose interlocutors were reporters, editorial writers, market participants, policy-makers, and others who are invited to comment in the press) focused on how adequately *to govern remuneration*. One of the most frequent measures cited was *disclosure* (FT192, FT200, DT70, DT72, GU55). More specifically, some argued that disclosure would only be useful if it were comprehensive: *naming and shaming*. The FT's *Lex* column supported strong

[21] Cited in *The Sunday Times* (2009).

disclosure. "To enable shareholders to monitor risk taking," it stated, "investors need to *identify which employees*, and therefore which *product lines* and *business units*, are generating abnormal rewards ... [The] argument that there is no evidence that *naming and shaming* would improve risk governance is weak" (FT192).

Alongside disclosure, *deferring payments* and *using share options* in place of cash bonuses emerged as the two consensual management protocols. According to regulatory proposals, financial executives should only be awarded bonuses for their trades once those investments have matured and their risk has been adequately assessed. In a similar bid to promote a more long-term investment approach, the use of share options as compensation is intended to encourage traders and lenders to act their company's interest. A third protocol – which had not been evident in regulatory papers but emerged in reporting – was to *moderate retirement packages*. Some of the closest media scrutiny was placed on chief executives who retired with very large 'golden parachutes'. In the UK, the referential case – "widely seen as the clearest single example of banking hubris and excess" (Daily Telegraph 2009) – was that of former RBS CEO Fred Goodwin, who retired with an annual pension of £555,000, after having led RBS to a $24 billion loss, the largest in UK history (ibid). After intense public debate and even vandal attacks on his home in Scotland, Goodwin agreed to reduce the pension to £342,500, effectively returning £4.7 million to the bank.

These three protocols for improving remuneration, which I note in Figure 5-13, were uncontroversial in comparison to other regulatory proposals. Some failed proposals had been intrusive and legalistic, rather than principles-driven. One of the most stringent and most feared (WSJ92) was a cap on bonuses as a percentage of salary. France and Germany had supported this option, while the US and UK opposed it (DT79).

Figure 5-13. New sub-properties and (dimensions) of *Aligning remuneration with risk management*

Disclosing remuneration packages
(detailed information 'naming and shaming')
(individuals)
(business lines)
Moderating retirement packages
Renouncing bonuses if required

At a summit in Pittsburgh in September 2009, the G20 endorsed the more discretionary recommendations, stating that "[regulatory] supervisors should have the responsibility to review firms' compensation policies and structures with institutional and systemic risk in mind and, if necessary to offset additional risks, apply corrective measures" (G20 2009). This statement foreshadows some of the theoretical conclusions that I draw in the next chapter about the enforcement of CMR. G20 governments promoted a discretionary regime for governing remuneration, while simultaneously reserving the right to enforce it. The statement captures succinctly the push for 'regulating self-regulation', anchored in a concern over systemic risk. Both sides, firms and regulators, responded. At the end of 2009 and start of 2010, Barclays, Lloyds, RBS, and Goldman Sachs CEOs *renounced their latest bonuses*.[22] On the regulatory side, the SEC "stretched the law" to "confiscate" bonuses and other compensation from CEOs and CFOs in US companies, according to a former SEC assistant director (WSJ84).

One month before the G20 summit, the US House of Representatives passed a bill on executive compensation that empowered regulators to scrutinise executive compensation schemes, and gave shareholders the right to vote on those schemes. (The votes would be nonbinding.) Higher shareholder activism had already been endorsed by the SEC in several testimonies (e.g. SEC9), and it emerged as a significant topic in the media data.

5.2.1.8. Shareholder responsibility

Much of the media's reporting of the regulatory documents was faithful to regulators' emphases on transparency, impartial risk committees, and disciplined non-executive directorships; yet two additional subjects received new attention. One was *being a responsible shareholder.* In a column titled "Watchdogs that must be taught to bark in the boardroom", the *Guardian*'s City editor argued that "institutional investors also have a case to answer" for their role in permitting the crisis to occur (GU55). Additionally, she argued, shareholders "should invest responsibly, *carefully monitoring* the businesses in which they own stakes" (ibid). The UK's City Minister, Lord Myners, was cited saying, "Institutional shareholders need to ask themselves: were they appropriately *engaged in asking questions about the risk appetite* of our banks? Were they asking sufficient questions about competency of directors and appropriately engaged in examining and approving compensation cultures?"(ibid).

Figure 5-14. The category *Being a responsible shareholder*, property and sub-properties

Investigating directors' fitness
Investigating compensation culture
Monitoring businesses over time
Managing conflicts of interest
Escalating activities as required

The UK's government's Walker Review of corporate governance – which had remarked that "Shareholders who do not exercise [thorough] governance oversight are effectively *free-riding on the governance efforts* of those that do" (UKT2: 71; Ch 5) – spawned a new code of conduct: the

[22] Curiously, the FT had reported after the G20 summit that the recommendations "mirrored existing best practice among leading financial groups", citing one executive saying, dubiously, "It is what everybody already does, although it is good to have it written down in black and white" (FT210).

Code on the Responsibilities of Institutional Investors published by the Institutional Shareholders Committee (ISC).[23] Its seven principles included:

- Disclosing a policy on how their "stewardship responsibilities" would be discharged;
- "Managing conflicts of interest in relation to stewardship";
- Monitoring "investee" companies;
- Establishing guidelines on how to escalate activities;
- Disclosing a policy on how activities will be "escalated" (shareholder activism) (ISC 2009: 2-5).

Thus the ISC code encouraged shareholders to establish their own codes. Myners found it superficial and stated that it did not resolve what he called the problem of "ownerless corporations" (FT198). The head of Tomorrow's Company, an NGO, encouraged a more radical approach; to distinguish between fund managers and asset owners (fund managers' clients), and encourage the latter to exert more pressure. Other NGOs, like Governance for Owners, and service providers, like RiskMetrics, proposed a range of options for resolving the stewardship gap, ranging from league tables to pools of funds to support activism among shareholders (ibid). Like regulators' proposals, these called for *providing adequate information to shareholders* while the latter *effectively exercise their voting rights* – conceptual properties of *proactive improvement.*

As Myners put it, "Responsible ownership means industry as a whole playing its part to drive up standards so that governance becomes the norm and responsibility of all, not limited to governance geeks" (FT198). The well-known concept of 'shareholder rights' thus acquired a complement in 'shareholder responsibilities'.

5.2.1.9. Ethics of competence

The second institutional issue given relatively higher prominence in the media was ethics. Regulatory papers from the SEC, FSA, and their Treasury counterparts, had characterised many lending practices as dishonest (see also GU49). Several commentators in the media expanded the charge of mischievousness throughout the system. Gretchen Morgenson, author of the *New York Times'* influential Market Watch column, wrote,

[23] The ISC describes itself as a "forum which allows the UK's institutional shareholding community to exchange views and, on occasion, coordinate their activities in support of the interests of UK investors"; it is backed by the influential Investment Managers' Association and Association of British Insurer, among others; www.institutionalshareholderscommittee.org.uk.

> "Companies, even those in cyclical businesses, routinely told investors that the reason they so regularly beat their earnings forecasts was honest hard work – and not cookie-jar accounting. They were believed. [...]
>
> Wall Street dealmakers were fawned over like all-knowing superstars, their comings and goings celebrated. No one doubted them.
>
> Banks engaging in anything-goes lending practices assured shareholders that safety and soundness was their mantra. They, too, got a pass.
>
> Directors who didn't begin to understand the operational complexities of the companies they were charged with overseeing told stockholders that they were vigilant fiduciaries. Investors suspended their disbelief. [...]
>
> My hypocrisy meter konked out last week." (NYT21).

This excerpt is representative of a broader sample insofar as it frames ethics both in terms of honesty but also competence. *Being competent* is not something that the market will necessarily resolve by replacing incompetent people with better specimens.[24] Rather, *actively acknowledging incompetence* is partly one's own ethical prerogative. Indeed the close association between honesty and competence lay embedded in the FSA's "Fit and Proper test [sic] for Approved Persons", which individuals have to pass in order to obtain certain jobs in the financial industry or to acquire large companies. The two assessment categories in the test are "Honesty, integrity and reputation" and "Competence and capability". Explaining one decision to fail an individual, the FSA cited indications of a banker's incompetence, which as a result "prejudiced the interest of consumers" (FSA 2009e: 2).

The ethics of competence is also associated with the issue of performance-related remuneration, because *doing one's job well*, without outsized bonuses, is common practice outside of the financial industry. Publicising an idea they call "identity economics", George Akerloff and Rachel Kranton argued that,

> "the public, in America and elsewhere, are so angry about the bonuses on Wall Street[because] Most of us just get up in the morning and do our jobs [...] We take pride in jobs well done and we celebrate people such as [American Airlines pilot] Sully Sullenberger who, after ditching his plane in the Hudson River, checked the cabin twice for remaining passengers before being the last to evacuate. As he explained: 'I was just doing my job.' [...] Why then, we ask, do traders and bankers need outsize bonuses and performance pay to get them to do their jobs? [...]
>
> "In identity economics, performance pay demonstrates bad faith. It tells employees they are not trusted to do the right thing. Rather, incentives have to be right. [...]
>
> "<u>The incentive should not be to manipulate the system, but to live up to responsibilities: to pilot the plane; to storm the beach; to run to the fire. In the financial world, it is called fiduciary duty.</u>" (Financial Times 2010c, underlining added).

[24] This is analogous to the argument that the market will not necessarily remove 'bad' innovations.

Ros Haniffa, an accounting professor, extended this argument from individuals' performance to the level of business strategy:

> "We need to get the corporate elite in financial services to understand that protecting their professional integrity and maintaining high ethical standards will sometimes require taking less profit and bonus. The overall impact on the economy and society has to play a part in how the elite run these businesses.
>
> "What we have to do now is tackle the fundamental issue. There needs to be a major mind shift by those involved in the banking industry – from excessive greed to justifiable profit. And business schools have a significant part to play in educating the next generation of business leaders on ethical ways of conducting business" (FT199).

To code these arguments on a more abstract level, Akerloff, Kranton, and Haniffa call for *conducting business with some non-financial objectives*. At the individual executive's level, this entails *doing one's job well* without *being greedy*, and at the strategic level, it entails *justifying corporate profits*.

Figure 5-15. The category *Ethical competence*, properties and (dimensions)

Acknowledging fitness for role
(honesty, competence)
Conducting business with some non-financial objectives
Performing well, without greed
Justifying corporate profits

Across both dimensions, there is also the conceptual property *humanising technical activity*. The regulatory documents highlighted the importance of soft judgement in 'hard' risk management, such as understanding how to apply accounting standards in particular situations (SEC7: 4). Using almost identical language, Haniffa called on ethical grounds for "*training* in how to apply codes of conduct in everyday [accounting] situations" (FT199). In the context of education, she continued, "Students must be *exposed to alternative business models and thinking*, not just trained to resolve complicated financial problems through mathematical modelling. These tend to be detached from the real world and consideration of human elements" (FT199). Ethics is thus closely associated with introducing a human, qualitative dimension to typically formalist methodologies of risk management (see also NYT21 and WSJ67).

5.2.1.10. Humanising technical activity

Technology got ahead of our ability
to use it in responsible ways.

Andrew Lo, Finance Professor at MIT[25]

To what extent did risk managers delegate their responsibilities to non-human processes? Which is to ask, did they neglect their responsibilities? Parties to the regulatory debate frequently invoked

[25] Cited in NYT24.

what the FSA termed a "misplaced reliance on sophisticated maths" (FSA6: 16). Press reports also pursued this theme. In these reports, the issue was not only technical content (such as the relative usefulness of value-at-risk modelling versus stress-testing), but also human judgement. At senior level, managers were criticised for failing to understand their risk models, while at less senior levels, for "confusing the model with the world" (NYT24): "The quantitative models typically have their origins in academia and often the physical sciences. In academia, the focus is on problems that can be solved, proved and published — not messy, intractable challenges. In science, the models derive from particle flows in a liquid or a gas, which conform to the neat, crisp laws of physics. Not so in financial modelling," wrote a *New York Times* reporter (ibid). "The price of an asset, like a house or a stock, reflects not only your beliefs about the future, but you're also betting on other people's beliefs," said an economist at the Federal Reserve, "It's these hierarchies of beliefs — these behavioral factors — that are so hard to model" (ibid). Leslie Rahl, head of Capital Market Risk Advisors, stated that "Complexity, transparency, liquidity and leverage have all played a huge role in this crisis. And these are things that are not generally modelled as a quantifiable risk" (ibid). The problem was that many institutions held as a guiding principle that anything could be modelled. When an executive at the credit ratings agency Standard & Poor's voiced reluctance to rate a particular product, his colleague was reported to have replied by email, "We rate every deal. It could be structured by cows and we would rate it" (NYT21).

Figure 5-16. The category *Humanising technical activity*, properties and (dimensions)

Training in alternative business/thought models
Understanding models' limitations
(reverse stress-testing the models)
(triggers, thresholds)

Mistakes were also made in the other direction. Economists at the Federal Reserve assessed several models used by Wall Street analysts that "correctly predicted that a drop in real estate prices of 10 or 20 percent would imperil the market for subprime mortgage-backed securities. But the analysts themselves assigned a very low probability to that happening" (NYT24). I have noted that there is evidence that banks wilfully neglected (the BIS's) warnings about housing market vulnerabilities.

In this difficult interaction between risk methodologies and business prerogatives, the lesson is therefore not that models should be used less and human intuition trusted more. Rather, it is that in order to *use models responsibly*, risk managers must actively seek to *understand their methodological weaknesses*. We can develop this principle by recalling some of the recommendations for stress-testing. Stress-testing is the practice of assessing how well a firm's finances (or operations) could withstand a shock. Some of the recommendations included selecting and modelling scenarios specifically on the grounds that they would be the most hurtful for the company. An analogous technique might be extended for using risk models more responsibly. Under what conditions will the models fail to estimate risk correctly? Is it possible to *stress-test risk models* themselves?

We know that models tend to fail in extreme (stress) scenarios. As Alan Greenspan argued, in an article titled, "We will never have a perfect model of risk":

> "The most credible explanation of why state-of-the-art statistical models can perform so poorly is that [...] these models do not fully capture what I believe has been, to date, only a peripheral addendum to business-cycle and financial modelling – the innate human responses that result in swings between euphoria and fear that repeat themselves generation after generation with little evidence of a learning curve" (Greenspan 2008).

Greenspan adds that common practice is "to introduce notions of 'animal spirits', as John Maynard Keynes put it, through 'add factors'. That is, we arbitrarily change the outcome of our model's equations" (ibid). The "arbitrary" criteria for these changes bring to mind the notion of "random sampling", the fundamental belief, in rationalist methodologies, that one should not presuppose the outcome of the tests. Yet, based on the data above, I infer that another requirement is to seek to identify the extreme situations in which the model is likely to fail. Similar to the process of reverse stress-testing, this would allow risk modellers to *identify triggers and thresholds*, and thus to raise alarm.

5.3.2. Preliminary conclusions

The press data helped to identify how the issues raised by the regulatory debate became part of wider expectations beyond official regulatory circles. This was a technical contribution insofar as it comprised new properties of the CMR management protocols. Clearly, *aligning remuneration with risk management* was a higher priority for the public debate – where it dominated reporting – than within for the regulatory debate specifically. Questions about the competence and honesty of some of the people receiving outsized remuneration coincided with a wider discussion about *ethical competence*, and touched both on issues of *strategic orientation* (justifying profits), and of *technical activity,* which became detached from the interests of banks' clients and banks themselves. New sets of actors were called to responsibility, namely shareholders, who were said to have been too passive in not investigating risk management and investment policies in companies. Insofar as news media influence expectations and activities in the marketplace, and insofar as the fallout from the Credit Crunch is set to dominate economic policy for several years, then these concepts are likely increasingly to play a part in shaping expectations of corporate conduct.

5.4. Theoretical integration

Before setting out what this episode tells us about CMR, it is important to understand the various relationships between these concepts themselves. Theory is, as Strauss and Corbin (1998: 15) put it, "a set of well-developed concepts related through statements of relationship, which together constitute an integrated framework that can be used to explain or predict phenomena". By identifying, comparing, and conceptualising these relationships, a grounded theorist aims to discover a unifying theme that explains the episode. In the following paragraphs, I argue that the central categories in this episode are *responsible compliance* and *humanising technical activity.*

This episode was different from the Citigroup and SWFs cases. The latter were more sequential. It was possible to discern specific signals of controversy (the problem), its resolution, and the generic processes like *judging conduct* that explained the trajectory. This episode, by contrast, takes place in a cycle of debate that has had no clear resolution. All of the concepts display significant inter-relationships, whatever point in the sampling period they emerged in. The reason for this may be the high number and variety of actors involved in the Credit Crunch controversy. Whereas the earlier controversies focused on a single actor and then a single set of actors, this one called a much wider range of financial firms into account. Below, in Figure 5-17, I have set out some of the key relationships between the concepts, as a tool for identifying the central themes.

Each relationship is defined by each concept's properties that were identified in the data. (For example, the matrix notes that a relationship between *responsible compliance* and *choosing business activities* is *establishing and disclosing parameters for short-selling*. This is because *establishing parameters for short-selling* is related to both concepts in the data itself, rather than because it was simply logically deduced.) This table helps us to identify which categories comprise a unifying theme for the episode. The table uses the language of grounded theory methodology: the label 'proposition' refers to the CMR propositions shown in Figure 5-1 at the start of this chapter. The label 'category' refers to concepts in the data. 'Properties' are characteristics of each category.

Several paths are available in order to find such a theme. The simplest would be to assess which categories are related to the most other categories. However, in the present episode, all of the concepts are interrelated. Instead, a second option would be to identify which concept has the <u>same relationship</u> with every other; where the same conceptual property explains all of the relationships. This option's strength is to provide a high degree of certainty that the concept matters; a high degree of <u>fit</u> with data. However, it is also possible that the concept would matter in a relatively peripheral way; that is, have little resonance. One example of this is *being a responsible shareholder*, which is related to several other categories through *providing (receiving) high quality information*. While high quality of information is certainly a fundamental issue, shareholders' responsibilities were not central to the problematique. A third and preferable alternative is to identify which concepts show both strong relationships (defined by references of relationship in the data), and a variety of relationships. This process demonstrates that the final unifying concepts are theoretically dense – packing lots of references in the data and lots of conceptual properties – and account for variation in the behaviour being studied – namely, CMR.

Figure 5-17. Conceptual relationships: how various properties link different categories

Proposition	Category	Doing accounting fairly	Aligning remuneration with risk management	Humanising technical activity	Responsible compliance	Stress-testing	Ethical competence	Choosing business activities	Being a responsible shareholder
Risk Management	**Board accountability**	Setting strategic risk appetite; enterprise-wide CRO accountability	Disclosure; cutting parachute / guaranteed bonus	Understanding models and risk exposure	Enabling a compliance culture; setting tone	Assuming no govt bailouts	Testing 'fitness'; non-financial strategic objectives	Aligning corporate objectives with strategy	Seeking high quality information to shareholders; director elections
Risk Management	**Doing accounting fairly**		Deferred payments (dates of maturity)	Training in new thought models; knowing ratings don't fit	Ind't authority to push back on trades; pursuing best practice	Linking test results with risk appetite	Acknowledging 'fitness'; understanding human impact	Innovating for customers' true needs (eg SCD's)	Seeking high quality information
Risk Management	**Aligning remuneration with risk management**			Aligning pay with technical risk performance	Disclosing pay comprehensively; using stock options	Aligning pay with risk profile over time	Aligning pay with dates of maturity; using stock options	Aligning pay with dates of maturity; using stock options	Disclosing pay fully; investigating pay
Risk Management	**Humanising technical activity**				Pursuing best-practice; providing high quality info	Promoting imagination; stress-testing the models themselves	Aknowledging 'fitness'; finding models' limitations	Innovating for customers' true needs (eg SCD's)	Seeking high quality information
Proactive Improvement	**Responsible compliance**					Assuming no govt bailouts; testing full system failure; disclosure	Pursuing shared objectives (w/ reg), compliance culture	Establishing and disclosing parameters for short-selling	Seeking high quality information; resolving conflicts; escalating activities
Risk Management, Proactive Improvement	**Stress-testing**						Choosing tough scenarios despite moral hazard	-	Monitoring business risk appetite
Risk Management, Proactive Improvement	**Ethical competence**							Innovating for customers' true needs (eg SCD's)	Assuming stewardship role
Investment Policy	**Choosing business activities**								Link - short-selling, innovation

The two categories that fulfil these criteria are *responsible compliance* and *humanising technical activity*. They both featured in many codes in each dataset. The regulatory data, as I noted in Section 5.2.6, pointed to two core balances that should be struck – between hard knowledge and soft judgement (*humanising technical activity*) and between regulators' and corporations' responsibilities for systemic regulation (towards *responsible compliance*). In the media data, the strong emphasis on *improving remuneration* was related to *responsible compliance* via *full disclosure*, which was not specifically mandated in rules. The media data also placed strong emphasis on how technical knowledge became detached from corporate governance and ethical competence. *Humanising technical activity*, by *holding boards to account*, improving judgement in *assessing credit ratings,* and *improving ethical performance*, were notable management protocols. The strong emphasis in both datasets is one reason for highlighting these two categories.

Another reason is that *responsible compliance* and *humanising technical activity* are related to each of the other concepts in a variety of ways. As the matrix shows, each relationship between these core categories and the others is given by a different set of conceptual properties. We can say in the language of grounded theory methodology that, together, these categories "account for most of the variation in a pattern of behaviour" being analysed (Glaser 1978: 93). Effectively these categories render what the post-crisis debate is <u>about</u>. This is not the same as saying that the categories are the 'most important' alongside the others, but rather that they help to explain the other concepts. On this basis, Figures 5-18 and 5-19, below, recap what they are.

Figure 5-18. Unifying theme I: Responsible compliance

	Conceptual category	Explanation
What	**Responsible compliance**	
	Specifically, this entails	
	Pursuing shared objectives with the regulator; implementing technical regulation responsibly	*This often entails 'exceeding' minimum requirements, although it may be less costly. It is the opposite of 'literal compliance', which pursues only letter of the law, rather than its spirit*
	Enabling a compliance culture; setting the tone at the top	*This shares many properties with risk management; including appointing independent risk teams, and setting risk appetite*
	Providing high quality information	*Disclosure is not sufficient unless it enables market and state supervisors to do their job well*
Why	*This is important because:*	
	Regulators cannot safeguard systemic risk on a solely prescriptive basis	*Regulatory attempts to do so would conflict with encouraging corporate innovation as an engine of growth*
Who	*Responsibility falls primarily to:*	
	Functionally, throughout the organisation; regulatory accountability at Board level	*The Board should appoint several of the required management structures and set the tone*
When	*This matters most when:*	
	At all times	*Under 'comply or explain' systems, responsible compliance may be less costly than literal compliance*
Conse-quences	*This may lead to:*	
	New management structures, systems, and expenditure	*Similarly to other categories that are part of Proactive Improvement*

Figure 5-19. Unifying theme II: Humanising technical activity

	Conceptual category	Explanation
What	**Humanising technical activity**	
	Specifically, this entails	
	Establishing models' (and ratings') limitations and proper usage	*To prevent abdicating of managerial judgement and accountability in favour of formalist methods, which may fail. Stress-testing the models is a possible mechanism for this (extrapolated from the regulatory data)*
	Ethical competence	*Acknowledging one's 'fitness' for technical roles; justifying activities in non-financial terms*
Why	*This is important because:*	
	Technical methods were insufficient to mitigate risks	*Poor understanding of risk in structured products - both on supply and demand sides - raised systemic risk*
	Prerequisite for accountability	*Perceived lack of accountability and ethical positioning at Board level fuelled public controversy*
Who	*Responsibility falls primarily to:*	
	Accounting and risk functions; regulatory accountability at Board level	*Adequate communication between technical and strategic levels is key*
When	*This matters most when:*	
	Markets are highly liquid; or in structured and derivative product trades	*Particulalry in retail credit markets*
Conse-quences	*This may lead to:*	
	The firm may need to abstain from certain profitable transactions that exceed risk tolerance or whose (internal or external) impact cannot be reliably assessed.	*Similarly to other Risk Management categories*

5.5. Conclusion

For many influential actors, the financial crisis re-defined their perception of financial capitalism and incited questions about markets' fundamental behaviour. Alan Greenspan, Chairman of the Federal Reserve in 1987-2006, a staunch advocate of liberalisation, was among those who acknowledged significant mistakes. Testifying to the Congressional Committee on Oversight and Government Reform, he stated:

> "Those of us who have looked to the self-interest of lending institutions to protect shareholders' equity, myself especially, are in a state of shock and disbelief. [...] I made a mistake in presuming that the self-interest of organisations, specifically banks and others, were such [that] they were best capable of protecting their own shareholders and their equity in the firms [...]
>
> "I've found a flaw [...] in the model that I perceived as the critical functioning structure that defines how the world works" (US Congress 2008: 35-7).

In the private sector, some well-known financiers made similar arguments. Among them, George Soros said in 2009:

> "All we are doing right now with this talk of public-private partnerships and new regulation is tinkering. It assumes that the system is basically OK. The idea that the markets are self-correcting has been proven false. The efficient markets hypothesis has been broken ... the market, rather than reflecting the underlying reality [of companies], is always distorting it. There is mispricing and it affects the fundamentals [of companies]." (WSJ66).

Within this broad public discussion about markets, this chapter pursued a much narrower problematique. Taking systemic market instability as the starting point, I asked, what can we learn from these controversies, about how companies are expected to contribute to an inherently imperfect system? I looked primarily to the regulatory debate for answers because it anticipates a policy response but also seeks to motivate a "market response" (FSA 2009b: 10), a change in corporate conduct.

The analysis identified *responsible compliance* and *humanising technical activity* as central challenges – both epistemological and practical – for corporate conduct. The concepts are frames of reference for investigating financial market controversies, and structuring new questions. If 'the regulators and the people have spoken', then one unanswered question is, 'how have firms responded?' This chapter's first contribution is to enhance our understanding of this contemporaneous debate in financial governance, and to inspire new questions for investigation.

The second contribution is more technical. The various, unique conceptual properties of risk management, investment policy, and proactive improvement in this chapter are components of a broader emerging theory of CMR. The next chapter integrates the three empirical episodes, and presents a substantive set of theoretical propositions about corporate market responsibility more broadly. The fact that those propositions contain data from the current regulatory debate serves to increase the credibility, relevance, and usefulness of the emerging theory.

Chapter 6: Theorising Corporate Market Responsibility

Experience in controversies such as these brings out the impossibility of learning anything from facts until they are examined and interpreted by reason; and teaches that the most reckless and treacherous of all theorists is he who professes to let facts and figures speak for themselves.

Alfred Marshall, mentor to J.M. Keynes

6.1. Introduction

The controversies involving Citigroup, sovereign funds, and others during the Credit Crunch, suggest that regulators and other economic and societal actors hold financial firms responsible for helping to reduce systemic risk. They also suggest that this requires corporate activities other than compliance and profit-maximisation, which are firms' traditional economic responsibilities. Instead, actors are compelled to adopt certain management protocols related to risk management, investment policy, and proactive improvement. The protocols are voluntary, but enforced. In the absence of responsible conduct, firms faced higher regulatory risks, because CMR conduct was perceived to decrease systemic risk. This thesis was devoted to answering the research question, 'how are firms responsible for helping to ensure orderly financial markets?' The answer is presented in this chapter, in a substantive theory of corporate market responsibility.

To arrive at this point, where theoretical propositions may be advanced, three episodes were analysed. What these episodes had in common is that the firms in question had pursued legal, profit-maximising behaviour but lacked internal management systems to prevent them from destabilising markets. The episodes varied in that each had a broader scope than the previous. In Citigroup's Eurobond controversy, the setting was European government bond markets, and a single bank was punished for the management failures that led to their large bond trade. In the sovereign wealth funds (SWF) episode, the setting included bond markets, but also equities, commodities, real estate, and others. The post-Credit Crunch regulatory debate had a broader range of actors, including all large banks and so-called quasi-banks in the financial system. Thus from a bounded, micro-level case, through to a fully systemic level episode, the analysis led to a substantive theory about financial market governance.

CMR embodies many of the characteristics described in the literature on decentralised governance (e.g. Braithwaite and Drahos 2000; Cutler, Haufler and Porter 1999), particularly the paradigm that Levi-Faur (2005) called "regulatory capitalism". The state assumes a supervisory role and businesses develop "internal controls and mechanisms of self-regulation in the shadow of the state" (Levi-Faur

2005: 15). I will argue that as a technique, CMR is a form of "meta-regulation" (e.g. Parker 2002); that is, regulators compel firms to improve management systems voluntarily in order to meet the regulators' broader market objectives (Black 2006). Thus positioned within existing theoretical frameworks, CMR may contribute to several current debates in political economy and economic sociology. I argue that CMR enhances Underhill and Zhang's (2008) framework for legitimacy in financial governance, both as a normative ethic (CMR as theory) and as an observation (CMR as data). In economic sociology, I argue that the CMR episodes demonstrate new variations of markets' embeddedness in social norms and networks (e.g. Granovetter 1985), and the performativity of economic models (e.g. MacKenzie 2006). Addressing behaviours that are problematic in both disciplines, CMR is argued to be an integrative concept that enables better multidisciplinary theory-building.

6.1.1. Purpose and contribution of chapter

The main purpose of this chapter is to present a substantive theory of CMR; my theoretical findings. Each preceding chapter contributed a conceptual rendering of an empirical episode, and here I integrate those conclusions in a set of propositions that are tentatively generalisable to new situations. I outline what CMR is as a practice (a set of management protocols) and as a principle of market governance (its relationship with regulatory risk and systemic risk). I examine the implications for existing theories in political economy and economic sociology, both of which are disciplines where financial market governance is an important topic.

The purpose of this analysis of literature is to demonstrate that CMR is an integrative concept that addresses issues that are analysed in a range of disciplines. The purpose is not to 'square' CMR with extant concepts, to verify or falsify existing ideas, or to resolve a theoretical debate. Rather, the chapter seeks to show that CMR theory can advance existing knowledge in several domains. By showing how CMR comprises different forms of self-regulation (Chiu 2009); how it increases accountability in financial governance (cf. Underhill and Zhang 2008); and how it delegitimizes regulatory arbitrage (cf. Greenspan 1998); among other issues; this chapter demonstrates that CMR is a frame of reference for pursuing ideas in several related theories and drawing connections between them.

6.1.2. Chapter outline

The chapter is organised into three parts. The first part, 'What is CMR?', presents the theoretical propositions on CMR, consolidating the findings from the three empirical chapters. Then, the CMR propositions are assessed against the quality criteria of grounded theory methodology. The second part of the chapter integrates CMR propositions with existing theoretical knowledge in the fields of political economy and economic sociology. This section draws on political economy and economic sociology to position CMR within the academic debate, and extend contributions to these disciplines. The third and final part of the chapter, 'Where may CMR go?', discusses future directions for research.

6.2. What is corporate market responsibility?

Corporate market responsibility (CMR), as a concept, refers to an expectation by regulators and other political, economic and social actors that companies will help to regulate systemic risk through certain management protocols. CMR, as a corporate practice, refers to these management protocols.

6.2.1. Theoretical Propositions

My analysis of CMR leads to three sets of propositions. The first is a single proposition affirming the existence of CMR and its protocols (Figure 6-1 below).

The second set of propositions focuses on firms' conduct. It advances propositions about each of the CMR protocols (Figures 6-2, 6-3, 6-4). They are the direct answer to how firms are responsible for regulating systemic risk. They refer primarily to management systems and controls (protocols); rather than corporate structures (entity) or financial trades (actions). Although the latter two elements do feature, the dominant themes in the data across the three episodes are the management systems[1] related to Risk Management, Investment Policy, and Proactive Improvement. Each has several practical processes associated with it. These processes show what regulators and other societal actors expect firms to do in practice. The reader will find annotations about how the processes varied in each episode, to help discipline generalisation. The right-hand columns point to

[1] I develop this distinction between entity, actions, and protocols – and substantiate my focus on protocols – in Chapter 4, Section 4.4.1.

specific Figures throughout the thesis where data on each process is detailed, to help establish an audit trail for the analysis.

The third set of propositions look outside the firm, to CMR as a mechanism of systemic regulation (Figure 6-5). These propositions explain the relationship between firms' behaviour, wider expectations, and market impact. Specifically, they relate CMR protocols to regulatory risk faced by firms, and to systemic risk. These are referred to as meta-propositions because they are more abstract and cover the episodes in their entirety, rather than specific company activities. Whereas the CMR protocols firms' responsibilities (the research question), these meta-propositions convey the entire research problem; that is, why the research question matters. In particular, they establish a positive relationship between CMR and regulatory risk.

Together, the follow propositions comprise my theoretical findings about CMR, and constitute a substantive theory of corporate market responsibility.

Figure 6-1. Core CMR proposition

	Core CMR Proposition	Annotation	Data in Figure:
What	**Companies are expected to help regulate systemic risk in financial markets.**		
How	**Specifically this corporate market responsibility (CMR) entails:**		
	Ensuring market confidence and stability by establishing a set of protocols, as follows:		
	Operating a sound risk management system that anticipates the systemic impact of investment transactions	*Risk management protocols were central recommendations in all episodes. This was important for Citigroup to anticipate the impact of transactions; for SWFs to reassure host countries that they would not be a destabilising force; and post-Credit Crunch to ensure board-level accountability among other issues*	3-13,4-16,5-6,5-7,5-8,5-9
	Operating transparent investment policies	*Significant for Citigroup, whose strategy to change market structure was not "investment-driven", according to regulators (WSJ18). Central for SWFs, to discourage political investments. Significant post-Credit Crunch to discipline short-selling and innovative products.*	3-9,4-14,5-10
	Improving CMR shortcomings proactively	*All the episodes showed that standards may be fluid and not consensually understood; proactive improvement was shown to reduce regulatory risk with Citigroup and SWFs; post-Credit Crunch, "responsible compliance" called for pursuing joint objectives with regulators*	3-18,4-8,5-11,5-15
Why	*This is important because:*		
	Compliance with only minimum standards may not suffice to maintain efficient and orderly markets. In the event of market instability, compliance with only minimum standards increases regulatory and reputational risks.	*All the episodes showed compliance with minimum standards did not prevent controversy. Citigroup and SWFs showed that the boundaries of acceptable market conduct may shift quickly and be poorly understood. The post-Credit Crunch debate showed that regulators feel unable to mitigate systemic risk without discretionary help from firms; hence their call for 'responsible compliance' and 'ethical competence'.*	3-9,4-5,4-7,5-11,5-15
Who	*Responsibility falls primarily to:*		
	Large, liquid market participants.	*Media and regulatory data frequently singled out the particular responsibility of large, "systemically important" firms.*	3-7,4-5,5-12
	Senior management is held accountable externally, and junior management internally; junior and senior staff share implementation responsibility.	*The occasional differences are noted in the tables below.*	3-17,3-15,4-13,4-16,5-6,5-8
When	*This matters most when:*		
	Liquidity is rapidly rising or falling	*Citigroup's trade injected a high amount of liquidity, and when confidence dried up a liquidity shortage followed. The Credit Crunch also saw exceptionally high liquidity followed by a crisis of confidence, and a crunch. SWFs rise to prominence was driven by high liquidity, and one of the concerns is that they would subsequently hoard it. The goal is liquidity stabilisation*	3-6,3-10,4-5,4-6,5-5
	Making or assessing extraordinary transactions	*Large, fast, unprecedented transactions are more likely to impact market confidence and liquidity, thus courting regulatory scrunity. Citigroup's trade and SWFs' high-profile equity acquisitions were examples. Post-Credit Crunch, very high leverage, enabling large transactions was highly criticised*	3-6,3-7,4-5,4-6,5-5
	Entering or creating new markets	*The geographic dimension of new markets was key for Citigroup and SWFswhere the controversy emphasised the investors' national origins. Entry into new financial product markets was also very significant for Citigroup and post-Credit Crunch, where innovations were very contentious*	3-9,4-6,5-10
	Being a market-maker	*In a market-making system, the potential to contribute to too little or too much liquidity is more acute.*	3-10
Conse-quences			
	Establishing independent governance structures with clear mandates	*Impact on* entity.	3-14,4-13,5-6
	Restricting certain kinds of investments	*Impact on* actions.	3-13,3-7,4-14,5-10
	Collaborating with regulators and political bodies	*Collaboration increased market confidence and curbed regulatory risk in the Citigroup and SWF episodes; post-Credit Crunch this evolved into 'responsible compliance'*	3-18,4-8,5-11

Figure 6-2. CMR proposition on Risk Management

	Risk Management Proposition	Annotation	Data in Figure:
What	**Financial companies have a responsibility to operate a sound risk management system that anticipates the systemic impact of investment transactions.**		
How	*Specifically this should:*		
	Establish a risk management framework (incl risks and lines of responsibility)	*All episodes noted that some risks, particularly systemic risk, may be underestimated.*	3-13,4-16,5-6
	Align high-level objectives with mid-level strategy	*The Citigroup and SWFs cases emphasised escalating strategies upwards, whereas the Credit Crunch emphasised setting the tone downwards from the top*	3-13,3-14,5-6
	Anticipate the impact of its activities on systemic risk	*All cited this as a key failing of Citigroup. For SWFs and post-Crunch, this issue related primarily to Investment Policy (see next proposition)*	3-14,4-16,4-14,5-10
	Implement risk monitoring systems (rules, incentives, reporting, ...)	*Using well-structured analysis and monitoring risk exposure were highlighted specifically by the FSA, and other systems were noted extensively in the SWF GAPP. Post-Credit Crunch, key issues were remuneration and stress-testing, below.*	3-13,4-16,5-13,5-7
	Conduct stress-tests	*For SWFs, this is in the GAPP. For Citi, the FSA limited its punishment, saying (like others) that Citi's competitors should have prepared for the scenario in advance. Post-Crunch, poor stress-testing was a key concern, particularly in relation to moral hazard.*	3-15a,4-16,5-9
	Align remuneration with risk management	*This was particularly emphasised post-Credit Crunch.*	5-13
	Humanise technical activity (finding models' limitations, understanding role of subjective judgement, ...)	*This was particularly emphasised post-Credit Crunch.*	5-16
	Do accounting fairly (understanding value-verification, limiting credit ratings to where they are appropriate, ...)	*This was particularly emphasised post-Credit Crunch.*	5-7
	Improve ethical competence (training staff, acknowledging fitness, having non-financial objectives, ...)	*All cases emphasised that a wide range groups must be 'fit and proper', and the Credit Crunch episode also emphasised the ethics of acknowledging one's (lack of) fitness for the role.*	3-13,4-16,5-15
	Disclose this framework for external monitoring	*Disclosure figures highly in the SWF GAPP and the post-Crunch debate in the context of responsible compliance and being a responsible shareholder (see propositions below).*	4-16,5-11,5-14
Who	*Responsibility falls to:*		
	Lower management is responsible for implementation and *escalation of key decisions* to senior management. Senior management is held accountable for *setting the tone.*	*All cases emphasise that accountability and reporting requirements (e.g.to independent risk functions) should be clearly delineated. Individual Citigroup traders were not held accountable by the FSA.*	3-15,4-13,5-13
Conse-quences	*This may lead to:*		
	The firm may need to abstain from certain profitable transactions or payment structures that exceed risk tolerance or whose impact cannot be reliably assessed.		3-6,3-15,4-6,5-10

Figure 6-3. CMR proposition on Investment Policy

	Investment Policy Proposition	Annotation	Data in Figure:
What	**Financial companies have a responsibility to operate transparent investment policies.**		
How	*Specifically, the policy should...*		
	Be based on a well-accepted level of risk tolerance, and clear parameters for transactions (acceptable uncertainty levels, including external uncertainty, particularly in the context of short-selling)	*All episodes emphasise underpinning investment strategy with risk assessment.*	*3-15,4-14,5-10*
	Be driven by financial returns on invested assets	*Central for SWFs who might be acting on political grounds. Also significant for Citigroup (the German regulator and FT criticised Citigroup for looking to re-shape the European bond market into US-style market). Post-Credit Crunch, this is directly linked to, and discourages, 'naked' short-selling.*	*3-9,4-7,4-13,5-10*
	Have a benchmark against which the strategy can be evaluated.	*Explicit for SWFs. Citigroup suggests that if a planned trade is unprecedented - has no possible benchmarks - then other CMR responsibilities are more acute. Post-Crunch, related to auditors' and investors' ability to appraise innovative products and strategies.*	*3-13,4-16,5-10*
	Establish systems to monitor asset allocation/concentration and trading positions/exposure	*Ensuring that the investment policy is complied with.*	*3-15,4-14,5-6,5-11*
	Promote being a responsible shareholder (both towards company investments and its own investors)	*This was emphasised post-Credit Crunch.*	*5-14*
	Be generally disclosed and regularly audited and reviewed	*Disclosure may be solicited after perceived wrong-doing particularly.*	*3-9,4-14,4-15*
Who	*Responsibility falls primarily to:*		
	The policy is implemented by operational management and defined by the owner or governing body(ies), with special responsibilities falling to shareholders.	*In private companies, the owner's responsibility may fall to shareholders.*	*3-15,4-13,5-14*
Conse-quences	*This may lead to:*		
	Adjusting corporate hierarchy and mandates	*Impact on* entity.	*3-15,4-13,5-6*
	Establishing new systems of accountability, transaction analysis and information escalation		*3-14,3-15,4-13, 5-6*
	Disclosing investment positions in times of audit or scrutiny	*Disclosing investment position was central for SWFs as a matter or course. For Citigroup it was more situational - other banks needed to understand Citigroup's position and intent during the trading itself.*	*3-7,3-9,4-15,5-11*

These specific propositions about management protocols vary in some respects from the central proposition that CMR exists; namely in *how* CMR is implemented, *who* is responsible, and *with what consequences.* However, they do not differ from the core proposition as to *why* and *when* they matter.

Figure 6-4. CMR proposition on Proactive Improvement

	Proactive Improvement Proposition	Annotation	Data in Figure:
What	**Financial companies should pursue responsible compliance, correcting their shortcomings proactively even if they are not in literal breach of regulation.**		
How	*Specifically, they should:*		
	Cooperate with regulatory and political authorities, including to understand and codify its responsibilities, as well as to investigate past transactions	*The SWFs cooperating on a code-of-conduct, and Citigroup with regulators, were cited as increasing market confidence and curbing regulatory risk.*	3-18,4-8,5-11
	Promote responsible compliance (pursuing shared objectives with regulators, pursuing best-practice, ...)	*This was particularly emphasised post-Credit Crunch.*	5-11
	Emphasise its values from the level of owner, or governing body(ies) or CEO, downwards	*All episodes emphasised this. The owner's responsibility may also fall to shareholders.*	3-18,4-13,5-11
	Promote ethical competence	*As noted under 'Risk'.*	3-18,4-5,4-16,5-15
	Invest in surveillance and information-reporting quality	*Post-Credit Crunch, this related to accounting fairly, and stress-testing.*	3-13,4-16,5-7,5-9
	Strengthen its compliance department and systems	*Citigroup moved compliance staff to trading floor.*	3-18,4-13,4-14,5-11
Who	*Responsibility falls primarily to:*		
	Senior management should express and cascade value messages, and are held accountable externally. Junior management implements the various processes, and must report and escalate known shortcomings.	*Regulatory and media data did not highlight the role of specific individuals, but tended to hold the entity accountable at corporate level. Senior staff have a more active role in Improvement processes than other CMRs.*	3-15,4-13,5-6,5-11
When	*This is particularly important when, in addition to other CMR conditions:*		
	The company is perceived to pose or have posed a risk to orderly and efficient markets.	*For Citigroup, these initiatives mitigated the FSA punishment. For SWFs, drafting and signing the GAPP was the first thing they were expected to do. Post-Crunch, this became a continuous requirement, as part of* pursuing shared objectives *with regulators.*	3-18,4-8,5-11
Conse-quences	*This may lead to:*		
	Re-defining corporate strategy, management structures, systems, and expenditure	*This shows that CMR has central governance implications, and cannot be effective only at the margin.*	

These CMR protocols matter for market governance because of their relationship with *regulatory risk* and *systemic risk*. This tripartite conceptual relationship shows the CMR theory's broader relevance in market governance. By clarifying how these concepts are related to each other, I establish meta-propositions that account not only for how the specific episodes developed (which the propositions above already do), but also for why they matter more broadly. The meta-propositions below are more abstract, and represent a tentative step towards generalisation, which I then discuss. I begin by showing how systemic risk and regulatory risk were manifest in the episodes.

Systemic risk refers to threats to the functioning of financial markets as a whole (Kaufman 1996, 1999; BOE2), or a core part of the system (FSA6), either as a result of a single institution's transactions or due to collective action (Marshall 1998). Dow's (2000) review of theories of systemic risk promotes "the idea that systemic risk, being a matter of public policy, should refer to cases of risks being imposed on the financial system where some element of externality exists. In other words, financial regulators have a legitimate interest in intervening when somebody takes a risk that then causes further risk for others in the financial system" (p. 2; also IMF 2010). The financial regulators themselves refer to reducing systemic risk as part of maintaining "fair, orderly, and efficient markets", which both the SEC (2009) and the FSA (2006) share.

Systemic risk was the trigger for controversy in each of the three episodes. First, Citigroup's Eurobond transaction destabilised the level of liquidity in Eurozone bond markets, led its competitors to suffer extensive losses, and eventually forced a suspension of trading in the market. This is a systemic effect insofar as it happens within a bounded system across several the European bond markets. In the SWFs case, controversy emerged due to a concern that SWFs might destabilise global financial markets due to their size, use of political influence, or hoarding of international reserves. Then, the credit crunch episode looked at the regulatory debate that followed the financial crisis, which focused on systemic risk as a central challenge in financial regulation (e.g. FSA1: ch. 2).

The connection between systemic risk and the third variable, regulatory risk, was an intrinsic part of each episode – indeed one reason why the episodes were chosen. Regulatory risk refers to the potential for new legal and regulatory changes to impact on business operations, inducing losses directly (e.g. through fines) or indirectly (e.g. prohibiting certain business activities) (EIU 2005; and see Black 2006). In all of the episodes, the increase in systemic risk that triggered a controversy, and the ensuing controversy itself, increased regulatory risk. In the Citigroup episode, many market and societal actors showed mixed feelings regarding the bank's transaction and explicitly awaited the regulator's judgement, reflecting an increase in regulatory risk.[2] The regulator interpreted its principles-based regulation in order to decide on the correct punishment. It also cited Citigroup's proactive attempts to improve its risk management systems as a reason why the regulatory punishment diminished, illustrating the non-rigid (risky) nature of the regulatory response. A similar dynamic emerged in the SWF episode. Government authorities in the US and Europe threatened to implement new regulations targeting SWFs, as a result of the funds increasing systemic risk. SWFs then agreed a code of conduct designed to mitigate systemic risk and by extension regulatory risk. The credit crunch episode captured the post-crisis regulatory debate. The existence of this debate

[2] The reputation pressure on Citigroup may also be regarded as a form of regulation (Braithwaite and Drahos 2000).

was an increase in regulatory risk. This risk had come about because of the higher systemic risk during the crisis.

With this analysis, it is possible to generate more abstract meta-propositions about the three core variables. They are presented in Figure 6-5 below.

Figure 6-5. Propositions about CMR, regulatory risk, and systemic risk

Meta-proposition	Annotation
Less CMR conduct leads to higher regulatory risk	*In all three episodes, the lack of CMR was cited by regulators as a justification to threaten new regulatory interventions.*
More CMR conduct leads to lower regulatory risk	*The Citigroup and SWF episodes showed that proactively implementing some CMR protocols could decrease the regulatory punishment, or threat. The reason for this relationship is that higher CMR is perceived to help lower systemic risk.*
Less CMR conduct leads to higher systemic risk	*In all the episodes, and across both public debates and regulatory decisions, the perception among market and non-market stakeholders is that this relationship holds. This was at the core of the post-Credit Crunch regulatory debate, which framed the causes of the crisis as the "age of irresponsibility".*
Higher systemic risk leads to higher regulatory risk	*All three episodes showed higher systemic risk leading to higher regulatory risk.*

This figure summarises the relationships between CMR, regulatory risk, systemic risk. These meta-propositions abstract from specific micro-level processes and show CMR in the broader context of market governance. They explain the episodes in their entirety. They show why CMR matters and how it emerges. CMR conduct matters for regulators and other actors because it is perceived to help reduce systemic risk. Therefore, regulators increase the threat of new rules or punishments when CMR conduct is absent. CMR conduct matters for firms because in its absence they face higher regulatory risks, and may also face higher systemic risks. Firms can reduce regulatory risk by pursuing CMR conduct. Put differently, financial firms may reduce regulatory risk by striving to reduce systemic risk.

These meta-propositions help explain why the research problem emerged. Regulators perceive that certain discretionary corporate behaviours impact on their ability to meet their key objective of regulating systemic risk. As a result, they attempt to compel firms to adopt new behaviours. In sum, these meta-propositions comprise the raison-d'etre for the thesis. I return to them in the discussion of market governance literature, in Section 6.3.

The following are the parts of the CMR relationships that I have not established:

- Whether more CMR conduct leads to lower systemic risk
This relates to the effectiveness of CMR as systemic risk regulation. If we assume that the actors cited in the data asking for CMR are rational, then this relationship should hold. However, the episodes focused on the absence of CMR conduct.

- Whether higher regulatory risk leads to more CMR conduct
This relates to the effectiveness of regulatory pressure in promoting CMR. If regulatory pressure does not bring about CMR, but regulators invoke CMR nonetheless, then we may anticipate future controversies, with a lack of CMR leading to further regulatory punishments.

In the final section of this chapter, I present several outstanding issues as directions for future research. These two CMR relationships would require new empirical contexts where CMR behaviour can be fully observed.

6.2.2. Generalisability

Taken together, the propositions about CMR constitute a *substantive grounded theory* of corporate market responsibility. A substantive theory is a conceptual rendering of specific events and environments, not yet extended beyond a few similar empirical contexts (Charmaz 2006, Glaser 1978, Strauss 1987, Strauss and Corbin 1998). While tentatively generalisable among certain groups and places, it is still specific to the environments from which it emerged. A substantive theory may become more generalisable as researchers analyse further variations of the core concept in more empirical settings. Eventually, this may lead to formal theory, which pursues the general implications of the core concept (Glaser 1978: ch. 9; 2007).

The choice of research methods is an important determinant of the level of generalisability in a theory. Any theory, writes Charmaz (2006: 143), "bears the imprint of its author's interests and ideas". However, she continues, researchers may generate theory that is "sufficiently abstract to cover a range of situations" (op cit: 145) by adopting methods like Strauss and Corbin's (1998), which tend towards objectivism. This is what I did. Adopting these methods (see Chapter 2, Section 2.3.), I identified my methodological approach as postpositivist grounded theory (Charmaz and Bryant 2007: 52), which makes "limited, tentative generalisations, not universal statements" (ibid).

How generalisable are my findings, then? The theoretical propositions should make sense to other researchers as potential explanations for new emerging phenomena. For example, at the end of this chapter, I note that the recent debate about hedge funds and 'dark pools' of capital *might* be understood as an attempt to define a 'corporate market responsibility' for the market actors involved. If I have done my job well, then the propositions should help researchers and practitioners better understand, learn from, adapt to, and shape some emerging situations in financial market governance. In other words, the substantive theory should be tentatively generalisable across empirical contexts. Moreover, it should have some predictive power within the contexts that I studied. It should improve the understanding of these episodes such that another analyst with a similar theoretical background and following the same procedures would arrive at similar conclusions: "The same problems and issues should arise regardless of whether they are conceptualised and integrated a little differently", as Strauss and Corbin (1998: 266-7) write.

However, each of the episodes (and each new future episode) is historically and culturally embedded, somewhat idiosyncratic, and never fully apprehendable. This limits the generalisability of my findings. I have argued that this acknowledgment (which many theoreticians do not make) is fundamental for building self-aware social science. Specifically, I would delineate the boundaries of generalisability for this thesis as follows, based on the characteristics of CMR already outlined. The propositions apply especially in relation to:

- Large financial institutions (entities)
- When making extraordinary transactions (actions)
- Western regulatory jurisdictions (location)
- In situations of unstable liquidity, or where liquidity is threatened (conditions)
- The present era, rather than historically (time-period)

Combining insights from micro- and macro-level episodes bears implications for what kind of theory CMR is. CMR theory claims that firms have, at the micro level, a responsibility for system-wide governance. It links the particular to the general, by outlining corporate practices that serve a systemic purpose. Yet the micro and macro levels are not always commensurable. Economic theories, for example, often present distinct constructs to explain micro and macro levels of economic activity. Only a few concepts (like utility-maximising behaviour) are invoked at both levels. In this thesis, the argument intends primarily to show how micro-level phenomena (corporate practices, regulatory pressure) have macro-level effects (systemic risk). That is, CMR refers to how individual actors impact on the systemic commons.

As such, CMR is a middle-range theory. It does not present an overarching explanatory framework for the commons, nor does it focus strictly on agent-level problems. Its focus is on the (dis)connection between the two levels. It could be seen as a response to the problem of systemic financial governance of the modern era, insofar as too much attention was placed on corporate risk management, under the mistaken assumption that systemic risk management was a natural by-product of agent-level activity. CMR awakens us to the connection between the two levels of risk and calls for self-aware systemic risk management at corporate level.

The theory makes some causal claims about the relationship between the core variables – CMR, regulatory risk, and systemic risk – presented in Figure 6-5, above. In this respect, CMR makes some tentative normative claims for public policy. CMR protocols comprise mechanisms through which systemic risk can be managed at a corporate level. That said, it has not been an objective of this thesis, contrary to much governance literature, to present an agenda for a new regulatory framework. Such an endeavour would have required a deeper investigation of how CMR is socially constructed and the practical limitations of its implementation. In addition, CMR theory is in part an explanation, or illustration, of (already) observable trends in financial governance and therefore is not a wholly new agenda. The value in the thesis is that many of these expectations have been implicit. CMR theory is therefore also a heuristic that practitioners may use to anticipate expectations and reactions under situations of unstable liquidity. In this way, CMR theory comprises terms of reference for a new regulatory framework that could better regulate systemic risk.

By and large, CMR theory is limited to the financial sector, and I do not make claims as to its generalisability beyond the sector. Finance is a unique industry. It draws capital from the real economy and creates its own parallel markets and derivative capital. It can enhance productivity and growth throughout the entire economy. The repercussions of its failures extend to all other industries. The term 'systemic risk' is apt, not only because it refers to failures throughout the financial system, but also throughout the wider economy. A few other industries have similar effects, and may also have special responsibilities. One such industry is energy. Large sections of the economy rely on stable, affordable energy in order to function. As a result, one might pursue the argument that energy companies have an economic responsibility beyond their own shareholders. The difference between this argument and the CMR theory presented here is that this argument would examine energy companies' responsibility to the entire economy, whereas this CMR theory only pursued financial firms' responsibility to their own markets.

6.2.3. Assessing the theory's quality

Grounded theory methodology presents a clear set of criteria for evaluating the quality of the research findings. The methodology has transitioned from positivistic roots (Glaser and Strauss 1967, Glaser 1978), to include postpositivist (Strauss 1987, Strauss and Corbin 1987, Charmaz and Bryant 2007), and constructivist (Charmaz 2006) variants. I contrasted the criteria of the more extreme positivist and constructivist strands, and showed how they overlap, in Chapter 2 (Section 2.3.3.3.). I now assess my research process and findings in light of these quality criteria.

6.2.3.1. Fit and credibility

- A grounded theory should fit the data (Glaser 1978: 4). There should be sufficient data to merit the claims (Charmaz 2006: 182-3).

During the research and analysis process, I built detailed code logs that showed, for each news article or regulatory paper, which codes had appeared and which other codes they related to. The logs are not complete conceptual summaries of the data, because when conceptual categories became theoretically saturated (the data stopped conveying variation), they were no longer coded. Although the method calls for sampling to cease at the point of theoretical saturation, I established minimum sampling periods for each episode, and on those grounds, I would argue that the data is sufficient to merit the claims.

- Data is not selected to fit an extant theory; most categories are generated directly from data; categories are re-fit to new data; there is emergent fit between data and pre-existing categories (Glaser: op cit).

The selection of data emerged directly from my first empirical observation; a news report about the Citigroup episode. I chose regulatory and media documents as my data specifically in line with the research problem (see Chapter 2, Section 2.4.2). During the analysis process, I was careful not to introduce concepts that had not yet emerged. For example, I only began to conceptualise the relevant aspect of orderly markets as *systemic risk* in Chapter 5, because this concept emerged in the Credit Crunch data. Other categories evolved as more data emerged. For example, *escalating strategies to senior management* (upwards), became *aligning high-level objectives with mid-level strategy* (both upwards and downwards), during analysis of the post-Credit Crunch debate.

- Achieving intimate familiarity with the topic (Charmaz: op cit).

In the empirical analysis, I place some of the most vivid data in citations to illustrate the more idiosyncratic perceptions. I also sought to convey intimate familiarity by limiting how much I generalised my theoretical findings.

6.2.3.2. Relevance and resonance

- Theory allows core problems and processes to emerge; theorist does not have to spend time to convince others of the relevance of his work (Glaser: op cit).

The contemporaneous nature of the SWF and Credit Crunch controversies, particularly, is sufficiently strong to immediately convey the relevance of this thesis. In addition, throughout the research, I have allowed empirical and theoretical problems to emerge that I had not anticipated. One example was my discussion of alternative explanations for the SWF controversy. The data showed a number of commentators attributing the controversy to classical protectionism on the part of Western governments, rather than attributing it, as I do, to a concern over their market conduct. I disputed their argument based on data showing that protectionism did not emerge where we might have expected it (the EU and the US's CFIUS), and that 'protecting' Western banks now meant welcoming SWFs, not prohibiting them.

- Categories portray the fullness of the studied experience; reveal unstable 'taken-for-granted' meanings; analysis offers insights to people in the analysed environment (Charmaz: op cit).

It would be difficult review the data on these episodes and find conceptual categories that are both significant and not represented in my propositions. An exception to this would be the debate on capital adequacy requirements, which I have not analysed. I judged in Chapter 5 that the technical, financial nature of this debate was outside my ability to analyse it critically, although my analysis on *humanising technical activity* and *ethical competence* would merit consideration in that debate. My analysis shed new light on some taken-for-granted meanings. One example was my argument on protectionism; that in the context of SWFs, it had come to mean welcoming foreign investors rather than blocking them. Another is my argument later in this chapter that the putative *gentlemen's agreement* that many commentators suggest should have discouraged Citigroup from their transaction probably did not exist, but rather was as a post hoc construction.

6.2.3.3. Workability, modifiability, and usefulness

- Categories allow for ready, quick modification to help explain surprising or new variations in an ever changing world, as new data emerges; can be extended to new substantive contexts; maintain tractability and hence relevance (Glaser: op cit).

One of the most important heuristics I employed, both to help meet this criterion and to help organise my thoughts, was to code the data as generic processes, almost always in gerund form (verbs ending in *–ing*). Identifying generic processes is extremely helpful for trying to understand relationships between concepts. Another advantage is that, as processes, these codes give researchers a better idea of what is meant by them and how they may be extended to new contexts. For example, the code *aligning remuneration with risk management* is more helpful than the code 'remuneration relationship with risk management'. The categories are also modifiable because I have expressed their properties and dimensions. The category *banks being unsettled* has as one of its properties *panicking*, with dimensions such as *hedging* and *withdrawing from the market*. In new settings, these categories and properties can be readily modified.

- Interpretations that people can use practically; generic processes; analysis sparks further research in other areas; contributions to knowledge and making a better world (Charmaz: op cit).

Coding generic processes also enables people to use these findings practically. In the CMR propositions, corporate managers may identify specific practices to implement. By outlining the relationships between CMR and regulatory risk and systemic risk, and particularly the aspects of those relationships that I have not established, I have also indicated areas for future research. Moreover, I believe that CMR can contribute to a better world by improving accountability and legitimacy in financial governance, as I argue in Section 6.3.3 below.

6.2.3.4. Originality

- Categories are fresh and offer new insights; new conceptual rendering of the data; challenge, extend, or refine current ideas (Charmaz: op cit).

The core category in the thesis, corporate market responsibility, is a new conceptual dynamic in market governance. As I integrate CMR with existing theories in the following sections, CMR may be regarded as a form of meta-regulation (Parker 2002), similar to Ayres and Braithwaite's

(1992) 'enforced self-regulation' concept. I will also argue that CMR offers new insights into legitimacy in financial governance, and I show that my analysis of Citigroup and SWFs offers insights for economic sociology from a new perspective. It is the first time, to my knowledge, that these episodes have been analysed using grounded theory methodology. Therefore, each of the preceding chapters arguably offers an entirely original conceptual rendering of the data.

6.3. Integration with other theories

CMR raises questions of, and lends weight to, a number of theories in contemporary market governance. A central problem in this governance is the decentralised and complex nature of networks where state and market actors assume overlapping roles. In this section, I position CMR within this literature and argue that CMR advances several discussions in political economy and economic sociology.

To order the complexity of decentralised governance, I draw on Goodhart, Hartmann, Llewellyn, Rojas-Suárez, and Weisbrod's (1998) relational paradigm of regulation, which posits that financial regulation reflects interdependency between regulators and the regulated, an argument also underpinned by Underhill's (2000) notion of a "state-market condominium". I position CMR within this field by arguing that it is a form of meta-regulation, often described as the "regulation of self-regulation" (Parker 2007, Black 2006, Black and Baldwin 2006, Gray and Hamilton 2006), and shares some characteristics with similar models such as enforced self-regulation (Ayres and Braithwaite (1992) and ethical self-regulation (Chiu 2009). My aim in this analysis is to use extant theory to further define and refine the CMR concept. Even though CMR grew from empirical data, it is very compatible with existing theoretical ideas. This adds to CMR's relevance because it speaks directly to current debates in financial governance, and it increases CMR credibility because extant theory confirms that similar processes have been observed elsewhere. Moreover, the argument that CMR is an example of meta-regulation illustrates this extant model in a new substantive context.

After positioning CMR as meta-regulation I begin a more critical discussion, exploring CMR's implications for current arguments in political economy and economic sociology. In political economy, I focus on accountability in financial governance. This is intrinsically relevant because CMR is a way in which regulators and other actors hold firms accountable for their impact on the financial system. I argue that CMR lends weight to Underhill and Zhang's (2008) argument that financial governance is detached from traditional democratic mechanisms and in some respects lacks legitimacy. However, my analysis also suggests that CMR is a means to improve accountability and legitimacy in governance. It is therefore an answer to some of the problems that Underhill and Zhang raise, and it justifies taking a more optimistic perspective than theirs.

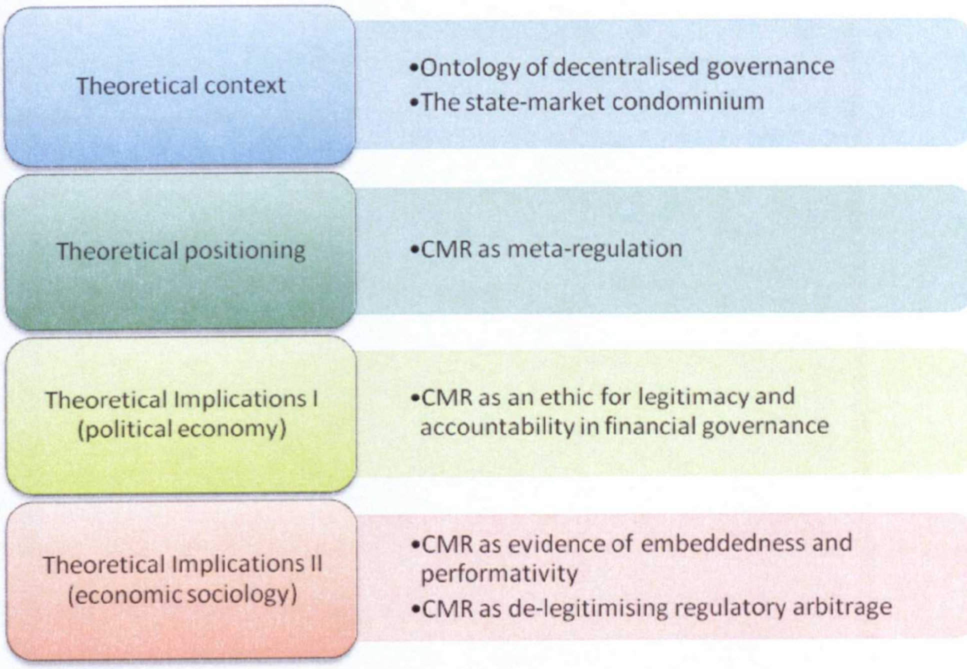
To explore the implications for economic sociology, I break CMR down into its constituent empirical episodes. The CMR episodes lend weight to two central concepts in economic sociology:

embeddedness and performativity. First, they present evidence that markets are embedded in social networks and values, rather than atomised rational action, which is the traditional argument of economic theory. For example, the Citigroup case showed that governance in bond markets relied on implicit meanings about what constitutes acceptable market conduct. The episodes also present evidence that actors in financial markets *perform* economic theory – that economic models drive financial behaviour and do not merely describe it (MacKenzie 2006). For example, sovereign wealth funds had to be 'trained' in economic behaviour, even though they were already pursuing financial returns. CMR also shows new dimensions of embeddedness and performativity. I argue that the putative ***gentlemen's agreement*** that Citigroup was widely said to have violated most likely did not exist, but was a post hoc construction designed to help perform economic theory. The SWF episode also extends the concept of performativity into what I call performativity-plus: the funds were not only 'trained' in economic theory (disembedding them from their traditional decision-making structures), but also in how to apply it *responsibly* (re-embedding them into a CMR ethic).

A connection between embeddedness, performativity, and legitimacy is outlined based on the Credit Crunch episode. I argue that CMR expectations served to de-legitimise regulatory arbitrage; the practice whereby firms look for lower regulatory requirements in new jurisdictions, or by innovating new products. CMR de-legitimises atomised economic behaviour by setting the expectation that firms will help regulators achieve a stable financial system, which is in the public interest.

With these analyses, I demonstrate that CMR is an integrative concept that helps us to understand key patterns of interaction that are problematic for theories of political economy and economic sociology. The structure of this theoretical integration that I have just described is illustrated in Figure 6-6 below.

Figure 6-6. Structure of theoretical integration



As the figure shows, I begin by setting a theoretical context that shows why financial market governance is problematic in theory. Then I establish the concept of CMR as a form of meta-regulation. Third, I proceed to draw implications for current theoretical discussions.

6.3.1. Theoretical Context: Decentralised market governance

In recent political economy, market governance is often characterised as decentralised, or 'messy' (e.g. Black 2002; Braithwaite and Drahos 2000; Chiu 2009; Cutler, Haufler and Porter 1999; Haufler 2000; Higgot, Underhill and Bieler 2000; Matthews 1997; Rosenau 2002; Underhill 2000; Vogel 1996). Several criss-crossing vectors of decentralised governance are apparent. State authority, often regarded as a starting point for governance, has become more diffuse, if not necessarily reduced. A transnational space has emerged, where the issues requiring governance and the mechanisms of governance cut across and transcends state borders (Scholte 2000). Civic coalitions with single-issue or public-interest agendas increasingly influence political ideas, regulatory standards, and business behaviour (Matthews 1997). Regulatory institutions mandated by the state to create rules for corporate behaviour are increasingly independent from the political arms of government, whose primary function has often become to supervise, rather than guide, industry regulation (Levi-Faur 2005). Private regulatory institutions now exercise many similar functions as state regulators, often obscuring the traditional accountability mechanisms of governments (Underhill and Zhang 2008). Not only do industries self-regulate (under the influence of state and civic organisations) but they are seen to have legitimate authority to do so (Cutler, Haufler, and Porter 1999: 334).

One of the most important domains of decentralised governance is regulation; that is, governance through prescriptions and enforcement (Levi-Faur 2005: 13). The complexities of governance generally are replicated in the regulatory domain specifically, along several dimensions including, but not exclusively:

- Who creates regulation: regulatory institutions exist in public forms (e.g. the SEC), state-mandated private forms (e.g. the FSA), formal private organisations (e.g. the British Banking Association), informal conventions (e.g. industry codes-of-conduct), and market mechanisms (e.g. credit ratings);
- Where regulatory design and supervision take place: there are subnational, national, intergovernmental, transnational, and global levels ;
- How specific the regulation is: rules (specific prescriptions), principles (unspecific prescriptions), norms (implicit prescriptions), and standards (thresholds of compliance);[3]
- How voluntary or compulsory these measures are; How effectively non-compliance can be monitored and punished: i.e. accountability.

[3] See especially Braithwaite (2002).

Goodhart, Hartmann, Llewellyn, Rojas-Suárez, and Weisbrod (1998) order this "messy world" (Rosenau 2002) into a relational paradigm that distinguishes between regulators and the regulated but acknowledges their interdependency and overlap. Underhill (2000) goes further and argues that states and markets function as a "condominium". Whilst recognising the state-market dichotomy as a useful heuristic, Underhill rejects the frequent thesis in political economy that firms and regulators think differently and pull in opposite directions:

> "The preferences of market agents and other constituencies of market society are integrated into the institutions of the state through policy and regulatory processes at domestic and international levels of analysis, depending on their individual organizational capacities/coherence, and of course power. The incentives and constraints of state policy and regulation are in turn part of the landscape of firm decision-making, conferring advantages on some and costs on others just as some are more capable of affecting the policy outcome than others" (Underhill 2000: 821).

This state-market condominium implies that decentralised regulatory governance does not derive from a dichotomy of preferences of state and market actors, but rather from a "complex alignment of principles, mechanisms and actors" (Drahos and Braithwaite 2001: 123) which Levy-Faur (2005: 14) frames as "regulatory capitalism": "Regulation is both a constitutive element of capitalism (as the framework that enables markets) and the tool that moderates and socialises it (the regulation of risk)". In this view of the political economy, "the state retains responsibility for steering [economic development and rule-making], while business increasingly takes over the functions of service provision and technological innovation" (op cit: 15). The implications of this division of labour extend well beyond regulation, to include, for example, privatisation of social utilities, which were within the remit of government particularly between the 1940s and the 1980s. In regulatory terms, argues Levy-Faur, "This new division of labour goes hand in hand with the restructuring of the state (through delegation and the creation of regulatory agencies) and the restructuring of business (and other societal organisations) <u>through the creation of internal controls and mechanisms of self-regulation in the shadow of the state</u>" (ibid, underlining added). (This process is intrinsic to CMR.) Thus, regulatory capitalism heralds an increase in privatised service provision, an increase in the number of regulatory agencies, and an increase in industry self-regulation. The key point is that we see responsibility for market governance diffused among several overlapping actors, as in my own analysis of CMR.

In Drahos and Braithwaite's influential work, they call for a better understanding "of when a particular web [of regulatory actors, mechanisms, and principles] tightens or unravels" (2001: 123-4). Global regulatory capitalism "cannot be understood in terms of the agency of single actors using single mechanisms," they write, "Theories that concentrate on a single actor, such as realist international relations theory, or a single mechanism, such as rationality, end up giving a poor account of the patterns of regulatory globalisation, [...which, rather,] depends on a complex alignment of principles, mechanisms and actors" (ibid). In particular, Drahos and Braithwaite's studies "reveal regulatory globalisation to be a contest of principles" (ibid). This contest of principles is evident in the emergence of CMR along several dimensions. Nominally, CMR is a set of principles for corporate conduct that will challenge established management structures in some corporations. It is also arguably an ethic that increases accountability in governance by contesting existing, taken-for-granted standards of conduct and levelling the playing-field for some smaller actors, as I will argue in detail. One CMR's strongest contributions to the contest of principles may be how it de-legitimises regulatory arbitrage, a widely accepted principle for action. This is also covered later in this chapter.

The topology of this conceptual world – decentralised governance; regulatory capitalism underpinned by a state-market condominium; contests of principles – helps us position CMR theory within a broader analytical tradition. CMR sheds new light on existing ideas and indicates new directions for research; my objective in the following pages. I will not attempt a systematic alignment of CMR and regulatory capitalism because that would be to force CMR into an extant framework unnecessarily. Some features of both theories will remain outside the following analysis, and may even contradict it. Instead, my contribution is to advance the theoretical discussion along three dimensions:

- **Establishing CMR as a form of meta-regulation**: CMR may be understood as an empirical example of this regulatory model.
- **Exploring implications of CMR I: Legitimacy**: CMR is a governance ethic that may enhance legitimacy in terms of input, output, and accountability (cf. Underhill and Zhang 2008).
- **Exploring implications of CMR II: Embeddedness, performativity, and regulatory arbitrage**: The Citigroup episode shows CMR as a driving force for the state-market condominium to operate as a business model for governments and firms. The SWF episode shows CMR as a tool for the state-market condominium to sustain markets by 'performing' market theory. The credit crunch episode shows CMR as a response to a principle-agent problem because shared norms and objectives are demanded. The profit motive is deemed insufficient grounds to eschew regulatory objectives.

These first two arguments draw on political economy, with input from theories of law (e.g. Black 2002, Braithwaite 2002). The rationale for extending CMR in this way is that these arguments contextualise CMR more firmly within an existing tradition. So doing, it is hoped that CMR will become a more useful concept for political economists. The other arguments are exploratory, and draw on economic sociology. My rationale for this is to help de-silo our understanding of market governance and to highlight this discipline which I believe to be very fertile, and worthy of political economists' attention. Financial markets have received relatively little, but increasing, attention in sociology (see Knorr Cetina and Preda 2005). To my knowledge, sovereign wealth funds have not featured in any sociological studies; which is interesting, given the way in which these funds cohabit the social and economic environments.

I also take these extant theories to be a form of data (Wallis 2009) insofar as they represent the views of other theorists. If some theories are highly consistent with CMR, they arguably lend weight to the idea that CMR exists. For example, the fact that several theorists have shown "meta-regulation" to exist helps me argue that my theory, which was born from empirical observations rather than an extant theoretical framework, is, at a minimum, not peculiar.

6.3.2. Theoretical Framework: CMR as 'meta-regulation'

A key feature of decentralised governance and regulatory capitalism has been the search for better instruments of regulation (Levy-Faur 2005: 21). Regulation is a form of governance that takes place through rules, principles, and enforcement (op cit: 13). A defining feature of decentralised governance is self-regulation by firms and industry association. Chiu's (2009: 27) comprehensive review of models of financial regulation groups three models as examples of "shared governance", where, "although leadership is provided by regulation, the regulated may be co-opted to provide governance within discretionary parameters". The shared governance models are meta-regulation, enforced self-regulation, and ethical self-regulation. All three stand out for their consistency with key features of CMR, none more so than meta-regulation. In this section, I argue that CMR is a substantive example of meta-regulation.

Examining these three models serves two purposes. One is to refine CMR. The comparison between CMR and extant theory introduces CMR to the literature on recognisable and commensurable terms. In addition, showing CMR's proximity to the generic model of meta-regulation builds credibility for the concept, because it helps to 'verify' my theory-building. CMR departed from data analysis rather than pre-conceived hypotheses, but it arrived at a very similar place as other theoretical frameworks. In this respect, extant theory assumes the role of data, verifying the plausibility of CMR. The second purpose of this analysis is to show a new substantive variation of these generic models. Because CMR is grounded in empirical data, it adds new empirical evidence and variations to these models. To my knowledge, these models have not been discussed in relation to the Citigroup or SWF episodes. Inevitably other researchers will be analysing their relevance for the Credit Crunch, as the timing is propitious.

6.3.2.1. Meta-regulation

The first of these models, "meta-regulation", is a regulatory technique that advances parameters for firms' internal management systems, usually in order to help regulators meet their objectives (Black 2006: 3). It is often referred to as the "regulation of self-regulation", hence the "meta" in the name. It does not refer to the way in which private actors create regulation (self-regulation) but rather how regulators influence *discretionary* management systems in firms. Recent studies have looked at its role in financial regulation (Black 2006, Black and Baldwin 2006, Chiu 2007, Gray and Hamilton 2006), risk management (Braithwaite 2003, Power 2004), corporate social responsibility (Parker 2007), and as a form of decentralised governance (Grabosky 1995, Parker 2002). In this model, "the quality of firms' internal controls are the paramount focus of attention" (Black 2006: 3), usually with the aim of managing "risks that the regulatory agency will not achieve its objectives ... and more specifically the extent to which, and ways in which, those firms will comply with regulatory requirements".[4] Chiu's (2009: 29) discussion of meta-regulation shows various fundamental similarities with CMR.

> "This approach may be manifest in the emphasis placed on corporate governance, risk management, ethical business management and even corporate social responsibility - encouraging corporations to improve and self-reflect from the inside. The meta-regulation of risk management in financial institutions is in particular, a key feature of financial regulation in the EU and the UK. The [EU's] Markets in Financial Instruments Directive provides for broad principles of organisational soundness, the establishment of a compliance function, risk management systems, internal audit, and the responsibility of senior management for compliance generally. These cannot be excessively prescribed as regulators are not in a position to micro-manage firms, and hence, these represent a meta-regulatory approach where regulators expect certain internal measures to be in place in firms, and the regulators' role is to monitor the performance of such measures. Some commentators have lauded this approach as being reflexive and cost-effective, and likely to entail more permanent solutions that would be viewed as convincing for firms. ...
>
> [Under meta-regulation, firms'] "capacity to self-regulate may be enhanced by value orientation, management commitment, the acquisition of skills and knowledge and the design of internal processes and systems. The 'self-regulation' of each microcosm should then be accountable to regulators and stakeholders in order to achieve not just 'compliance' but responsibility towards the democratic polity" (Chiu 2009: 29-30).

The emphasis on internal systems, rather than corporate structure or specific types of trades, is entirely consistent with the CMR protocols. This is especially true of the emphasis on corporate

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[4] Black 2006 and Chiu 2009 associate meta-regulation closely with the risk-based regulation approach of the FSA and the EU – where regulation is designed to mitigate risks to the regulators' objectives. Black argues that meta-regulation goes hand-in-hand with this approach; is fuelled by it, and in turns fuels it (p. 3).

governance, risk management, and ethical business management. Also in this vein, Black (2006: 22) writes that part of the purpose of meta-regulation is "to determine how much those at the top of the organisation, essentially the board, know about how the risks identified by the regulators are being managed... The aim is then to ensure that the firm's own system of regulation is enhanced to enable the regulator to spend fewer resources monitoring it in future". Throughout the CMR episodes, the notions of *escalating trades to senior management, integrating high-level objectives with mid-level strategy,* and having the board *setting the tone of responsible compliance from the top* were integral to the recommendations. Meta-regulation's aim of "enhancing the capacity to self-regulate through value-orientation" (Chiu op cit) was also notable in the Credit Crunch episode's contributions to the CMR concept; namely, pursuing *responsible compliance, humanising technical activity,* and *ethical competence.*

Meta-regulation's move from strict compliance and towards "responsibility towards the democratic polity" (ibid) is also apparent in the CMR protocols. Firstly, the protocols emerge not only from regulators, but also from other political, economic and social actors, whose reactions and prescriptions in each of the controversies were captured in media data. Second, exceeding minimum compliance is a fundamental feature of the CMR problematique.

A principles-based approach in meta-regulation, in contrast with "excessively prescriptive" rules (ibid), is another consistency between the models. Finally, the particular application of meta-regulation in financial industries (ibid; also Black 2006, Braithwaite 2003) is of course consistent with the substantive context of the CMR propositions.

Against this background, CMR may be regarded as a substantive example of meta-regulation. CMR is a form of meta-regulation designed to ensure an orderly financial system. One difference is that CMR protocols are drawn both from regulatory statements and from broader stakeholders, whereas meta-regulations typically depart directly from regulators and regulated firms.[5] This may enable CMR to overcome some limitations of the generic model. The generic model "may be seen as an excessively microcosmic approach to regulation. It offers no particular insight as to the collective effects of firm self-regulation and issues of social risk or communitarian concerns, or systemic risk," writes Chiu (op cit: 32). By contrast, CMR is underpinned by a focus on mitigating systemic risk, which is in the public interest, as I will argue in more detail.

[5] See, however, Hutter (2005) on the role of various government institutions in the application of risk-based regulation.

Meta-regulation has also been criticised for leaving regulators open to "technocracy capture" (see also Porter 2004 on "technical authority"), where regulators "find it difficult to judge the performance of the firm's systems and designs," writes Chiu (ibid), "In this respect, shared governance such as meta-regulation that allows and entails reliance on the internal expertise of firms may create a presumed legitimacy". CMR is also vulnerable to this claim. Further, as Black (2006: 2) notes, technocracy capture often means that the "most important problems" remain "obscured from public scrutiny until a 'scandal' occurs". On this note, however, CMR's emphasis on systemic stability (outcomes), combined with its explicit threat of regulatory punishment, should provide a disincentive for firms to hide problems behind technology. This is because if the "scandal" that reveals the corporate misconduct is a systemic crisis, the regulatory response is likely to be acute. Put differently, if CMR propositions were only about specific protocols (management systems), then technocracy capture would be significant vulnerability. Because the protocols are also linked both to systemic risk and regulatory risk, CMR shows a disincentive for firms to obscure problems.

A more significant problem with meta-regulation and CMR lies in its instrumental value for regulators. Black (op cit: 22) writes, "Whilst it may have a new label, reliance on a firm's internal management controls to implement regulatory norms and objectives is inevitable ... Meta-regulation arguably simply aims to turn weakness into strength by turning this inevitability into a regulatory technique". Consequently, this may not solve the regulatory problem, but rather move "the onus for its resolution to the firms whilst not necessarily helping them to develop the capacity to resolve it" (ibid). Here we are moving into a more normative space, about the effectiveness of CMR to resolve systemic risk, which we can only be assessed empirically. However, if meta-regulatory frameworks like CMR are hollow envelope-pushing, then we may be able to anticipate higher systemic risk and increased conflict between firms and regulators, because neither set of actors is adequately prepared to manage the system. This concern would be acute because meta-regulation "is growing rapidly in vogue, and has been hailed as one of the hallmarks of the 'new regulatory state'," according to Black (ibid).

6.3.2.2. Enforced self-regulation and ethical self-regulation

Meta-regulation is classed by Chiu (2009) as a model of "shared governance" in financial regulation alongside two others: enforced self-regulation and ethical self-regulation. Like meta-regulation, these improve our understanding of CMR. They do so particularly in the area of enforcement.

Enforced self-regulation is a technique proposed by Ayres and Braithwaite (1992) whereby regulators set objectives, firms write their own rules, and regulators subsequently monitor them, and punish non-compliance.[6] This is similar to meta-regulation insofar as regulators take the lead in setting objectives and firms subsequently have discretionary space for agreeing rules. In addition, enforced self-regulation promotes the independence of the compliance department in firms (Ayres and Braithwaite op cit: 115-6), as does CMR in several key processes. However, the regulations in this model do not necessarily focus on internal systems and controls, which is the emphasis of meta-regulation. They may cover any aspect of management, incorporation, or trading.

In the enforced self-regulation model, firms articulate specific rules for themselves, sometimes in "a lengthy process of writing and re-drafting" regulations (op cit: 111). It is only in a minority of cases that Ayres and Braithwaite "envision instances in which regulators should develop different sets of defaults that the regulated firms can choose between as an additional alternative to developing idiosyncratic self-regulation" (op cit: 109). By contrast, CMR has specific principles as defaults, derived from outside the firm. This is a key difference: CMR is less about firms self-regulating, and more about external stakeholders influencing discretionary firm behaviour. Put differently, enforced self-regulation emphasises compliance with written rules, whereas CMR (and meta-regulation more generally) emphasises meeting regulatory objectives and does not explicitly call for firms to write their own rulebook.

Notwithstanding these differences, Ayres and Braithwaite *advocate* enforced self-regulation on some of the same grounds that I *describe* CMR. In particular, enforced self-regulation may spur companies to adopt higher standards than regulator-led regulation would. "Regulations mandating a certain hazard-reducing technology, while forcing less responsible companies to upgrade to this standard, can also cause industry leaders to adopt this fix when, left to their own devices, they would have installed a technology superior in both hazard reduction and economy," write Ayres and Braithwaite (op cit: 110). Indeed, they continue, "internal corporate rules ted to cover a much wider range of industrial hazards and corporate abuses than do governmental regulations" (op cit: 112; also Goodhart et al 1998). In this way, Ayres and Braithwate argue that the model offers incentives for what the CMR protocols term *responsible compliance*; that is, *pursuing shared objectives with regulators*, rather than only minimum literal compliance (see Chapter 5, Section 5.2.4).

[6] Ayres and Braithwaite present enforced self-regulation as a form of responsive regulation more broadly. See also Black and Baldwin (2006).

In order to overcome the problem of literal compliance, CMR invokes ethical prerogatives rather than rules written by firms. CMR shares this characteristic with ethical self-regulation, the third model. Chiu (2009: 32) summarises the model thus: "In a narrow sense ethics may relate to the prevention of fraud or other anti-social and detrimental behaviour that may inflict organisational and social costs. Seen in that, light ethical self-regulation would include risk management, social responsibility in the sense of prevention or mitigation of externalities, and corporate governance. Ethics may also relate to 'proactively' adding to social good ... ". The content of an ethics-based regulatory programme summarised here by Chiu is similar to the content of CMR: risk management, much of which is related to corporate governance, and *proactive improvement* in performance that leads a more orderly financial system, attending to externalities such as the impact on a firm's clients and competitors (e.g. NYT1, FT28). One of CMR's properties related to ethics was *responsible compliance*, noted above. The other was *ethical competence*; particularly *conducting business with some non-financial objectives* and *acknowledging one's fitness for one's role*. Outsized remuneration in the lead-up to the Credit Crunch was both a risk management issue and an ethical one because it implied that bankers needed a bigger reward for their work than other equally socially valuable people (Financial Times 2010c). Elaborating some of the parallels between ethical self-regulation and meta-regulation, Parker (2007) writes of "legally accountable corporate social responsibility", and Shamir (2008) of "responsibilisation" for moral conduct. Where specific rules were unfeasible in the CMR episodes, ethics were invoked as a supplementary enforcement mechanism.

While much of the literature on these regulatory frameworks assesses their relative merits in achieving regulatory objectives (Ayres and Braithwaite 1992, Chiu 2009, Goodhart et al 1998), I have, at most, assessed their merits in explaining the CMR episodes. More precisely, the analysis shows CMR's convergence and divergence with these other frameworks of shared governance. CMR arguably constitutes a substantive example of meta-regulation, displaying some of the same enforcement drive of the enforced self-regulation and ethical self-regulation models. These existing frameworks help to confirm the plausibility of my findings and introduce them to a broader theoretical discussion, where CMR contributes empirical evidence. Having thus positioned CMR within a broader framework, I now explore some ways in which CMR enhances our understanding of key problems in political economy and economic sociology.

6.3.3. Political Economy: CMR as accountability in financial governance

In the first of two discussions on the theoretical implications of CMR, I address the question of legitimacy in financial governance, which is intrinsic to the paradigm of decentralised governance. Such legitimacy has been severely criticised (Black 2008: 137). I focus my analysis on a specific framework of (il)legitimacy advanced by Underhill and Zhang (2008), who argue that the increasing transfer of regulatory authority to private actors has "aligned financial governance with the preferences of powerful market players, transforming the notion of the public interest in the international financial domain" (p. 536). This has meant that "private market interests increasingly define supervisory standards" (p. 541). Together these trends have decreased (democratic) legitimacy in financial governance regimes, an argument that Underhill and Zhang illustrate with two case studies on banking and securities regulation under the auspices of the Basel Committee and the International Organisation of Securities Commissions (IOSCO). This is an interesting argument to engage with because it is concerned with the interaction between private authority over financial regulation and the public good. Similarly, CMR is concerned with self-regulation in pursuit of stability of the system as a whole. In addition, Underhill and Zhang's model is divided into three phases that map onto CMR, systemic risk, and regulatory risk in a way that enhances our understanding of both frameworks.

CMR builds on Underhill and Zhang's premise that regulatory authority is being diffused to powerful private interests, who are closely aligned with regulatory institutions. Yet I would argue that CMR is, normatively and descriptively, an ethic of accountability that could lead to higher legitimacy in private financial governance. The theory of CMR provides a normative underpinning for more legitimate governance. The observation of CMR suggests that regulators' willingness to pay the cost of financial instability on behalf of their friends in the private sector may have limits. The threat of regulatory risk embedded in CMR may owe itself to regulators often taking the blame when private authority does not act towards the public good.[7] Because there is an express threat of higher regulation when CMR is not observed, CMR may represent a conditionality framework for devolution of authority, which would mean that the transfer of regulatory power to private

[7] I do not assume that bankers-turned-regulators are willing accept the damaging consequences (for their professional standing, for example) of bad behaviour by banks. The close relationship between regulators and banks need not preclude resentment and competition between them. In illustration, Hector Sants, chief executive of the 'light-touch' FSA, himself a former banker, said in March 2009, "There is a view that people are not frightened of the FSA. I can assure you that is a view that I am determined to correct. People should be very frightened of the FSA" (BBC 2009).

authorities need not be considered an unconditional structural process. The following discussion positions CMR as a partial response to the problem of legitimacy as Underhill and Zhang present it.

6.3.3.1. Three-phase framework of legitimacy

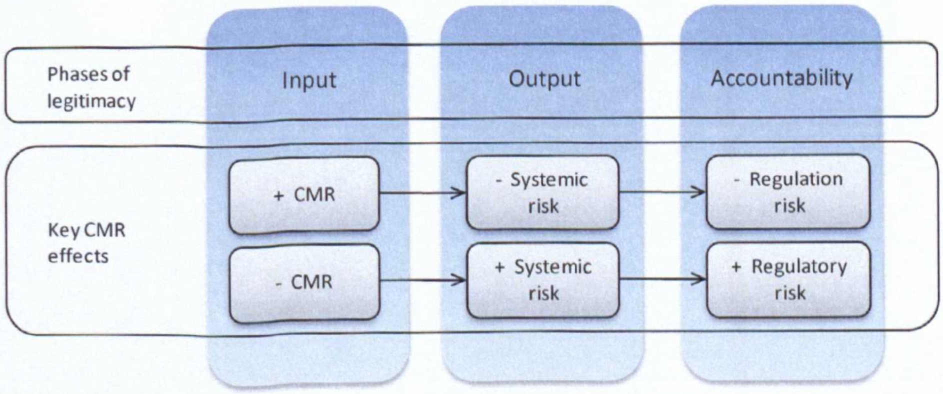
Underhill and Zhang's (2008) framework for legitimacy in global governance distinguishes between input, output, and accountability dimensions of legitimacy. Legitimacy is important on both normative and instrumental grounds because it induces compliance through "an internal sense of obligation rather than by the fear of retribution or self-interested calculation, both of which are more costly and tend to have only ephemeral effects" (p. 573). The three dimensions of legitimacy are distinguishable thus:

> "The input side refers to the decision-making process and the extent to which the interest of the broader community are included. The output side concerns results: the capacity of rule-makers to produce outcomes which resolve problems and achieve collective goals in line with accepted and shared preferences or norms of the community. [... The accountability phase] concerns the democratic accountability of global policy processes *and* outcomes to the broad range of constituencies that are affected by the output phase, beyond the rather narrow, often technical, policy communities which currently participate in decision making" (pp. 538-9).

Underhill and Zhang present evidence to suggest that, in practice, the financial policy-making process and its outcomes are detached from democratic institutions, and captured by powerful financial interests. In the following paragraphs I show how CMR integrates with this framework.

The meta-propositions about CMR – that regulators and other societal actors expect firms to help reduce systemic risk and in return will face lower regulatory risk – maps on to each of the three phases of legitimacy, input, output, and accountability (see Figure 6-7).

Figure 6-7. CMR enhancing legitimacy (developing Underhill and Zhang 2008)



First, at the input phase, specific CMR propositions provide parameters for discussion (input-content) that facilitate broader constituency participation (input-process). These inputs are geared to provide orderly financial markets, which is an output *in* the public interest. Non-observance of these management principles increases regulatory risk, which is an accountability mechanism.

Several legitimacy gaps that Underhill and Zhang point out are not represented here, such as the accountability of regulators to national authorities. However, my claim is that CMR represents an evolution of the legitimacy framework in the substantive environment of systemic risk management. This claim exists on normative and descriptive planes. Normatively, CMR is an idea around which constituencies can coalesce. Descriptively, CMR is empirical evidence of some conditionality in the regulatory diffusion process, and therefore an improvement in legitimacy. The following paragraphs illustrate this argument.

6.3.3.2. Input: CMR propositions as 'content' legitimacy

Underhill and Zhang (2008) argue in favour of a policy-making process that "facilitates the inclusion of new and wider constituencies as participants in the input phase" (p. 539). They argue that decisions made without "a democratic process with input from those who bear the costs of decisions" (p. 539) leads to outcomes that are either not in the public interest or perceived not to be, and are therefore illegitimate.

Whereas Underhill and Zhang devote more attention to the process side of input legitimacy, my analysis emphasises the content side. The process side relates to *how* input is received – which constituencies participate, the equitability of costs of participation, the mechanisms to ensure constituency views count (e.g. voting rights), etc. The content side relates to *what* inputs are received – items on the agenda, their assumptions, and the parameters for final decisions. This input-content is separate from the output, which relates to final decisions and their outcome. Input-content merits specific attention. Parameters for what measures will be discussed in a policy-making context need to be appropriate for each constituency in order for their representation to be meaningful. Very technical and complex discussions tend to favour powerful interest groups. Underhill and Zhang make this point but in reference to the *output* of Basel II negotiations: "Complexity raises the relative compliance costs more for smaller and less sophisticated banks, erecting barriers to entry and hindering competition" (p. 546). The same is true on the input side: complexity increases the cost of participating, and in addition, it decreases participating groups' ability to represent their constituencies faithfully. For inputs to have legitimacy, some baseline parameters for the discussion must be set out. Such a set of parameters can help marginalised constituencies to focus their resources on developing the capabilities required to discuss the most material problems, rather than chase ever-expanding agendas (both in scope and complexity), which intrinsically favour well-resourced groups.[8]

CMR provides such a set of baseline parameters because, to begin with, it is geared to something in the public interest: systemic stability. Therefore CMR as a starting point provides some discipline to ensure that the agenda for discussion attends to public interest. That agenda includes the principles of CMR, namely risk management protocols that specifically look to anticipate the impact of transactions on a broader stakeholder group; discipline the choice and pursuit of business opportunities; and promote proactive improvement, which is part of good implementation of the rules on the output side. Thus, the management protocols for financial companies constitute an agenda for discussion. CMR's intrinsic principles-based nature also de-limits the agenda to a manageable scope. The propagation of self-regulatory regimes is often argued to favour the powerful interests that design them. That may be true, but having a degree of flexibility in regulation also decreases costs for poorly represented constituencies like low-income country governments precisely because it permits them to enter and steer the discussion to the issues they regard as priorities. CMR protocols are sufficiently vague – principles rather than rules – thus allowing interpretation by individual parties based on their particular conditions and a shared objective of systemic stability. This flexibility is a stepping stone for closer integration of ideas on the input side, and therefore greater legitimacy.[9] Over time, as Underhill and Zhang put it, legitimate input "should help a sense of community to emerge as outcomes correspond better to an accepted set of norms around particular issues" (op cit: 539).

CMR principles are Western by design, and it is not intuitive to present them as facilitators for non-Western participation in policy-making. However, one must note that institutions that depart too far from the underlying distribution of structural power cease to be taken seriously by those who possess it (Strange 1997b). In this case, there is more to be gained from adopting an agenda that is anchored in systemic stability and contains voluntary elements – like CMR – than one that more directly serves the interests and capabilities of particular groups. Secondly, CMR is grounded specifically in reactions to the potentially destabilising influence of very large and powerful financial actors, who typically set the rules of the game. These reactions were not only regulators' but also from a broader stakeholder group that included Citigroup's small competitors, which the bank had intended to "kill off"; trade unions that feared SWFs' potential asset-stripping instincts; and

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[8] On this point, see also Ayres and Braithwaite (1992: 122).

[9] On this point, Vojta and Uzan (2003: 284) argue that encouraging emerging market private sector institutions to develop best practice standards for risk management would improve financial governance.

consumers who fell prey to predatory lending before the credit crunch. Being grounded in reactions to controversies in governance, CMR is, I contend, an apt starting point for improving the terms of debate.

The interpretation of CMR I have just presented is normative. It is an ethic that can be used to increase legitimacy on the input side of policy-making. Underhill and Zhang note concerns that "the enhanced rule-setting power of private interests may have severely undermined the authority of public actors to formulate financial and regulatory policies in line with the public interest, a situation approaching policy capture" (op cit: 553). As one solution, they propose enhancing constituency representation on technical committees at international institutions like the Basel Committee for banking regulation or IOSCO for securities supervision, whilst noting that such projects would likely meet with "fierce opposition" from entrenched interests (ibid). I would note that successful cooperation is frequently achieved when interests coalesce around a common ethic (Braithwaite and Drahos 2000), of which CMR is an example.

6.3.3.3. Output: Systemic stability as a public interest

Underhill and Zhang define the output side of legitimacy as "outcomes which resolve problems and achieve collective goals in line with accepted and shared preferences or norms of the community" (op cit: 538). Here they focus on content, not only process, as do I. They present evidence to suggest that, "It is often difficult clearly to define the public interest, as distinct from the particularistic claims of private market actors in relation to the financial system" (op cit: 541). The emergence of CMR, especially the discovery of systemic risk as a pivotal regulatory concern, may be seen as an improvement. CMR aims for systemic stability. This is a public good insofar as its enjoyment by one party does not prevent its enjoyment by another (non-rivalry), and it is difficult to exclude parties from it (non-excludability), except through illegal market abuse. Market stability is also a more equitable outcome for marginalised groups than market instability. Large and powerful actors ('shapers') can use instability to promote more favourable market structures and outcomes, whereas less influential actors ('adapters') must take the future as given (Courtney, Kirkland, and Viguerie 2001: 10). Further, systemic stability attends to externalities in the real economy. While there is nothing inherently illegitimate about instability arising from the failure of an incompetent company, questions arise when this instability has extensive negative repercussions in the real economy purely as a result of highly interconnected financial markets. Then, questions arise as to whether financial activity is too detached from the real economy and therefore illegitimate. On these grounds, the emergence of CMR as an ethic of regulation represents a focus on outcomes in financial governance that are more closely aligned with the public interest.

This argument has its limits. CMR is embedded in the paradigm of market-based regulation, and a market economy. The relative distribution of costs and benefits has been increasingly inequitable throughout the modern history of market economies (Scholte 2000). This inequitable distribution is one of the negative (illegitimate) outcomes of many private regulatory regimes (Underhill and Zhang 2008: 542). Indeed, like many such regimes, CMR arguably presents policies that "reinforce the market orientation of economic governance, thus aiming to enhance both growth and stability" (op cit: 540). More specifically, CMR reinforces the trend whereby authorities adopt "market-oriented approaches to regulation, supervision and corporate risk management, [and] where private firms are responsible for risk management through complex mathematical models implemented under the approval of supervisory agencies" (op cit: 541).

However, CMR does steer this trend in a more equitable and self-aware direction. Its overriding focus on systemic risk promotes the market commons by limiting the socialisation of private, self-interested risks. An orderly market commons becomes a self-aware objective in itself, rather than an assumed by-product of 'normal' business activity where powerful interests predominate. This is most evident in the CMR proposition of continuous improvement. Even in areas like accounting, where powerful companies exercise technical authority (Porter 2004), companies are called to interpret regulation in terms of its ultimate objective, rather than its literal requirements (see Power 2004). The CMR proposition on investment policy, where large firms are expected to forego potentially profitable opportunities and products in order to safeguard the system, also reflects a public purpose.

6.3.3.4. Accountability: CMR as regulatory conditionality

Completing the circle of illegitimate policy-making processes and outcomes is the demonstrable lack of accountability of private and quasi-private actors, who dominate financial governance, argue Underhill and Zhang. "This concerns the (democratic) accountability of global policy processes *and* outcomes to the broad range of constituencies that are affected by the output phase, beyond the rather narrow, often technical, policy communities which currently participate in decision-making," they write (op cit: 539). The existing mechanisms of accountability are limited to "such means as disseminating information affecting the reputation of individual and corporate actors, through protest, and through the activity of civil society NGOs" (ibid).[10] Some new measures of accountability have been proposed, such as possible compensation for groups that are disadvantaged by outcomes (ibid). Lack of accountability means that the input and output dimensions of governance are less amenable to change and therefore increasingly illegitimate.

The two current trends that fuel this problem are financial firms' "close and relatively exclusive relationships with regulatory agencies" and international regulatory regimes' "frequent recourse to self-regulation" (op cit: 541). Underhill and Zhang write that the "relative disarmament of public authorities means that private market interests increasingly define supervisory standards" (ibid). One of their case studies illustrates how powerful private interests defined the changes to Basel I capital adequacy accord that turned it into a more market-oriented Basel II. This process showed how the capital adequacy policy domain was "far more likely to take into account the articulated preferences of private sector interlocutors in developed countries than the interests of developing country supervisors and their corresponding financial sectors" (op cit: 546). The pivotal moment in this process was a report that reviewed Basel I; a report which appears to have a great deal of resonance with some CMR issues:

> "The report ... observed that management controls should play a central role in the supervision of financial systems and that 'core' financial institutions should take the initiative to develop a new system along with 'international groupings of supervisors'. In essence, financial globalisation had rendered the supervisory process increasingly difficult and placed it beyond the reach of national supervisors. The conclusions of the report implied that regulatory agencies should rely more on the private institutions that they supervised and that these institutions themselves would accept the responsibility to improve the structure of, and the discipline imposed by, they internal control functions and risk management mechanisms" (op cit: 545, underlining added).

The resonance with CMR is strong, insofar as CMR focuses on management controls, core institutions, and their acceptance of responsibility. Thus CMR is further evidence of the general dynamics described here. However, the CMR narrative has a subtle difference that is consequential.

The CMR narrative is not one where regulators surrender regulatory powers to corporations who "accept that responsibility", but one where regulators and other public stakeholders compel corporations to take responsibility. This is underpinned by the trade-off with regulatory risk that is explicit in CMR. Firms that do not observe CMR face higher regulatory risks.[11] Underhill and Zhang noted in an earlier work (2003b) that "Private sector burden sharing and responsibility issues have been notable for their absence in the policy debate" (p. 380). The regulatory risks in CMR call firms

[10] Underhill and Zhang reference Keohane (2006: 79-80).

[11] The data suggests that firms may face higher regulatory risks individually or collectively, depending on the circumstances. Citigroup faced individual sanction, but the SWF and post-Credit Crunch episodes showed collective pressure applied to firms.

to account for how their management protocols impact on the wider system. CMR episodes also showed accountability to broader stakeholder groups, such as business counterparties and trade unions. The Citigroup episode saw the bank's competitors attempt a broad boycott, including in presentations to the Citigroup's clients. Further, the Citigroup, SWFs, and (part of) the Credit Crunch response invoked principles-based regulation, whose motivation is also to give regulators more flexibility in interpreting misconduct (Lomnicka 2001). In complex environments principles can bring more interpretive certainty for regulators than rules (Braithwaite 2002: 54). Thus, CMR seeks to increase the accountability of management protocols that often define market governance, flattening the inverse relationship between self-regulation and accountability.

In situations where regulatory risk is a red herring, CMR compensates with a normative ethic. It is true that close relationship between private actors and regulators may sometimes preclude a strong regulatory response to misconduct. I do not believe this is automatically the case because the dominant epistemic elite argues in favour of competition and may compete among themselves for professional plaudits. But in any case CMR is embedded in a narrative of normative responsibility. As such it empowers stakeholders to build coalitions driven by ideals of leadership that endeavour to bring private authority to account.

6.3.3.5. CMR as accountability: normative and descriptive underpinnings

Underhill and Zhang (2008) conclude their argument in "search of normative underpinnings for global financial order" (p. 552) and I contend that the theory of CMR is a partial response to that search, in the domain of financial systemic risk. Normatively, CMR provides an ethic for participants in governance regimes to delimit the content of policy discussion (inputs) and to coalesce around the mutual goal of systemic stability (output), which is relatively equitable vis-a-vis the status quo. Intrinsically, the call for firms to take responsibility for better outcomes provides an outcome-based rationale for bringing private authority to account. Descriptively, the observation of CMR in practice suggests that the legitimacy framework for financial governance is evolving. Within the trend of diffusion of authority to the private sector, CMR episodes demonstrate a willingness of regulators and other public stakeholders to make systemic stability an objective *in itself* (output), and to compel firms to adapt their management systems to work towards that common goal, under threat of regulation. As such, CMR is evidence both that the diffusion of regulatory authority continues, and that some normative conditionality has emerged. Ultimately, however, accountability mechanisms are not neutral but embody their own interpretive and discursive logic (Black 2008: 158). As a result, CMR's effectiveness as an ethic of accountability will depend on specific contexts. In the Citigroup and SWF contexts, it arguably worked because the firms adapted to the expectations. The jury remains out on banks' longer-term response to the Credit Crunch.

I argued in Section 6.3.3.3. that, in the context of these episodes, systemic stability is in the public interests, whereas systemic instability is not. This is a narrow interpretation of the public interest because it does not attend to the distribution of welfare in the system. My claim rests on the assumption that more equitable welfare can be achieved under stable financial conditions than under unstable conditions because, in the latter, powerful "shapers" fare better than powerless "adapters" (see Courtney, Kirkland, and Viguerie 2001). A Marxian worldview would ascribe greater benefits to creative destruction than I have herein. Nevertheless, as I argued in Section 6.3.3.4., CMR entails some mechanisms of accountability. We saw informal mechanisms of accountability being replaced by formal mechanisms when they were perceived to be insufficient. Keohane (2006) identifies informal accountability mechanisms that include peer networks of influence and efforts to impose costs on others. Citigroup saw its competitors attempt to create a boycott among its clients. SWFs were urged by private equity funds to adopt the same codes of conduct that the private equity industry had designed for itself. Whilst tangible, these efforts were deemed insufficient and replaced by formal accountability mechanisms, specifically regulatory enforcement. This mix of informal and formal accountability mechanisms is of course intrinsic to a reflexive regulatory model, like meta-regulation or enforced self-regulation.

Underhill (2000: 823) writes that a key question for political economy is "how long is the current form of state-market condominium sustainable in the face of the increasing volatility of global financial markets?" One topic for investigation is therefore the feasibility of CMR. Three challenges to CMR as a form of governance, and therefore to its enduring ontological significance, were explained earlier: the asymmetry between the focused profit-motive versus a diffused systemic motive; the possibility that senior management will scapegoat junior executives for technical failure; and the potential for finger-pointing among companies and the limitations that poses for an effective and efficient regulatory response. I presented a limited counter-argument that I will now broaden to include sociological factors. In the following paragraphs, I show the extent to which markets are embedded in social networks and norms, and the power of new theories (of governance, for example) to influence, or "perform", market activities. My argument is that the propagation of meta-regulation generally and CMR specifically need not face the challenges above. The socio-political embeddedness of markets and the role of social values mitigated narrow self-interest in the episodes I have presented. Persistent scapegoating would likely be untenable because of reputational effects within companies and the "social capital" of effective managers (Parker 2007). Moreover, the propagation of CMR theory could itself be performative.

6.3.4. Economic Sociology: Embeddedness, performativity, and regulatory arbitrage

CMR, as an integrative concept, enables us to see the interaction of both sociological and political economy processes in financial governance. This section pursues a different analytical direction from the preceding focus on legitimacy. Here I break down CMR into the three empirical episodes and analyse them in light of two concepts from economic sociology, embeddedness (Granovetter 1985, Smelser and Swedberg 2005) and performativity (Callon 1998, MacKenzia, Muniesa, and Siu 2007). I proceed to argue, first, that the CMR episodes lend empirical weight to these concepts. This is an important contribution because economic sociology has only recently, since the 1980s and especially in the 2000s (Knorr Cetina and Preda 2005: 8), begun to focus on financial markets. Research in the sociology of financial markets is conversant with political economy, often drawing on the work of political economists like Robert Shiller, Susan Strange, Barry Eichengreen, and Saskia Sassen, who herself has written on embeddedness (Sassen 2005). However, compared with political economy and economics, the sociology of financial markets remains an "incipient discipline" (Knorr Cetina and Preda: op cit). The same could be said of economic sociology more broadly (Swedberg 2004: 2). Empirical evidence that supports two central concepts in the discipline is a worthwhile contribution. In this section, I present the CMR episodes as evidence of those concepts, and I argue that the Citigroup and SWF episodes reveal new variations of embeddedness and performativity.

Drawing on this analysis, the empirical emergence of CMR is argued to demonstrate the introduction of regulatory norms into market conduct. The argument then goes one step further, to posit that these norms may de-legitimise some rational economic practices, like regulatory arbitrage. This part of the argument refers to the Credit Crunch episode. Thus, I show that CMR is an integrative concept that helps researchers to bridge issues of concern in both political economy and economic sociology, helping further de-silo these two research traditions. Figure 6-8 below summarises this analysis.

Figure 6-8. CMR integration with economic sociology

Concepts: Embeddedness (market conduct is embedded in social norms and networks) & Performativity (economic models shape conduct, do not merely describe it)

Episode	Arguments	Contribution
Citigroup	Episode is evidence of market embeddedness; shows the "state-market condominium" as a business model. Embeddedness can be a post hoc construction, that becomes performative.	Adds empirical substantiation to extant concepts and shows new variation of embeddedness post hoc. Illustrates the "state-market condominium" as a business model
SWFs	Episode is evidence of performativity; SWFs perceived to be 'wrongly' embedded, and their 're-educated' in profit maximisation. Episode illustrates 'performativity-plus', the performance not only of economic conduct, but responsible economic conduct.	Adds empirical substantiation to extant concept and show new variation of performativity; early sociological analysis of SWFs in the global economy
Credit Crunch	Episode shows the embedding of new socio-economic norms (in CMR), de-legitimising the practice of regulatory arbitrage.	Synthesising sociological and political economy understandings of regulatory arbitrage

6.3.4.1. The concepts of embeddedness and performativity

Economic sociology helps us explain and conceptualise the Citigroup and SWF episodes which, in turn, lend weight to some core propositions in this discipline. Economic sociology studies the effect of social norms, behaviours, and culture on economic transactions. In contrast with economics, where the analytic starting point is typically the individual, in economic sociology the starting points are typically groups, institutions and society (Smelser and Swedberg 2005: 4). The two disciplines also diverge when it comes to the scope of rationality in economic action:

> "The economist traditionally identifies rational action with the efficient use of scarce resources. The sociologist's view is, once again, broader. Weber referred to the conventional maximisation of utility, under conditions of scarcity as *formal rationality*. In addition, however, he identified *substantive rationality*, which refers to allocation within the guidelines of other principles, such as communal loyalties or sacred values. A further difference lies in the fact that economists regard rationality as an *assumption*, whereas most sociologists regard it as a *variable*" (ibid; see also Teubner 1983).

Two of the most important concepts in modern economic sociology are embeddedness and performativity (Smelser and Swedberg 2005). Embeddedness refers to how economic activity is conditioned by social relations and structures. Granovetter (1985) became the main reference for this concept, arguing both against over-economised renderings of economic behaviour and over-socialised ones (see also Nee and Ingram 1998). Both rely on what Granovetter calls social atomisation. Among sociologists, "oversocialised conceptions of how society influences individual behaviour are rather mechanical: once we know the individual's social class or labour market sector, everything else in behaviour is automatic, since they are so well socialised" (op cit: 486). Economists, on the other had, "invariably abstract away from the history of relations and their position with respect to other relations – what might be called the historical and structural embeddedness of relations. The interpersonal ties described in their arguments are extremely stylised, average, 'typical' – devoid of specific content, history, or structural location" (ibid).

Granovetter "insists" that "while social relations may indeed often be a necessary condition for trust and trustworthy behaviour, they are not sufficient to guarantee these and may even provide occasion and means for malfeasance and conflict on a larger scale than in their absence" (op cit: 491). Uzzi (1997) has gone on to argue that companies may be over-embedded (strong social ties) or under-embedded (arm's length market transactions), and that firms are likely to be most successful when they balance these two (Smelser and Swedberg 2005: 15). I will argue that Citigroup traders under-estimated the degree of embeddedness in the market. Traders explicitly assumed that other banks would replicate the illicit trade ("copycat trades", FT53) because formally the trade was a 'rational' allocation of resources. However, its competitors felt the bank had violated their trust.

The second concept I address is performativity, which refers to how ideas, like economic theory, or CMR, do not only capture an independent reality, but transform frames of reference for actors in the studied environment, who may then 'perform' that theory. Strictly, a performative statement, according to Austin's (1962) widely cited *How To Do Things with Words*, is one that causes the reality that it describes: for example, "I hereby sentence you to prison", or "I marry you" (Callon 2007: 317). Since Callon's (1998) *The Laws of the Markets*, sociologists have increasingly focused on the thesis that "economics can influence the behaviour of real economic agents, which it claims to analyse objectively and from a distance" (cf. Callon 2007: 313). Studies of performativity show how economic theory has been applied practically to construct new markets (Garcia-Parpet 2007, MacKenzie and Millo 2003), design financial trading strategies, particularly derivatives (MacKenzie 2003, 2007, Lépinay 2007), and national development strategies in low income countries (Mitchell 2007). The way in which "representative" economic statistics affect decision-making, and do not merely describe it, further illustrates the theme (Didier 2007).

To understand the conceptual ties between embeddedness and performativity, we can look to a heated debate on the implications of performativity (e.g. Holm 2007). The debate began with Miller's (2002) argument that economic theory and abstract market models are used to defend capitalism from other forms of exchange. He accuses Callon of "treating the economic model of the market as though it were core to actual economies rather than a projection of economists" (Miller

2002: 219). Miller writes that "what lies within the frame [of economic theory] is *not* the market system as an actual practice, but on the contrary a ritualised expression of the ideology of the market" (op cit: 224). Here lie conceptual ties between performativity and embeddedness. Where Callon holds that actors may be socialised to perform a market, embedded in social norms, Miller argues that the market does not exist as such and its manifestation is a "performance" – he calls this market "virtualism". Miller's position is therefore highly relativistic and he sees no evidence of 'rational' performed economic action. On the contrary, his studies showed that economic "decisions were constantly embroiled in larger cultural concerns and indeed I felt that the more successful companies were those trying to become still more entangled in the 'street culture' of consumers" (2002: 229). The question arises of whether economic theory's performativity leads to actual performance or simply the illusion of rational economic activity.

The CMR episodes provide several illustrations of the concepts of embeddedness and performativity. The Citigroup episode suggests that Callon's performation of economic theory, and Miller's "ritualised expression of the ideology of the market", are not mutually exclusive. A plausible interpretation of the Citigroup controversy is Citigroup traders were unaware of the market norms. As I will argue, the *gentlemen's agreement* that Citigroup was said to have violated very likely did not exist but was a post hoc rationalisation that transformed an expected *standard* of conduct, into an explicit *principle.*[12] This interpretation brings something to both sides of the Callon-Miller debate. On one hand, Citigroup appeared to operate as an atomised, self-interested 'market' actor, and believed that other market participants did the same (see Miller 1999). From Citigroup's perspective, the market existed, independently of whether it was being performed as a result of economic theory. This could fall into Callon's framework. Citigroup's traders were, however, mistaken in their view, because other stakeholders, including its competitors, held that atomised self-interested behaviour had its limits. As they saw it, the market brought gains to participants but should not supersede the dominant socio-political norms in the exchange mechanism. Several stakeholders said they would defect from the system if Citigroup behaved in the same way again (DT3). The liquid, transparent, 'pure' MTS market was constructed to safeguard a mode of exchange that was not native to the participants. In a nod to Miller's view, a rival exchange called the MTS's output "virtual liquidity". This interpretation, which I set out below, shows that the two sides of the controversy – Citigroup and the others – could be seen to correspond, respectively, to Callon and Miller's view of embeddedness and performativity.

[12] Braithwaite (2002: 50-52) defines a standard a a threshold of what is desired, and a principle as a plan for action.

6.3.4.2. Citigroup: Discovering embeddedness through controversy

The Citigroup episode was deeply socially embedded, along several dimensions. The controversy itself was a social intermediation of public judgement over Citigroup's conduct. Commentators did not see the market as an amoral space, but one moderated by *emotions* such as anger, concern, and jealousy, which the data frequently linked to the ensuing risk appetite on the market. Citigroup's competitors *lodged protests*, appealing to non-market institutions to intervene. They had been *taken by surprise* because Citigroup was reputed to be risk averse in the market (DT3). Ten senior managers planned their response at one of the most *social networking environments* there are: dinner. Their retaliation included reaching out to their *client networks* to attempt to hurt *Citigroup's reputation*, which by some measures they succeeded in doing (TT6). In two instances, Citigroup *apologised* for the trade. One such "public statement of contrition" (FT28) was widely characterised as a "humiliating" (DT7) attempt to placate regulators (FT28, TT6, NYT1). One competitor called it "birch beating in public but [also] a high-risk strategy". A tactical apology could fire back if it was "seen as manipulative" by regulators (FT28). These signals of controversy all involved transmitting influence through social channels, including various networks that were in turn expected to punish Citigroup and thus restore confidence to the market.

A second dimension of embeddedness was the political construction of the MTS platform itself.[13] The market-making rules of the exchange, which required dealers to quote publicly the prices at which they would buy and sell securities, had been set up to ensure that smaller Eurozone governments would have sufficient liquidity for their debt, given that the Euro had eliminated currency risk and the market might uniformly prefer safer bonds. This was a *politically constructed market structure* (see Fligstein 1996) that employed a "sociotechnical device" (cf Callon 2005: 319) in the form of its market-making rules to create, as a rival exchange put it, "virtual liquidity" (TT4). The liquidity was said to be "virtual" because it did not arise from innate, ad hoc utility-maximising behaviour, but rather because it was politically mandated. These rules made the market so liquid and transparent, that it decreased arbitrage opportunities for banks. In order to secure banks' participation, governments tacitly agreed (FT8) to reward those market participants with more lucrative opportunities in primary markets, i.e. bond issuance. Thus, participating in a market that helped smaller governments finance their fiscal policies gave banks a networking opportunity for new business. This market had major socio-political underpinnings; I would say it that expresses the state-market condominium as a business model: Eurozone governments received a discount on their

[13] See also Beunza, Hardie, and MacKenzie (2006).

borrowing, and banks received alternative lucrative business – both state and market actors profited.

The reason behind the controversy may have been that Citigroup underestimated the extent to which the MTS market was embedded; indeed, how much the market relied on its embeddedness to function properly. This is where embeddedness played its most significant role. Although Citigroup was often said to have broken a "gentlemen's agreement", which would itself be evidence of social norms and networks at play, it appears at least as likely that such an agreement did not exist ex ante, but emerged as a post hoc rationalisation that enabled commentators to justify the oddity of a competitive, by-the-book transaction having so angered them. This argument, which I now expand, would also characterise the putative gentlement's agreement as a performative device.

To begin with, Citigroup appeared unaware that such a gentlemen's agreement had existed. In a leaked internal memo, Citigroup traders planned the operation with explicit references to "killing off smaller dealers" and undermining the Eurex market, where Germany, a powerful client, had extensive interests (FT53). The memo did not in any way foresee controversy. On the contrary, the traders expected other banks to engage in "copycat trades", which would help undermine the market, as Citigroup intended (ibid). Citigroup therefore saw the MTS as atomised entities trading self-interestedly and perhaps rationally, rather than conditioned by norms. If a gentlemen's agreement indeed existed, then traders at the world's (then-)largest bank did not know about them, or they thought it was fragile.

So had an agreement existed? As I noted in Chapter 3, there is no persuasive evidence for it. Despite numerous reports citing an agreement as the main reason for the controversy, only one article in a sample of 168 reports actually ventured a guess at what it had been. That report said that a gentlemen's agreement had "barred firms from swamping the market with a barrage of sell orders" (TT1). It is a rather precise description of Citigroup's transaction. Yet, no individuals were quoted describing the agreement, and even whilst several politicians and regulators invoked the need for "fairness" in markets, none mentioned unwritten rules. It is entirely possible that there were <u>standards</u> of conduct – that is, thresholds of "fair" and "unfair" conduct – without there being any <u>principles</u> – that is, prescriptions for action (see Braithwaite 2002). I believe this was the case.

The inconsistency between, on one hand, claims that a gentlemen's agreement was central to the controversy and, on the other hand, a near total inability to articulate what the agreement had been, has at least two possible explanations. The first is that the agreement was made at a high level of the organisation and Citigroup traders did not know about it. Granovetter (1990) and Moran

(2005) would call this structural embeddedness; that is, the embeddedness was determined by a hierarchical configuration in the company. In support of this argument, Citigroup's upper management distanced themselves from the traders' actions, calling them "knuckle-headed" and said they had not met the bank's standards (NYT1). However, their apology did not invoke market rules, norms, or a gentlemen's agreement, but focused more generically on acting in the interests of their markets (plural) and their clients (ibid). Therefore, the possibility that an agreement existed and the traders were unaware of it is tenuous.

An alternative interpretation for the hollowness of the gentlemen's agreement is that it did not exist, but instead emerged as a post hoc rationalisation that helped stakeholders interpret what had gone wrong. When rational action failed to serve the common interest, the gentlemen's agreement construct formally assumed behavioural norms required in the market. Put differently, if generalised morality did not exist, someone had to invent it. Suppose that, as economic sociologists argue, economic theory is performative; or, in MacKenzie's words (2006), economic theory is an engine of economy, not only a camera. Actors draw on economic theory to shape their decisions under uncertainty, which is to say that they are socialised by it. From this perspective, a broken gentlemen's agreement was a much more straightforward issue for a performer of economic theory to rationalise than a controversy arising from a legal and profitable operation. For those who learned morality from economic theory, the emergent gentlemen's agreement became a heuristic to make opposition to Citigroup's transaction epistemologically coherent. It helped stakeholders to articulate the deeper underlying explanation for the controversy – that traders were expected to help maintain orderly markets. This corporate responsibility was intrinsically obvious (a standard), but never stated (as a principle). It was only implicit that traders had to use their judgment to moderate the market rules, not to inject *too much* liquidity into the system. Interpreting the gentlemen's agreement as a post hoc rationalisation helps explain why the condemnations of Citigroup often appeared so mixed. Said one trader: "They didn't do anything wrong, they just cornered the market. I'll tell you this though, $25 million doesn't seem like a lot of profit when the whole world it lining up against you" (DT3) (see Section 3.2.2). Why was the world lining up against Citigroup if they had done nothing wrong?

It is possible that several stakeholders underwent an epistemological journey, departing from a position of atomised economic thinking and discovering themselves within a socio-economic network with norms that they had not previously articulated. They codified the notion of a "gentlemen's agreement" to articulate the requisite norm. In my reading, Citigroup's operation was a controversial discovery of embeddedness.

To clarify how the gentlemen's agreement construct was a performative instrument, we can divide it into *ex ante* and *ex post* dimensions. The ex post performativity is the affirmation that a gentlemen's agreement existed. From the moment it was public, it captured the existing outrage *and* set out norms for future behaviour on the MTS, so it immediately came into effect. The *ex ante* dimension is the reason *why* the affirmation was required. It was necessary to codify Citigroup's infraction as a violation of a gentlemen's agreement because atomised conventional wisdom could not explain the controversy. Conventional wisdom was economic theory, which justified Citigroup's self-interested behaviour. Had actors not been constrained by their performance of economic theory, the codification of a *post hoc* gentlemen's agreement would not have been necessary. Citigroup's infraction would have been a clear infraction, and the controversy moot.

6.3.4.3. SWFs: Performing economic theory, responsibly

The sovereign wealth funds controversy may also be characterised as an exercise in performation.[14] The SWF episode shows a new type of actor being integrated into global financial markets by means of "user manuals" based on economic theory. The manuals simultaneously described how funds should behave and created that new reality, having been adopted voluntarily as codes-of-conduct. One basis for this forced performation was SWFs' perceived embeddedness: the funds were not trusted to perform economic theory because they were instruments of the state. This was despite all available evidence suggesting that their increasing risk appetite was in line with global trends and without untoward intent. Underlining this distrust, a Guardian editorial stated, "After all, commercial implications are unlikely to be paramount for totalitarian regimes" (GU17). The assumption is that SWFs might have traditional or socio-political motives for their investment choices. Accordingly, the challenge was to train the funds to adopt idealised economic behaviour, particularly to invest solely on commercial grounds (rather than socially embedded grounds), providing transparency to other market actors, etc. These investors had to support markets, not undermine them.

While this alone constitutes evidence of the performative use of economic theory, the handling of SWFs went further. One might call it 'performativity-plus' – funds had to perform economic theory but, in addition, to perform it *responsibly*. The generic concern about sovereign funds was that the funds threatened systemic stability.[15] In response, sovereign funds were compelled, first, to dis-embed themselves from traditional or social investment norms, and to subsume those to economic

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[14] Performation is performativity expressed as an action rather than a quality.

[15] See Chapter 4, Section 4.2.3. Specifically, SWFs might destabilise liquidity, use political influence to further their investments, or hoard capital reserves thus not recycling their earnings into the global economy.

utility. The process of dis-embedding was performance of economic theory, through principles such as rational, risk-based utility-maximisation. But this dis-embeddedness from idiosyncratic social norms was an insufficient, perhaps even implausible, way to reduce systemic risk. (After all, the funds were already investing on commercial grounds before the controversy, according to available evidence.) To make up for this implausible dis-embeddedness, the funds were also compelled to *re-embed* themselves in a *responsible* market ethic, whereby their conduct would be shaped by systemic objectives, not simply atomised economic rationale. This new embeddedness within a responsible ethic was achieved by means of a performative code-of-conduct, which both described and created a new reality for (responsible) sovereign wealth funds. I would call this disembedding and re-embedding, 'performativity-plus'.

To accept this argument, we must hold the code-of-conduct as an actor-neutral manual of good conduct. That is, the code should be a generic economic performance manual, not only for funds, but for other actors. In support of this proposition, I showed in Figure 4-9 that the reprimand for Citigroup's transaction was based on the same principles as that for sovereign funds. Peter Mandelson's statement that a code-of-conduct for SWFs would "merely be a question of formalising existing investment practice" also framed this exercise as performation.

Thus far, I have showed that the Citigroup and SWF controversies provide evidence and variations of embeddedness and performativity. CMR protocols and objectives are not necessarily 'social', however, because they aim to sustain financial markets through economic processes like financial risk management. However, they are also not necessarily economic, because they call for a shared purpose with regulators, other market participants, and imply a use of ethics. This dimension of CMR protocols arguably de-legitimises some rational economic activities, like regulatory arbitrage, as I now argue.

6.3.4.4. Credit Crunch: De-legitimising regulatory arbitrage

Regulatory arbitrage is often seen as legitimate from the point of view of rational action. Among economists, the way to avoid it is to realign incentives such that firms are not inclined to engage in it (Goodhart et al 1998). Yet, the social processes witnessed in the Credit Crunch episode – particularly the call for *responsible compliance* and its property of *pursuing shared objectives with regulators* – served in part to de-legitimise that practice.

There are at least three kinds of regulatory arbitrage often seen as legitimate. One is to re-locate operations to jurisdictions where regulatory requirements are relatively lower. In the credit crunch media data, fears were often expressed that higher regulatory risk in the UK would drive financial firms to other jurisdictions such as Switzerland or Ireland (e.g. DT73, GU42).[16] A second kind of arbitrage is to exploit the differential between official requirements and the current position. Greenspan (1998: 165) gives an example from the banking sector, whereby "a group of loans attracts an internal capital charge that is very low compared with the Basle 8% [regulatory] standard, [and] the bank has a strong incentive to undertake regulatory capital arbitrage to structure the risk position in a manner that allows it to be reclassified into a lower regulatory risk category." In this example, if the bank has exceeded regulatory requirements, "preventing the bank from earning [what it regards as] an acceptable rate of return on its capital" (op cit: 166), then it is likely to try to reduce its excess compliance towards the minimum (see also Ayres and Braithwaite: 1992: 112-3). A third type of regulatory arbitrage is to use regulatory requirements as a pivot around which to create innovative new products and transactions (Minton, Sanders and Strahan 2004). This type of arbitrage explicitly seeks to exploit loopholes in regulation and is the type most frequently used to explain regulators' inability to keep up with the sophistication of the financial industry.

From the perspective of a rational, self-interested actor, these practices are legitimate (Goodhart et al 1998). Jurisdictional arbitrage is openly discussed by corporations; regulatory capital arbitrage is defended as efficiency and profit-maximisation (Greenspan 1998); and regulatory arbitrage through innovation is characterised as a problem for regulators to deal with, a natural consequence of self-interested corporate behaviour – John Mack, Chairman of Morgan Stanley, made this argument to the FCIC (2010). An implicit dichotomy here is that regulators are responsible for safeguarding the financial system, and corporations are responsible for maximising shareholder value.

The emergence of CMR as a regulatory expectation challenges this dichotomy. Firms also become responsible for *ensuring market confidence and stability.* The post-Credit Crunch regulatory debate, in particular, held that firms should *comply responsibly, pursuing shared objectives with regulators.* The SEC's affirmation that "mere compliance with the law, narrowly viewed, is not the highest goal to which we aspire, but the base from which we start" (SEC6: 14), was an explicit challenge to the legitimacy of regulatory arbitrage.

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[16] These fears always struck me as ill-founded. Few countries were in an economic or regulatory position desirable for large institutions to relocate to. In Ireland, for example, macroeconomic conditions deteriorated sharply during the financial crisis, and the government's escalating public debt increased the risk of tax hikes. Switzerland posed heightened regulatory risks. According to Philipp Hildebrand (2009), a governor of the Swiss National Bank, speaking at 'The Future of Financial Regulation' conference at Oxford University on 6 March 2009, one of the major investment banks had explicitly threatened Swiss authorities with re-location, in protest at new regulations. This occurred one week before the collapse of Lehman Brothers, after which the threat was rescinded because relocation options closed down.

In the rational, self-interested world, regulators' response to these practices seems to lie in realigning incentives. Goodhart et al (1998: xviii) argue that, "While there must always remain a role for *external* regulation, there can be no alternative to placing greater reliance on internal risk management". Accordingly, they propose "a reinterpretation of financial regulation as a *contract* which is designed so as to make it in institutions' own self-interest to maintain a 'socially desirable' (low) level of risk. [...] The main responsibility for risk control has to be shifted back towards *internal* management and away from *external* regulators" (op cit: xviii-xix). This emphasis on internal risk management is consistent with CMR.

However, the focus on incentives as the basic tool for changing risk management the poses a significant principal-agent problem. The regulators face three information gaps: what the quality is of banks' internal risk management processes (unless they undertake an intrusive audit); the thoroughness of banks' compliance with rules; and "residual risks", independently of the other two (op cit: 46). The principal-agent problem in turn leads to two potential market failures: adverse selection and moral hazard. Adverse selection would occur when high-risk bank managers look to comply with the lowest possible regulatory requirements. Moral hazard would occur when circumstances "materialise that incite bankers to take on larger risks than the maximum ones compatible with regulations – even though it was optimal *ex ante* to accept the rules" (op cit: 47; also the example given by Greenspan). This is a time-inconsistent issue: "The ex ante incentives to commit [to regulatory standards] can be different from the ex post incentives to adhere, once something unexpected happens" (ibid).

The implementation of CMR in the three empirical episodes included both punitive incentives and ethical principles that helped to mitigate this problem. Punitive disincentives are evident in the strong connection between CMR and regulatory risk. In all three episodes, regulators raised the possibility of establishing tighter rules and higher penalties if irresponsible conduct persisted. In addition, some CMR protocols, notably in the area of risk management, are designed to increase greater accountability. They are similar to some of the incentive structures recommended by Goodhart et al (1998) in their publication for the Bank of England. For example:

- "Ensure that appropriate sanctions are applied to internal management which allows failure of control to occur. *[Accountability]*
- "Require large institutions to establish an internal audit system. *[Systemically important institutions]*
- "Require the internal audit committee of such financial institutions to signify that it has considered the implications of the risk preferences of key personnel and their pay structures. *[Escalating strategies; aligning remuneration with risk]*

- "Decide what market movements are so extreme as to merit government support to withstand them. Require banks to hold sufficient capital to meet shocks up to this limit in stress tests of proprietary models *[Stress-testing]*" (op cit: 59-60, italicised phrases added).

This emphasis on improving accountability mechanisms relative to risk management is notably similar to CMR. These recommendations were made in 1998 to allow firms to regulate themselves better and thus help reduce systemic risk, traditionally the regulators' responsibility (op cit: 44-5, 52). Alongside them, the authors recommended internal systems based on practices like value-at-risk modelling and extensive structuring of credit derivatives (op cit: ch. 5) which, with the benefit of hindsight, became very problematic.

By 2008, the idea of pure self-interest was questioned. Many credit derivatives were criticised as socially useless (FSA 2009b: 15) or as contrary to the interests of investors to whom they were sold (SEC14: 3). The legality and self-interested nature of these instruments was not sufficient to legitimise them. The key regulatory issue was not <u>only</u> whether the right regulatory incentives had been in place. Companies' decision-making was also assessed on an ethical plane.

The expectation of CMR held that firms should pursue an ethic of common purpose, such as *anticipating the impact of investment transactions on the market and its participants,* and *choosing business activities* in a way that met customers' and investors' genuine needs. Curiously, in the incentives-based, self-interested world, 'moral hazard' is rarely discussed as a moral issue.[17] Rather, it is usually taken as given that if an economic incentive exists, morality is subsumed to it. When regulators called for *responsible compliance* in the wake of the credit crunch, they were intruding on the ethic of pure self-interest, and calling for firms to interpret and implement regulation the way that it had been intended. This process was closely related to being *ethically competent* and *humanising technical activity*. That is, rather than using technical authority to arbitrage regulatory requirements, it meant deploying those talents <u>specifically</u> to hard-to-read situations to ensure that the regulatory objectives – particularly systemic stability – were observed. Thus CMR as a meta-regulation introduced an ethical conditioning to the incentives-based world, and de-legitimised regulatory arbitrage. Financial incentives and self-interest would no longer suffice as a justification for arbitraging regulation – whether by seeking the minimum possible compliance or by innovating around it – if well-functioning markets were threatened.

[17] E.g. see Pauly (1968: 531): "the problem of 'moral hazard' in insurance has, in fact, little to do with morality, but can be analysed with orthodox economic tools"; cf. Dembe and Boden (2000).

This de-legitimisation of regulatory arbitrage synthesises concepts from interests-based political economy and values-based sociology.[18] On one hand, the regulatory expectation of CMR behaviour acknowledges intrinsically that markets operate based on financial incentives. On the other hand, it conditions these incentives by invoking values-based concepts like *responsible compliance, ethical competence,* and *humanising technical activity.* The idea appears to (re-)*embed* mechanistic, self-interested economic activity in *shared objectives* between regulators and regulated institutions. Is this plausible, or a fundamental contradiction? If incentives-based action, including regulatory arbitrage, is inevitable, and at the same time remains incompatible with systemic stability and expectations held of firms, then that might point to an enduring crisis in Western financial governance.

6.3.5. Summary

The analysis in this section sought to integrate the substantive theory of CMR with current academic debates in political economy and economic sociology. This happened in four parts: theoretical context, CMR's positioning, integration with political economy, and integration with economic sociology. First, the context of decentralised governance in financial markets was explained. Decentralisation diffuses authority and rule-making among both public and private actors, who often operate as a condominium (Underhill 2000), a network entangled in a "complex alignment of principles, mechanisms and actors" (Drahos and Braithwaite 2001: 123). Levy-Faur (2005) frames this paradigm as "regulatory capitalism". In it, the state assumes a supervisory and "steering" function and encourages businesses to restructure "through the creation of internal controls and mechanisms of self-regulation in the shadow of the state" (op cit: 15). The regulatory technique that promotes this focus on firms' internal controls, the regulation of self-regulation, is meta-regulation.

The second part of the theoretical integration positioned CMR as an example of meta-regulation. In this model, the emphasis on reforming internal controls; the regulators' encouragement of self-regulation by firms in order to meet regulators' objectives; and the push towards corporate accountability to a wider "democratic polity" (Chiu 2009: 28) were some of the factors that align CMR with meta-regulation. Thus CMR may be better understood through existing literature as part of a wider trend of meta-regulation that "has been hailed as one of the hallmarks of the 'new regulatory state'" (Black 2006: 22).

[18] I note that ethical variants of political economy and interest-based sociology also exist; see Braithwaite and Drahos (2000) and Swedberg (2004).

The third and fourth parts of the theoretical integration sought to advance current debates in political economy and economic sociology. In the political economy space, CMR was argued to enhance Underhill and Zhang's (2008) framework of legitimacy in financial governance. The CMR protocols comprise valuable inputs for financial governance that is aimed at an orderly financial system, which is an output in the public interest. The covariance of CMR and regulatory risk was presented as evidence of accountability in the substantive episodes that were covered. In the space of economic sociology, each of the CMR episodes contributed empirical evidence to the concepts of embeddedness and performativity, and showed new variations of the concepts in action. So doing, it was argued that CMR helped to explain key patterns of interaction that are problematic in both political economy and economic sociology.

6.4. Directions for future research

The presentation of CMR in Section 6.2 explained what CMR is, how it is implemented, by whom, when, and with what consequences. Yet the data provides only part of the answer as to why CMR emerges. Published explanations for the rise of shared governance are extensive, both in political economy (e.g. Cutler, Haufler and Porter 1999) and in sociology of law (e.g. Teubner 1983). My own grounded theory provided limited explanations. In each episode, CMR emerged because regulators and other actors explicitly perceived that CMR would reduce systemic risk. Still, the question is worth pursuing further and empirically.

Each episode presented some context-specific reasons for the emergence of CMR. In the Citigroup case, it was argued that the regulatory reaction to Citigroup was partly due to the interest that governments had in the MTS exchange, which enabled them to sell debt more cheaply, and which Citigroup had threatened. In the SWFs case, the controversy was partly due to protectionist instincts in Western governments that intended to prevent foreign acquisitions of domestic interests. In the Credit Crunch episode, the eventual prominence of remuneration on the regulatory agenda was partly driven, in my view, by the media's intense reporting on the subject, due to civic interest in the matter. These context-specific reasons for the emergence of CMR make it difficult to pursue the question of <u>why</u> it (CMR) all happened. However, grounded theory methodology does anticipate the quest for more abstract explanations, as researchers pursue a substantive theory like CMR across empirical settings, leading to formal theory (Glaser 2007). I suggest several empirical settings for that endeavour below.

The question of why CMR emerged (why only after regulatory interventions, and in whose interests?) is also worthwhile pursuing because it tells us about the feasibility of CMR as a regulatory programme. In each episode, firms adapted to the expected CMR conduct. The three empirical episodes showed that a significant cross-section of market actors recognised the need for CMR in order to assure systemic stability. However, each case required regulatory intervention before CMR was adopted. There may be an issue of policy capture by specific corporate or regulatory interests. A comparison may be drawn with the prisoner's dilemma in game theory, where the Pareto equilibrium is suboptimal. CMR implementation may rely on an external coordinating agent (such as a regulator), and this thesis therefore has a message for regulation and public policy on the need for enforcement. Exploring why CMR emerged and how it was constructed would help us understand whether it is consistently achievable and therefore how effective it could be. To do this, researchers would be well served to find cases that emphasise the observation of CMR rather than (as I have done) its absence.

In addition to 'why', two unanswered questions were raised by the data, noted in Section 6.2.1:

- Whether higher CMR leads to lower systemic risk
- Whether higher regulatory risk leads to higher CMR

Regulators' expectation of CMR is predicated on the assumption that CMR behaviour will help to reduce systemic risk. As a result they attempt to compel CMR behaviour. Yet both of these effects may fail to hold. CMR behaviour may not mitigate systemic risk, and regulatory risk many not compel adoption of CMR protocols. As a result, an enduring expectation that firms adopt the protocols and ensure orderly markets could be persistently frustrated, leading to further financial controversies and regulatory conflicts. For this reason, both questions are worth pursuing.

Both rely, of course, on observing CMR in practice. Are senior managers at financial firms cognisant of CMR expectations? Under what conditions do they implement which CMR protocols? What are the opportunities and constraints? In addition to contributing to our understanding of the effectiveness of regulatory frameworks, and the legitimacy of private regulatory authority, an analysis of who controls institutions and for what purpose is an increasingly fertile field of economic sociology (Stearns and Mizruchi 2005; Teubner 1994). The data frequently referred to a number of financial actors and settings where CMR appears to be increasingly relevant, and where these questions may be pursued. Theoretically, the CMR propositions apply to large, liquid, and innovative, banks, funds, and similar institutions. Private equity funds were singled out in the SWF controversy because they were perceived to be untransparent and potentially destabilising. The industry agreed a code-of-conduct (British Venture Capital Association 2007) in response to criticism, but the code was significantly "watered down" (FT123) relative to expectations, signalling a potential space for meta-regulatory intervention. Similarly, hedge funds faced calls from the German, French and UK governments to improve codes-of-conduct in the industry, particularly to increase transparency, and rejected them (Financial Times 2007b). During the Credit Crunch, the funds saw increased regulatory scrutiny (see SEC12), including a stringent ban on short-selling, which the industry resisted (Borges 2008). Given the systemic importance of these funds, and the persistent calls for closer oversight, they are a fertile subject for researching CMR.

New financial markets and practices could also expand the explanatory power of CMR. One of these settings, known as 'dark pools', are private markets where funds exchange financial securities away from public scrutiny. Actors who participate in these markets have faced face higher regulatory scrutiny from the SEC, for example, who announced that they would "take a serious look at what regulatory actions may be warranted to respond to the potential investor protection and market integrity concerns that dark pools may raise" (SEC14). Dark pools and other settings often see "high-frequency trading", also known as "flash trading", a relatively new practice where very large trades are conducted through computerised algorithms. Flash trading is reminiscent of Citigroup's transaction, insofar as it involves trading of very high values, very quickly, across multiple platforms. Flash trading is also under increased regulatory scrutiny in the US and UK due to its potentially destabilising effect (NYT33, NYT34). I believe that the propositions of CMR may help researchers frame and explain these emerging controversies.

These are contemporaneous trends, and they may obscure a wider generalisability for CMR theory. CMR may have emerged much earlier than the last decade, which has been my focus. As I mentioned in Chapter 2 (Section 2.5), several of the conditions underpinning CMR – very large financial transactions, interconnected financial markets – are increasingly apparent and the temptation is to claim that CMR is <u>increasingly</u> relevant historically. Nevertheless, CMR expectations may have deeper roots than I have uncovered. For example, banks and discount houses explicitly assumed a responsibility to stabilise financial markets, in their own interests, under the Gold Standard in the late 19th and early 20th century.[19] In this vein, fruitful new research on CMR theory might research more time-periods, not only new contemporaneous actors and transactions.

[19] I am grateful to Geoffrey Underhill for this insight.

6.5. Conclusion

This chapter presented a substantive theory of corporate market responsibility, which is a conceptual account of, and a partial explanation for, the three empirical episodes of the thesis. CMR, as a concept, was defined as an expectation by regulators and other political, economic and social actors that companies will help to regulate systemic risk through certain internal management protocols. CMR, as a corporate practice, refers to these management protocols. Accordingly, three sets of propositions were presented, which together comprise the theory of CMR. The first set contains a single proposition that CMR exists. The second set contains three propositions about the CMR management protocols: risk management, investment policy, and proactive improvement. The third set contains meta-propositions, which hold that more (less) CMR leads to more (less) regulatory risk, and that the absence of CMR probably increases systemic risk.

This grounded theory is *empirically* credible because the concepts in it emerged directly from data analysis, and gathered new properties and dimensions as new data was collected. It is *theoretically* credible because – despite departing from data rather than extant propositions – CMR is very similar to the model of meta-regulation (Parker 2002, Chiu 2009, Black 2006), and resonates with enforced self-regulation and ethical self-regulation (Chiu 2009). It is relevant because it addressed contemporaneous problematiques in the political economy, including the reaction to the Credit Crunch, often described as the biggest financial crisis in generations, and because it offers new insights about unstable taken-for-granted meanings (Charmaz 2006: 183), such as the construction of 'gentlemen's agreements' in bond markets. The theory is also useful because the CMR protocols are presented as modifiable generic processes that other analysts may pursue, and because they may contribute to a more stable financial system, or one where firms are more accountable for their impact on it. Finally, CMR is original, the fourth criterion of grounded theory, because it extends and refines ideas in political economy and economic sociology. The following concluding chapter addresses some of the theory's limitations.

Chapter 7: Conclusion – Contributions to knowledge

Building a grounded theory, like CMR, entails a conceptual journey. Analysis travels from sensitising concepts through data, into an integrative, explanatory concept that usually (ideally) differs from researchers' early ideas. Such a journey was evident in this thesis. Chapter 1 presented concepts and literature that framed the research question, whereas Chapter 6 presented concepts and literature that framed the answer. The questions that motivated this research originally related to how firms might address market failure, particularly when governments lack the capacity to do so and when CSR theory does not provide answers because some failures are market-bounded. Over the course of the research, data revealed that the problematique was the pressure brought to bear on firms to engage in endogenous market governance; their responsibility to shape internal controls in order to reduce systemic risk. Being a regulation of discretionary conduct (Grabosky 1995, Parker 2002), this 'corporate market responsibility' was interpreted as a form of financial meta-regulation.

The theory of CMR could develop in a number of directions. To varying degrees, I have shown CMR to relate to patterns of behaviour that are analysed in political economy, economic sociology, law, management,[1] and welfare economics. Such is the nature of an integrative concept. This nature is both a strength and a weakness. An integrative concept helps to discover explanations and meanings that disciplinary boundaries might obscure. On the other hand, integrative concepts lack a clear 'brand'. It is difficult to answer the question, which discipline does this study belong to?, even though it is easy to answer another, what is this a study of? In this case, the answer is market governance. In this chapter, I outline some of the thesis's other contributions and limitations, beginning with limitations.

Grounded theories are sometimes criticised for being inductive because they develop through empirical analysis (cf. Glaser and Holton 2004). As a result, one might ask whether CMR theory is only as good as the next response to a crisis. Generically, this charge of inductivism misunderstands the technical processes of axial coding, deduction, and theoretical sampling in grounded theory. These processes deliberately look for variations in concepts to 'falsify' researchers' original interpretations (Strauss 1987: 12). More specifically, this CMR theory derived from systematic comparison of environments of varying scope and depth – ranging from a single actor in a well-

[1] Including strategy (e.g. Baron 2001), CSR (e.g. Dubbink 2004), and corporate governance (e.g. Power 2005).

defined market, through a set of well-defined actors across various markets, to a full Western financial crisis. This progressively broader scope was a search for green, grey, and black swans – to extend Popper's (1978) terminology – within similar substantive contexts. Importantly, the literature on decentralised financial regulation suggests that CMR is consistent with established models, such as meta-regulation, enforced self-regulation, and ethical self-regulation. Therefore one could also invert the CMR argument, if necessary, to frame the empirical observation of CMR as substantive evidence of those models.

A possible limitation is that by pursuing documentary evidence rather than interviews or questionnaires, the sampling strategy may have reduced the persuasiveness of the findings among those who consider such direct testimonies essential. In explaining my decision, I argued in Chapter 2 that idiosyncratic testimonies would be unnecessary and unhelpful. They were unnecessary because I sought to understand broad-based expectations of market conduct, rather than idiosyncratic ones, and the documentary data contained extensive citations from individual actors that provided them. Some of my more important findings – the sociological discussion of the Eurobond *gentlemen's agreement* and the explanation of how SWFs' investment intent was judged – arose from individuals' quotations in media. Pursuing idiosyncratic testimonies outside the specific controversies would be unhelpful because, among a number of cognitive challenges, actors would have incentives to downplay concepts that implied taking on additional operating costs and opportunity costs, or characterised their own past conduct as irresponsible (Section 2.4.2.3). They would introduce idiosyncratic skew that I had worked to reduce by developing selection criteria for news sources. In recognition that individuals' perspectives are valuable, I pursued them through the social medium of news reporting rather than through individual testimonies.

This strengthened my findings, in my view. A broad-based, baseline perspective for CMR is valuable because it provides a firmer conceptual perspective for future research. With this substantive version of CMR, one may pursue research within specific institutions, as suggested in Chapter 6, incorporating idiosyncratic views. If respondents find CMR implausible, then this may signal future conflicts with regulators. Such arguments would be harder to pursue if the concept of CMR were already 'diluted' with idiosyncratic skew from individual interviews or questionnaires.

A more persuasive limitation of the thesis is that it does not attend to how CMR is socially constructed. News reports and regulatory documents were assessed 'as they are'. The politics of media companies and regulatory institutions were not analysed. Media hype and skew present challenges to understanding what is 'really' happening 'out there' (see Chapter 2, Section 2.4.2.1). In addition, meta-regulation may be a way for regulators to shift the onus of regulatory problems to corporations (Black 2006: 22),[2] which would make CMR effectively a red herring. However, I proceeded on the basis that news reports and regulatory documents establish precedents that become 'real'. For example, if the media overemphasised the idea of a *gentlemen's agreement* on the MTS market, the agreement nevertheless became a principle of conduct. While protectionism may have been a 'hidden' motive (in addition to CMR expectations) for asking SWFs to pursue CMR protocols, the protocols now exist and SWFs may use them in future bargains. Post-Credit Crunch, while the media overemphasised the issue of remuneration (relative to regulators), it also helped to move that issue up the agenda and influenced market responses. Regulatory and policy documents are references for corporate behaviour, whatever the motivations behind them. It may be that corporations choose to debate and oppose expectations like CMR, but CMR comprises terms of reference for that debate and therefore helps us understand it.

Among those who view research as a vehicle for advocacy (see Guba and Lincoln 2005), CMR may be seen as unrealistic; as something that firms would not adopt. However, the objective in this thesis, contrary to much governance literature, has not been to develop a realistic regulatory programme, but to investigate a 'real' regulatory problem. CMR accounts for empirically observed phenomena. Certainly the data suggest that regulators and others consider CMR conduct to be desirable, and enforce it, but the thesis itself has been agnostic as to whether CMR successfully reduces systemic risk.[3] A better question for advocates might be, under what conditions would firms adopt CMR? This is a worthy empirical pursuit, and this thesis should provide useful constructs and a frame of reference for it.

As a substantive theory, CMR's explanatory power is de-limited by several factors given by the empirical episodes. CMR is particularly relevant in relation to large financial institutions (entities), extraordinary transactions (actions), Western regulatory jurisdictions (location), in the present era rather than historically (time-period), and under conditions of unstable liquidity or where liquidity is threatened. The Citigroup and Credit Crunch episodes saw ample liquidity followed by liquidity crunches (in Citigroup's case, as banks suspended participation on the MTS), and the SWF episode was partly driven by concerns that SWFs would hoard liquidity (see Section 4.2.3). As such the key feature of systemic risk that CMR is relevant to is the level of market liquidity. The thesis has not explored how CMR would apply under different systemic risk conditions (see Goodhart et al 1998:

[2] See, however, Hutter (2005).

[3] The empirical evidence focused on the lack of CMR conduct rather than its observance.

chs 1, 7; Mishkin 2000), and it focuses on crisis prevention rather than crisis management (see Eichengreen 1999).

The contributions of this thesis can be presented along methodological, empirical, and theoretical lines. One measure of originality is the deployment of a methodology that is unusual for a certain discipline (Guetzkow et al 2004). Grounded *theory methodology is rare in the study of markets and* business management. Although it has been recommended as a method for building economic theory (Finch 2002, Lee 2005), it remains a niche practice. This is unfortunate because grounded theory facilitates the investigation of original concepts that may not easily fit in to existing theoretical frameworks, particularly when the concepts are multidisciplinary. The thesis shows how to implement a middle-ground position between positivist and constructivist methods, which researchers of business and markets are likely to find helpful, particularly in respect of governance.

Another methodological contribution is a code logging technique (explained in Chapter 2, Section 2.3.2, and illustrated in Chapter 3, Section 3.1.2) that enables systematic logging while developing conceptual categories and relationships. It is particularly helpful when the data set contains hundreds of documents and requires extensive logging. This technique is preferable to software programmes like Nvivo when the documents cannot be easily transcribed to such a programme.

The thesis also contributes new conceptual understandings of empirical phenomena. This is another dimension of originality (Guetzkow et al 2004). Each empirical chapter presents data on the relevant episode and develops a conceptual account and explanation for the episode. Much like case study analysis would aim to provide "thick descriptions" of phenomena (Geertz 1973), these conceptual renderings are "thick" theoretical explanations, where each concept is grounded in detailed data. Researchers seeking to understand these episodes, which present significant controversies, will find extensive empirical grounds in this thesis. The data on the public reactions (news reports) of these controversies have not previously been collected or analysed, to my knowledge.

On a theoretical plane, the data and resulting theoretical propositions serve to advance existing theoretical frameworks, like meta-regulation. Theoretical writing about meta-regulation is not extensive (as compared with "enforced self-regulation", for instance) but the practice of meta-regulation is "in vogue" (see Black 2006: 22). Guetzkow and colleagues (2004) single out a "new approach to a trendy topic" as a form of originality. CMR is a new form of meta-regulation in several ways. Chiu (2009: 32) argues that the generic framework of meta-regulation "offers no particular insight as to ... systemic risk", but the CMR form of meta-regulation is specifically designed to address this risk. CMR also shows how enforced self-regulation and ethical self-regulation may coexist as methods of enforcement. It combines incentives-based enforcement (Goodhart et al 1998), ethical enforcement (Shamir 2008), and legal accountability even in the absence of rules-violations (Parker 2007).

CMR's dimension of accountability is a partial response to the problems raised by Underhill and Zhang (2008). They argue that financial governance lacks legitimacy because it is increasingly aligned with powerful private interests, who increasingly define supervisory standards (op cit: 536, 541). CMR also suggests that private interests have increasing discretion in defining the scope of their compliance decisions. However, CMR carries an objective that is in the public interest (an orderly financial system), and an accountability mechanism (regulatory pressure), and therefore illustrates limits to the transfer of influence to private interests. In addition to these empirical observations of CMR, CMR as a theory is a normative ethic around which different constituencies may coalesce, in order to provide inputs and outcomes that are perceived as more legitimate, and thus become less costly and more effective (cf. op cit: 573).

Another theoretical contribution of CMR is to enhance two central concepts in the "incipient" (Knorr Cetina and Preda 2005: 8) and interesting field of sociology of financial markets. The CMR episodes seemed to show market actors constructing social norms 'post hoc' in order to help them perform market theory. This analysis speaks to the heated debate (Holm 2007) between Callon (1998) and Miller (2002) as to whether economic actors actually create and perform rational markets, or whether rational markets are virtual interpretations. The Citigroup episode showed that both forms of performativity can occur within the same market institution: Citigroup was ostensibly following a rational, atomised strategy on the MTS exchange, while others claimed that implicit standards of conduct had been in force. The SWF debate illustrated an extension of performativity: encouraging the funds to perform economic theory through "users' manuals" (GU17), but in addition, to perform it *responsibly*. In this vein, the thesis contributes one of the first sociological analyses of sovereign wealth funds. Finally, the Credit Crunch episode showed an interplay between regulatory incentives and ethics de-legitimizing the practice of regulatory arbitrage.

As a doctoral thesis the work illustrates my own epistemological journey. I began by exploring the research problem through CSR, economics, and political economy. Yet data analysis compelled me to search further afield, to other areas of political economy, economic sociology, and law. In part, this journey is testament to grounded theory methodology, which encourages researchers to keep an open mind in deriving theoretical explanations. It is also a source of personal satisfaction that, in this pursuit, I discovered extensive resonance between my empirical findings and extant concepts outside my initial theoretical 'silos'. The thesis built my ability to explore future research questions within a wider range of market governance disciplines than I had anticipated. The Credit Crunch was not only a financial crisis but, for this thesis, an empirical one. It is also a source of personal satisfaction that I framed and handled that problem.

Ultimately the contribution is CMR theory itself, a frame of reference to help researchers understand and anticipate governance problems in emerging domains of financial activity, and across several disciplines. The theory has its strengths, and researchers may identify new areas of theoretical relevance. CMR also appears increasingly relevant for actors like private equity funds, markets like dark pools, and practices like high-frequency trading. For practitioners in these domains, CMR matters because it conveys standards and provides principles of market conduct that that drive reactions from other actors, in markets and wider society. As I have noted, all three episodes in the thesis occurred under conditions of ample liquidity followed by significant credit shortages, or the threat of them. Currently, Western financial markets appear to be recovering slowly from the Credit Crunch. Investment banks have recovered pre-crisis levels of profitability. If JP Morgan's Jamie Dimon was right when he said that financial crises occur every seven years, then now may be a propitious time to attend to corporate market responsibility.

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Part 1: Data Sources

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I. NEWS SOURCES			
Financial Times	Citigroup deals unsettle rivals	09 August 2004	FT1
Financial Times	Bond trading curbed as Citigroup sales spark panic	09 August 2004	FT2
Financial Times	Citigroup coup stirs up emotions	10 August 2004	FT3
Financial Times	Lex live: Bond trading	10 August 2004	FT4
Financial Times	Citigroup eurozone bonds ploy leads to panic and clampdown on trading	10 August 2004	FT5
Financial Times	Bond trading	11 August 2004	FT6
Financial Times	Citi tactics put spotlight on trading platform	11 August 2004	FT7
Financial Times	On Europe: Citigroup sweeps competitors aside	13 August 2004	FT8
Financial Times	Citigroup sweeps competitors aside in otherwise staid sovereign bond market	14 August 2004	FT9
Financial Times	John Plender: The rogue elephant of global finance?	16 August 2004	FT10
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Financial Times	FRONT PAGE: FSA probes Citigroup trading	19 August 2004	FT14
Financial Times	MTS defends role in Citigroup deals	19 August 2004	FT15
Financial Times	Government bond trading	20 August 2004	FT16
Financial Times	Bursting the bonds of the past	23 August 2004	FT17
Financial Times	Bond trading slump undermines EU capital market	25 August 2004	FT18
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Financial Times	Lex live: Citigroup	15 December 2004	FT38
Financial Times	Deutsche Telekom reduces MTS stake	16 December 2004	FT39
Financial Times	DT to cut stake in Mobile TeleSystems	16 December 2004	FT40
Financial Times	Deutsche Tel to cut stake in MTS	17 December 2004	FT41
Financial Times	Citigroup move caps eventful year	27 December 2004	FT42
Financial Times	FRONT PAGE - COMPANIES & MARKETS: Citigroup eurozone bond trade dwindles	31 December 2004	FT43
Financial Times	Euronext in talks to buy MTS trading platform	04 January 2005	FT44
Financial Times	FRONT PAGE - COMPANIES & MARKETS: Euronext in talks to buy MTS trading platform	05 January 2005	FT45
Financial Times	MTS becomes pawn in LSE battle	06 January 2005	FT46
Financial Times	Citigroup to face criminal investigation in bond case	24 January 2005	FT47
Financial Times	Lex live: Citigroup/MTS	25 January 2005	FT48
Financial Times	German regulator seeks criminal inquiry into Citigroup bond case	25 January 2005	FT49
Financial Times	Citigroup/MTS	26 January 2005	FT50
Financial Times	Citigroup bond market trading memo revealed	31 January 2005	FT51
Financial Times	Citigroup 'planned bigger deals' in eurozone trades	01 February 2005	FT52
Financial Times	Citigroup internal memo	01 February 2005	FT53
Financial Times	Lex: Citigroup/MTS	01 February 2005	FT54
Financial Times	Dealers get the squeeze	01 February 2005	FT55
Financial Times	Citigroup bond trade memo is revealed	01 February 2005	FT56
Financial Times	Citi bond memo revealed	01 February 2005	FT57
Financial Times	Citigroup's Memo	02 February 2005	FT58
Financial Times	Citigroup trades broke gentleman's deal	02 February 2005	FT59
Financial Times	Citigroup defends controversial Eurobond trade	02 February 2005	FT60
Financial Times	Citi takes on Europe	02 February 2005	FT61
Financial Times	Citigroup 'planned bigger deals' in controversial eurozone trades	02 February 2005	FT62
Financial Times	Operator 'astonished' by Citi memo	02 February 2005	FT63
Financial Times	Citi says scale of trade in eurozone bonds controversy was unintentional	03 February 2005	FT64

Financial Times	European Comment: Fear of Polish painters	03 February 2005	FT65
Financial Times	Trichet calls for 'thorough' Citigroup inquiry	03 February 2005	FT66
Financial Times	Citigroup is sorry	04 February 2005	FT67
Financial Times	Citigroup trades exposed system weakness	04 February 2005	FT68
Financial Times	Citigroup says bond traders suspended	05 February 2005	FT69
Financial Times	John Plender: LSE, governance and public interest	06 February 2005	FT70
Financial Times	Citigroup trades spark call for wider regulation	07 February 2005	FT71
Financial Times	Citigroup says bond traders suspended	07 February 2005	FT72
Financial Times	That bond trade again	07 February 2005	FT73
Financial Times	New issues: Investors fight for a slice of Turkey	08 February 2005	FT74
Financial Times	FRONT PAGE: Citigroup bond trade sparks call for Europe-wide controls	08 February 2005	FT75
Financial Times	John Gapper: The market's true manipulators	09 February 2005	FT76
Financial Times	Bundesbank warns over Citigroup case	09 February 2005	FT77
Financial Times	The market's true manipulators	10 February 2005	FT78
Financial Times	Citigroup trade 'shows need for national control'	10 February 2005	FT79
Financial Times	Italian prosecutors probe Citigroup	28 February 2005	FT80
Financial Times	FRONT PAGE: Citigroup faces Italian probe into eurozone bond trades	01 March 2005	FT81
Financial Times	Italian prosecutors probe Citigroup	01 March 2005	FT82
Financial Times	Euronext makes joint MTS offer	15 March 2005	FT83
Financial Times	Euronext in talks over bid for MTS	15 March 2005	FT84
Financial Times	Citigroup fate up for debate in Germany	16 March 2005	FT85
Financial Times	Four on shortlist to buy MTS platform	27 March 2005	FT86
Financial Times	ESpeed leads bidding for MTS	10 May 2005	FT87
Financial Times	Battle over MTS set to drag on	10 May 2005	FT88
Financial Times	Belgium close to Citigroup ruling	10 May 2005	FT89
Financial Times	Battle for MTS looks set to drag on	11 May 2005	FT90
Financial Times	US banks make their presence felt in Germany	23 May 2005	FT91
Financial Times	US bulge-bracket investment banks make their presence felt	24 May 2005	FT92
Financial Times	Citigroup faces record FSA fine	01 June 2005	FT93
Financial Times	Citigroup in £14m settlement over bond trading	27 June 2005	FT94
Financial Times	FRONT PAGE - COMPANIES & MARKETS: Citigroup in £16m bond trade settlement	28 June 2005	FT95
Financial Times	FSA calls end to Citigroup affair	28 June 2005	FT96
Financial Times	New issues: High-yield waters tested	29 June 2005	FT97
Financial Times	High-yield waters tested	30 June 2005	FT98
Financial Times	John Plender: Pensions funds shunted to back	03 July 2005	FT100
Financial Times	Lawyers concerns over FSA fine on Citigroup	03 July 2005	FT99
Financial Times	Lawyers warn on implications of FSA fine on Citigroup	04 July 2005	FT101
Financial Times	Knuckleheads	04 July 2005	FT102
Financial Times	Trading questions	06 July 2005	FT103
Financial Times	Citigroup fine leaves bankers and lawyers puzzling over the rules	06 July 2005	FT104
The Guardian	Citigroup's brazen bond bet pays off	11 August 2004	GU1
The Guardian	Citigroup's £7bn bond trade under investigation	19 August 2004	GU2
The Guardian	Citigroup purge costs Britain's great survivor his job	21 October 2004	GU3
The Guardian	Pernod and Allied tread the rumour mill	05 February 2005	GU4
The Guardian	Throg Street Sharp move at Gillette	06 February 2005	GU5
The Guardian	Citigroup faces record fine over bond coup	26 June 2005	GU6
The New York Times	Citigroup Regrets Bond Trades in Europe	15 September 2004	NYT1
The Daily Telegraph	Citigroup faces bankers' wrath over bond coup	11 August 2004	DT1
The Daily Telegraph	Coup could lose Citigroup work, say rivals	12 August 2004	DT2
The Daily Telegraph	How Citigroup launched a wave of ill will in the bond markets ...	14 August 2004	DT3
The Daily Telegraph	Citigroup faces bond trades inquiry	19 August 2004	DT4
The Daily Telegraph	Europe widens Citigroup inquiry	20 August 2004	DT5
The Daily Telegraph	City diary	05 September 2004	DT6
The Daily Telegraph	We're sorry, Citigroup tells staff	15 September 2004	DT7
The Daily Telegraph	Citigroup apologises for Japanese failures	18 September 2004	DT8
The Daily Telegraph	FSA boss: don't copy Citigroup	02 October 2004	DT9
The Daily Telegraph	South Korea to monitor Citigroup	05 October 2004	DT10
The Daily Telegraph	You were juvenile, Citigroup tells traders	03 February 2005	DT11
The Daily Telegraph	City briefs	05 February 2005	DT12
The Daily Telegraph	Citigroup awaits ruling on bond trade	19 February 2005	DT13
The Daily Telegraph	Germany will not prosecute Citigroup	22 March 2005	DT14
The Daily Telegraph	Citigroup seeks FSA deal over bond 'raid'	08 May 2005	DT15
The Daily Telegraph	Citigroup cleared over bond coup	18 June 2005	DT16
The Daily Telegraph	Citigroup fined £14m for trade	29 June 2005	DT17
The Times	Citigroup contacts FSA over 'breached agreement'	11 August 2004	TT1
The Times	Top banks are the new global hooligans	13 August 2004	TT2
The Times	Markets board chiefs meet on Citigroup raid	15 August 2004	TT3
The Times	Business Focus: Bond raiders	15 August 2004	TT4
The Times	Citigroup in FSA inquiry	19 August 2004	TT5
The Times	Bank apologises for controversial bond transaction	15 September 2004	TT6
The Times	Citigroup regrets London bond scandal	19 September 2004	TT7
The Times	Traders on leave as bond inquiries start	05 February 2005	TT8
The Times	Citigroup waits as Europe watches the UK watchdog	11 February 2005	TT9
The Times	Citigroup plans tighter controls to tidy up its act	17 February 2005	TT10
The Times	Citigroup faces record FSA fine for bond deal	13 June 2005	TT11
The Times	Citigroup fined £*14m over bond trade	28 June 2005	TT12

The Times	FSA rebuke should sting Citi	28 June 2005	TT13
The Washington Post	OfficeMax CEO Resigns	15 February 2005	WP1
The Washington Post	Boeing Makes Big Sales	05 February 2005	WP2
The Wall Street Journal	MTS to Keep Curbs on Bond Trades	11 August 2004	WSJ1
The Wall Street Journal	MTS Will Keep Curbs In Euro-Zone Trading	11 August 2004	WSJ2
The Wall Street Journal	Citigroup Faces Broad UK Probe Over Bond Trades	19 August 2004	WSJ3
The Wall Street Journal	MTS Lifts Trade Curb	13 September 2004	WSJ4
The Wall Street Journal	Citigroup Image Takes a Buffeting	16 September 2004	WSJ5
The Wall Street Journal	Japan Orders Citibank To Halt Private Banking	20 September 2004	WSJ6
The Wall Street Journal	Citigroup's Japan Misstep May Bruise Bank's Global Image	22 September 2004	WSJ7
The Wall Street Journal	A Japanese Double Standard?	27 September 2004	WSJ8
The Wall Street Journal	Citigroup Profit Climbs by 13%	15 October 2004	WSJ9
The Wall Street Journal	Citigroup Ousts Three Top Officials	20 October 2004	WSJ10
The Wall Street Journal	MTS Takes Steps To Help Protect Its Market Makers	17 November 2004	WSJ11
The Wall Street Journal	Japan Legislators Castigate Official From Citigroup	01 December 2004	WSJ12
The Wall Street Journal	Citigroup Is Target Of German Inquiry	16 December 2004	WSJ13
The Wall Street Journal	A Big Loan to Design School	22 December 2004	WSJ14
The Wall Street Journal	Citigroup Sets Overhaul, Creates China CEO Post	05 January 2005	WSJ15
The Wall Street Journal	Germans Won't Have Easy Case	26 January 2005	WSJ16
The Wall Street Journal	Citigroup Trader's Memo Fuels Inquiry Into Euro-Bond Deals	02 February 2005	WSJ17
The Wall Street Journal	Bond Strategy Haunts Citigroup - WSJ.com	03 February 2005	WSJ18
The Wall Street Journal	Citigroup Begins Shake-Up of Team	04 February 2005	WSJ19
The Wall Street Journal	Citigroup Bond Case May Cause New Rules	09 February 2005	WSJ20
The Wall Street Journal	Citigroup May Admit to Lax Controls	02 March 2005	WSJ21
The Wall Street Journal	Greece Says Citigroup Trade Didn't Damage Greek Market	07 March 2005	WSJ22
The Wall Street Journal	Citigroup Fined $350,000 Over E-mail Error	10 March 2005	WSJ23
The Wall Street Journal	Frankfurt Prosecutors, Regulator to Discuss Trades by Citigroup	16 March 2005	WSJ24
The Economist	(none)		

II. REGULATORY AND POLICY DOCUMENTS			
FSA	Final Notice - Citigroup Global Markets Limited	28 June 2005	FSA1
FSA	FSA fines Citigroup £19.9 million for Eurobond trades (press release)	28 June 2005	FSA2
FSA	FSA Handbook - Release 35 (95)	20 July 2004(9)	FSA3
FSA	Principles-based Regulation - Focusing on the outcomes that matter	01 April 2007	FSA4
FSA	Senior Management Arrangements, Systems and Controls (Release 26)	01 December 2003	FSA5
UK Parliament	UK Financial Services and Markets Act	14 June 2000	UKP1
CMVM	Processo de contra-ordenação da CMVM no: 56/2004, Arguido(s): Citigroup 2 lobal Markets	16 June 2006	CMVM1
EC	Commission Directive 2004/72/EC: Market Abuse Directive	29 April 2004	EC1

CHAPTER 4: THE RISE TO PROMINENCE OF SOVEREIGN WEALTH FUNDS

I. NEWS SOURCES			
The Financial Times	The $2,500bn question	25 May 2007	FT107
The Financial Times	Private equity/China	22 July 2007	FT108
The Financial Times	UK warns over push for state protection	24 July 2007	FT109
The Financial Times	Sovereign fund to reshape its image	03 August 2007	FT112
The Financial Times	Alarm at Berlin's plan for curb on investors	10 August 2007	FT114
The Financial Times	Singapore's low-key champion	05 September 2007	FT116
The Financial Times	China sovereign fund may broaden mandate	13 September 2007	FT117
The Financial Times	Alaska faces debate on dividend or taxes	19 September 2007	FT118
The Financial Times	New global power brokers reshaping trends	03 October 2007	FT119
The Financial Times	Sovereign funds warning	15 October 2007	FT121
The Financial Times	The increasing influence of SWFs	17 October 2007	FT122
The Financial Times	Pressure pays off as private equity code of conduct is watered down	20 November 2007	FT123
The Financial Times	Private equity code	20 November 2007	FT124
The Financial Times	Temasek's changing strategy	28 November 2007	FT125
The Financial Times	Transcript of interview with Peer Steinbrück	30 November 2007	FT126
The Financial Times	Property rise tests Indian foundations	04 December 2007	FT127
The Financial Times	CIC	06 December 2007	FT129
The Financial Times	Survey of buy-out firms tells tale of gloom	14 January 2008	FT136
The Financial Times	The unsettling zeitgeist of state capitalism	14 January 2008	FT137
The Financial Times	Wanted: investors, no strings attached	14 January 2008	FT138
The Financial Times	Insight: China's investment traffic needs liberalising	15 January 2008	FT139
The Financial Times	Face to face with global leaders	05 February 2008	FT146
The Financial Times	Sovereign wealth investment is a force for stability	27 February 2008	FT149
The Financial Times	Mandelson hails sovereign wealth fund agreement	28 March 2008	FT155
The Financial Times	FRONT PAGE - COMPANIES & MARKETS: Sovereign wealth funds grow 18%	31 March 2008	FT160
The Financial Times	The wealth of nations is reflected in the stellar rise of sovereign funds	31 March 2008	FT161
The Financial Times	Germans agree on sovereign fund law	09 April 2008	FT164
The Financial Times	FT.com | Willem Buiter's Maverecon | Self-Regulation Means No ...	10 April 2008	FT168
The Financial Times	Left in the cold	25 April 2008	FT169
The Financial Times	Do not panic over foreign wealth	29 April 2008	FT171
The Guardian	Sovereign funds set to rule the markets	24 June 2007	GU7
The Guardian	Recipe for political tension	26 July 2007	GU9
The Guardian	No apocalypse now, but the party's over	29 July 2007	GU10
The Guardian	Wave of petrodollars from the emirates sets western stock markets alight	24 September 2007	GU11
The Guardian	Chancellor backs G7 move to get tough on sovereign wealth funds ...	19 October 2007	GU13

The Guardian	Chinese state-run institutions eye a Standard Chartered takeover ...	25 November 2007	GU14
The Guardian	Call for Virgin bid to comply with private equity code	12 December 2007	GU16
The Guardian	Leader: When Beijing goes buying | Comment is free | The Guardian	20 December 2007	GU17
The Guardian	The true face of economic patriotism | Business | guardian.co.uk	09 January 2008	GU18
The Guardian	Larry Elliot: Bubble economics | Comment is free | The Guardian	18 January 2008	GU22
The Guardian	Will Hutton: Come on, Mr Brown, stand up to the Chinese | Comment ...	19 January 2008	GU23
The Guardian	By all means welcome the Chinese, but not too warmly	20 January 2008	GU24
The Guardian	Sovereign funds defend themselves against calls for regulation ...	24 January 2008	GU25
The Guardian	Brown gathers business leaders for summit on sovereign wealth funds	03 February 2008	GU29
The Guardian	Investors talk to sovereign wealth funds | Money | The Guardian	18 February 2008	GU31
The Guardian	Brussels moves to rein in $3 trillion sovereign funds | Business ...	26 February 2008	GU33
The Guardian	Norway's pension fund publishes vote data, revealing stand on ethical issues	10 March 2008	GU35
The Guardian	Kuwait investor rejects west's plans for curbs | Business | The ...	10 April 2008	GU39
The New York Times	Public footprints in private markets - The New York Times	26 December 2007	NYT2
The New York Times	A Guide to Speed Dating With Sovereign Funds - DealBook Blog ...	15 January 2008	NYT4
The New York Times	Overseas Investors Buy Aggressively in U.S. - New York Times	20 January 2008	NYT6
The New York Times	Blackstone's Peterson Puts Riches Toward a Cause - DealBook Blog ...	15 February 2008	NYT7
The New York Times	EU warns governments not to overreact to sovereign wealth funds ...	25 February 2008	NYT8
The New York Times	DEALBOOK EXTRA; Dealbook Extra - New York Times	07 March 2008	NYT10
The New York Times	Rules Urged To Govern Investing By Nations - New York Times	20 October 2008	NYT16
The Daily Telegraph	**Business comment: Down to the last drops of an unreal era of easy ...**	22 June 2007	DT18
The Daily Telegraph	Dubai's towering ambition - Telegraph	23 September 2007	DT19
The Daily Telegraph	Protectionism is a disdain for others	04 November 2007	DT21
The Daily Telegraph	EC to rule on sovereign wealth funds - Telegraph	28 November 2007	DT23
The Daily Telegraph	Sovereign wealth funds: cavalry or Calvary? - Telegraph	23 December 2007	DT29
The Daily Telegraph	Bush convenes Plunge Protection Team - Telegraph	06 January 2008	DT31
The Daily Telegraph	Gordon Brown welcomes China's $200bn fund - Telegraph	17 January 2008	DT33
The Daily Telegraph	Invest in equities, expert tells IMF	18 January 2008	DT35
The Daily Telegraph	Russia should use sovereign wealth to help local banks - Telegraph	03 February 2008	DT38
The Daily Telegraph	Will private equity help banks out of toxic mess?	02 March 2008	DT41
The Daily Telegraph	California battle over sovereign fund investments	06 April 2008	DT46
The Daily Telegraph	Sovereign wealth funds to dwarf US economy	29 April 2008	DT49
The Daily Telegraph	Germany acts to halt the 'giant locusts'	19 August 2008	DT50
The Times	Chancellor set to open door to more takeovers in UK by foreign...	25 July 2007	TT14
The Times	America to press for restrictions on potent sovereign wealth funds ...	15 October 2007	TT15
The Times	Rising power of the sovereign funds	28 October 2007	TT16
The Times	Dubai starts to get message - Times Online	30 October 2007	TT17
The Times	US Government investigates sovereign funds - Times Online	11 January 2008	TT19
The Times	Brown seeks Chinese billions as US shuns fund	18 January 2008	TT20
The Times	Private equity defends sovereign funds	24 January 2008	TT22
The Times	Japan to create £25bn sovereign fund as fears mount on global sub ...	26 January 2008	TT23
The Times	Private equity bosses unite to present a co-ordinated message	05 February 2008	TT25
The Times	Sovereign funds involve issues of securities law enforcement, SEC ...	07 February 2008	TT26
The Times	China Investment Corporation poised for $10bn spree in Japan ...	22 February 2008	TT27
The Times	Japan plans activist sovereign wealth fund	03 March 2008	TT29
The Times	Predictions of further writedowns and cash shortfall rock ...	05 March 2008	TT30
The Times	The top 10 Chinese firms that will challenge the West - Times Online	09 March 2008	TT31
The Times	Singapore to act on sovereign wealth funds - Times Online	19 March 2008	TT34
The Times	Davos 2008: Policymakers clash over sovereign wealth funds - Times ...	21 March 2008	TT35
The Times	Virgin talks to Dubai International Capital over expansion plans	02 April 2008	TT37
The Times	Russia looks at all options to invest its oil billions abroad ...	22 April 2008	TT38
The Times	Sovereign wealth funds develop guidelines for behaviour	04 September 2008	TT40
The Washington Post	Sebastian Mallaby - The Next Globalization Backlash ...	24 June 2007	WP3
The Washington Post	Merrill Posts Wide Loss, Plans to Cut 3000 Jobs - washingtonpost.com	17 July 2007	WP5
The Washington Post	Countries Buying Companies - washingtonpost.com	23 October 2007	WP6
The Washington Post	Oil and Trade Gains Make Major Investors Of Developing Nations ...	29 October 2007	WP7
The Washington Post	Gerald Hyman - SWFs ISO Good Investments - washingtonpost.com	07 December 2007	WP8
The Washington Post	Private Equity's Loss of Leverage - washingtonpost.com	01 January 2008	WP9
The Washington Post	Allan Sloan - Four Wall Street Titans Flunk Investing 101 ...	21 January 2008	WP12
The Washington Post	George F. Will - Investors We Need Not Fear - washingtonpost.com	01 February 2008	WP15
The Washington Post	David Ignatius - Wall Street Bank Run - washingtonpost.com	20 February 2008	WP17
The Washington Post	Paulson Warns of Limits to Propping Up Economy - The Talk	16 March 2008	WP20
The Washington Post	Harold Meyerson - A New New Deal - washingtonpost.com	19 March 2008	WP21
The Washington Post	Foreign Wealth Funds Defend U.S. Investments - washingtonpost.com	26 March 2008	WP22
The Washington Post	Top Sovereign Wealth Funds - washingtonpost.com	27 March 2008	WP24
The Washington Post	Zoellick Wants Wealth Funds To Invest 1% In Africa ...	02 April 2008	WP26
The Economist	The world's most expensive club	23 May 2007	TE1
The Economist	The new Rothschilds	27 September 2007	TE2
The Wall Street Journal	Cross-Border Deals Take New Direction - WSJ.com	16 September 2007	WSJ25
The Wall Street Journal	The New Deal Diplomacy (SWFs buy small stakes and keep quiet)	28 November 2007	WSJ26
The Wall Street Journal	Middle East M&A: Buying Diversification, Modernization - Deal ...	03 October 2007	WSJ27
The Wall Street Journal	UBS's 'Undisclosed' Middle East Investor: Why the Secrecy? - Deal ...	10 December 2007	WSJ30
The Wall Street Journal	Lobbyists Smoothd the Way For a Spate of Foreign Deals	25 January 2008	WSJ34
The Wall Street Journal	Ascent of SWFs Illustrates New World Order	28 January 2008	WSJ35
The Wall Street Journal	China on Corruption Safeguards: 'Very Weak' - Real Time Economics ...	30 January 2008	WSJ36
The Wall Street Journal	State Funds May Not Bolster Freedoms	11 January 2008	WSJ38

The Wall Street Journal	Time for Sovereign Wealth Rules - WSJ.com	12 February 2008	WSJ39
The Wall Street Journal	Using Private Equity to Target Sovereign Wealth Funds - Deal ...	25 February 2008	WSJ43
The Wall Street Journal	California's Sovereign Wealth Fund - WSJ.com	07 March 2008	WSJ44
The Wall Street Journal	Wall Street in Crisis - WSJ.com	16 March 2008	WSJ47
The Wall Street Journal	Sovereign Funds - WSJ.com	18 March 2008	WSJ48
The Wall Street Journal	IMF: Moving Ahead on Sovereign Wealth Funds - Real Time Economics ...	19 March 2008	WSJ49
The Wall Street Journal	California's Stern Rebuke - WSJ.com	21 April 2008	WSJ50
II. REGULATORY AND POLICY DOCUMENTS			
US			
Treasury	Agreement on Principles for Soveriegn Wealth Fund Investment with Singapore and Abu Dhabi	20 March 2008	UST1
EUROPE			
EC	Sovereign Wealth Funds and Financial Stability - Guide	27 February 2008	EC2
EC	A Common Approach to Sovereign Wealth Funds	01 March 2008	EC3
EC	The EU response to the rise of sovereign wealth funds (Speech/08/168)	02 April 2008	EC4
GLOBAL			
IMF	International Working Group of Sovereign Wealth Funds is established to facilitate work on voluntary principles (IMF Release 08/97)	01 May 2008	IMF1
IMF	Generally Accepted Principles and Practices (GAPP) for Sovereign Wealth Funds - The Santiago Principles	01 October 2008	IMF2

CHAPTER 5: THE POST-CREDIT-CRUNCH REGULATORY DEBATE

I. REGULATORY AND POLICY DOCUMENTS			
UK			
Treasury	Reforming Financial Markets	08 July 2009	UKT1
Treasury	Walker Review of Corporate Governance of the UK Banking Industry	26 November 2009	UKT2
Bank of England	Financial Stability Report: Global Instability and Policy Response	26 June 2009	BOE1
Bank of England	Financial Stability Report: Building a more resilient financial system	26 June 2009	BOE2
UK Parliament	House of Commons Treasury Committee: Banking Crisis: Dealing with the failure of the UK banks	24 July 2009	UKP2
UK Parliament	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	UKP3
UK Parliament	House of Commons Treasury Committee: Banking Crisis: Regulation and supervision	31 July 2009	UKP4
UK Parliament	House of Lords: Future of EU Financial Regulation	20 August 2009	UKP5
FSA	Turner Review: A regulatory response to the financial crisis	15 March 2009	FSA6
FSA	Chancellor's response to Turner Review	27 March 2009	FSA7
US			
Treasury	Financial Stability Plan	01 March 2009	UST2
Treasury	Financial Regulatory Reform: A new foundation	17 June 2009	UST3
Treasury	Press Release: Systemic risk legislation	22 July 2009	UST4
Federal Reserve	Cole Submission to the House (Risk mgmt in banks)	18 March 2009	FED1
Federal Reserve	Bernanke Testimony to the House (Regulatory restructuring)	24 July 2009	FED2
Federal Reserve	Bernanke Testimony to the House (Regulatory reform)	01 October 2009	FED3
US Congress	Senate: DODD: HOW DO WE PROTECT MAIN STREET FROM WALL STREET?	23 July 2009	USC1
US Congress	House: Corporate and Financial Institution Compensation Fairness Act of 2009	30 July 2009	USC2
US Congress	Senate: *Restoring American Financial Stability Act 2010*	04 August 2009	USC3
SEC	Testimony Concerning Turmoil in U.S. Credit Markets: Recent Actions Regarding Government Sponsored Entities, Investment Banks and Other Financial Institutions	23 September 2008	SEC1
SEC	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	SEC2
SEC	Testimony Before the Subcommittee on Financial Services and General Government	11 March 2009	SEC3
SEC	Testimony Concerning Mark-to-Market Accounting: Practices and Implications	12 March 2009	SEC4
SEC	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	SEC5
SEC	Testimony Concerning Securities Law Enforcement in the Current Financial Crisis	20 March 2009	SEC6
SEC	Testimony Concerning Enhancing Investor Protection and Regulation of the Securities Markets	26 March 2009	SEC7
SEC	Testimony Concerning Strengthening the SEC's Vital Enforcement Responsibilities	07 May 2009	SEC8
SEC	Testimony Concerning the Oversight and Regulation of Executive Compensation	11 June 2009	SEC9
SEC	Testimony Concerning Regulation of Over-The-Counter Derivatives	22 June 2009	SEC12
SEC	Testimony Concerning SEC Oversight: Current State and Agenda	14 July 2009	SEC13
SEC	Testimony Concerning Regulating Hedge Funds and Other Private Investment Pools	15 July 2009	SEC14
SEC	Testimony: "Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Propos	22 July 2009	SEC15
SEC	Testimony Concerning Regulation of Systemic Risk	23 July 2009	SEC16
SEC	Testimony Concerning "Protecting Shareholders and Enhancing Public Confidence by Improving Corporat	29 July 2009	SEC17
SEC	Written Testimony Concerning SEC Oversight of Credit Rating Agencies	05 August 2009	SEC18
SEC	Testimony Concerning "Recent Innovations in Securitization"	24 September 2009	SEC19
EUROPE			
EC	Report of the de Larosiere Group	25 February 2009	EC5
EC	Communication on 'Driving European Recovery'	01 March 2009	EC6
GLOBAL			
BIS/FSB	Financial Stability Board response to Turner Review (Mario Draghi, Chairman)	27 March 2009	BIS1
BIS/FSB	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	BIS2
II. NEWS SOURCES			
FINANCIAL TIMES			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
Financial Times	Turner report: key themes under review	15 March 2009	FT172
Financial Times	Brown will use report to resist FSA split	16 March 2009	FT173
Financial Times	Brown signals measures to aid borrowers	17 March 2009	FT174
Financial Times	**Turner's only option is to lead a global race to the top**	18 March 2009	FT175
Financial Times	Farewell, light-touch regulation	18 March 2009	FT176
Financial Times	Indian banking veteran exit Merrill venture	18 March 2009	FT177

Financial Times	The Turner review	19 March 2009	FT178
Financial Times	Financials hearten FTSE	19 March 2009	FT179
Financial Times	UK regulator unveils reform plan	19 March 2009	FT180
Financial Times	Sir David Walker is Mr Reviews	19 March 2009	FT181
Financial Times	Why the Turner report is a watershed for finance	20 March 2009	FT182
Financial Times	It's hard not to wince as we look into Rock's past	20 March 2009	FT183
Financial Times	Plan to buy debt lifts banks	20 March 2009	FT184
Financial Times	G20	21 March 2009	FT185
Financial Times	Glimmers of hope	21 March 2009	FT186
Financial Times	New regulations will restrict mortgage loans	21 March 2009	FT187
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance	24 July 2009	
Financial Times	none		
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
Financial Times	Bank urges more frequent disclosures	26 June 2009	FT188
Financial Times	System remains vulnerable to shocks	26 June 2009	FT189
Financial Times	Growing risk appetite hits dollar	26 June 2009	FT190
Financial Times	Optimism returns to investment and insurance groups	29 June 2009	FT191
UKT2	Walker Review	26 November 2009	
Financial Times	Walker review	26 November 2009	FT192
Financial Times	Institutions urged to adopt tougher stance	26 November 2009	FT193
Financial Times	France Telecom chief stays the course in year of crisis	26 November 2009	FT194
Financial Times	IoD welcomes any steps to improve transparency	27 November 2009	FT195
Financial Times	The big name	28 November 2009	FT196
Financial Times	Include China in long climate view	29 November 2009	FT197
Financial Times	Walker plan points finger at 'freeriders'	29 November 2009	FT198
Financial Times	Time the boardroom learnt about ethics	30 November 2009	FT199
Financial Times	Banks face tougher rules on pay disclosure	30 November 2009	FT200
Financial Times	Corporate strategy	30 November 2009	FT201
Financial Times	Treasury seeks to set tougher rules on bankers' pay disclosure	01 December 2009	FT202
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
Financial Times	none		
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
Financial Times	US moots a revised uptick rule	24 March 2009	FT203
Financial Times	SEC pledges to strengthen its oversight	27 March 2009	FT204
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
Financial Times	High frequency trading	05 August 2009	FT205
EC5	Report of the de Larosiere Group	25 February 2009	
Financial Times	Trichet calls for supervision of all institutions	24 February 2009	FT206
Financial Times	City seeks 'bark and bite' to build on promising premise	26 February 2009	FT207
Financial Times	Utopian plan to stabilise Europe's banking system	04 March 2009	FT208
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
Financial Times	Leaders seek to retool global economy	25 September 2009	FT209
Financial Times	Leaders agree bank bonus standards	25 September 2009	FT210
Financial Times	Full GG0 communiqué	25 September 2009	FT211
Financial Times	Leaders bury differences over bonuses to agree standards	26 September 2009	FT212
Financial Times	EU finance ministers pushed on regulation	30 September 2009	FT213
Financial Times	Ministers shun bankers' pleas for fewer rules	04 October 2009	FT214
THE TIMES			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
The Times	The Governor's eyebrow should trump the law | Matthew Parris	21 March 2009	TT41
The Times	Coming to a bank near you: the 9% mortgage - Times Online	22 March 2009	TT42
The Times	FSA may outlaw super-sized mortgages	18 March 2009	TT43
The Times	Mortgage rates will be high for nine years - Times	22 March 2009	TT44
The Times	Lord Turner's review 'flawed' say our academics	22 March 2009	TT45
The Times	Lawyers welcome plans for financial shake-up	18 March 2009	TT46
The Times	No need for a security blanket	22 March 2009	TT47
The Times	First Britain, then the world for the enforcer's net	22 March 2009	TT48
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The Times	Government white paper 'muddle' say MPs	31 July 2009	TT49
The Times	Bonus party won't stop	16 August 2009	TT50
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The Times	Vulnerable banks still sensitive to possible economic shocks ...	26 June 2009	TT51
The Times	Darling gives FSA new weapons to fight crises - Times Online	09 July 2009	TT52
UKT2	Walker Review	26 November 2009	
The Times	Walker review on bonuses and risk-taking attacked by Institute of	22 September 2009	TT53
The Times	Bankers are forced to disclose pay - Times Online	22 November 2009	TT54
The Times	City regulator backpedals over bonuses - Times Online	12 August 2009	TT55
UST2	Financial Regulatory Reform: A new foundation	17 June 2009	
The Times	Healthcare, not bailouts, could break America | Anatole Kaletsky	18 June 2009	TT56
The Times	Brazil, Russia, India and China form bloc to challenge US	17 June 2009	TT57
USC3	Senate: *Restoring American Financial Stability Act 2010*	04 August 2009	
The Times	none		
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The Times	none		
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The Times	SEC 'not a prudent regulator' before crisis	20 April 2009	TT58

The Times	Lehman regulator admits it was inadequate	17 March 2009	TT59
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The Times	none		
EC5	Report of the de Larosiere Group	25 February 2009	
The Times	none		
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
The Times	G20 moves against bankers' pay and bonuses - Times Online	25 September 2009	TT60
THE DAILY TELEGRAPH			
FSA6	Turner Review: A regulatory response to the financial crisis	15/03/2009-29/3/2009	
The Daily Telegraph	Gordon Brown: Why we need tougher regulation of our financial ...	15 March 2009	DT51
The Daily Telegraph	Lord Turner is trying to fix financial regulation. Good luck to ...	17 March 2009	DT52
The Daily Telegraph	Proposed cap on mortgage lending by FSA is 'suicidal', say ...	17 March 2009	DT53
The Daily Telegraph	Lord Turner calls for sweeping revolution in financial services ...	18 March 2009	DT54
The Daily Telegraph	Lord Turner: a man under pressure to tighten the grip on banks ...	18 March 2009	DT55
The Daily Telegraph	Lord Turner's key recommendations on banking regulation - Telegraph	19 March 2009	DT56
The Daily Telegraph	G20 Summit: the financial world will be a duller but a much safer ...	20 March 2009	DT57
The Daily Telegraph	'History does not repeat itself, but it often rhymes, as Mark ...	20 March 2009	DT58
The Daily Telegraph	Prime Minister condemns management culture at Royal Bank of ...	24 March 2009	DT59
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The Daily Telegraph	Queen told how economists missed financial crisis - Telegraph	26 July 2009	DT60
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The Daily Telegraph	British banks highly vulnerable to future shocks, Bank of England ...	26 June 2009	DT61
The Daily Telegraph	Financial White Paper won't end tensions at the heart of British ...	26 June 2009	DT62
The Daily Telegraph	Government lambasted for further regulation reform delay - Telegraph	26 June 2009	DT63
The Daily Telegraph	FSA to add two new divisions in 'radical' overhaul, says chief ...	02 July 2009	DT64
The Daily Telegraph	Requiem for a dream - Telegraph	05 July 2009	DT65
The Daily Telegraph	**Finance White Paper: FSA wins extra powers – for now - Telegraph**	08 July 2009	DT66
The Daily Telegraph	Government white paper paves way for City 'super-regulator ...	09 July 2009	DT67
UKT2	Walker Review	26 November 2009	
The Daily Telegraph	Walker review: main points - Telegraph	26 November 2009	DT68
The Daily Telegraph	Walker Review wants banks to reveal number of staff earning more ...	26 November 2009	DT69
The Daily Telegraph	**Walker Review: disclosure will push bankers' pay up – Telegraph Blogs**	26 November 2009	DT70
The Daily Telegraph	More than 1000 bankers in the City earn over £1m a year, Sir David ...	26 November 2009	DT71
The Daily Telegraph	Sir David Walker says naming UK's millionaire bankers 'would drive ...	28 November 2009	DT72
The Daily Telegraph	Ian Powell of PwC, the man sorting out the mess left by Lehman's ...	28 November 2009	DT73
The Daily Telegraph	Sir Christopher Hogg provokes anger with tough rules for all ...	01 December 2009	DT74
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The Daily Telegraph	none		
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The Daily Telegraph	Geithner rescue package 'robbery of the American people' - Telegraph	24 March 2009	DT75
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The Daily Telegraph	SEC vows to end 'flash trading' - Telegraph	05 August 2009	DT76
The Daily Telegraph	Proprietary traders should welcome tougher FSA tests - Telegraph	27 July 2009	DT77
EC5	Report of the de Larosiere Group	25 February 2009	
The Daily Telegraph	European Commission proposes bodies to oversee banking risk and ...	25 February 2009	DT78
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
The Daily Telegraph	G20: Bankers evade bonus caps in leaders' agreement - Telegraph	25 September 2009	DT79
The Daily Telegraph	G20: Banks to be forced to double capital levels - Telegraph	25 September 2009	DT80
The Daily Telegraph	Financial Services Authority reviews bonus plans in wake of ...	27 September 2009	DT81
THE GUARDIAN			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
The Guardian	How can the FSA change when it is being run by ex-bankers ...	15 March 2009	GU40
The Guardian	Plea bargains to help FSA net fraudsters | Business | The Observer	15 March 2009	GU41
The Guardian	Brown calls for urgent reform of the financial regulation ...	15 March 2009	GU42
The Guardian	Banks could be forced to choose between savers and 'casino ...	17 March 2009	GU43
The Guardian	Chris Hamnett: The Turner review is a wake-up call for bankers ...	18 March 2009	GU44
The Guardian	Turner wants FSA control of bankers' pay | Business | guardian.co.uk	18 March 2009	GU45
The Guardian	Turner Review: A cap on income multiples on mortgages is not ...	18 March 2009	GU46
The Guardian	Turner review: experts' views | Business | guardian.co.uk	18 March 2009	GU47
The Guardian	Jonathan Michie: End economic reliance on the casino-like City ...	18 March 2009	GU48
The Guardian	Royal Bank of Scotland banker: 100% mortgages were 'immoral ...	19 March 2009	GU49
The Guardian	Northern Rock: Still crazy offering crazy loans | Money | guardian ...	20 March 2009	GU50
The Guardian	Banks under pressure as HSBC goes ex-rights | Business | guardian ...	20 March 2009	GU51
The Guardian	Ruth Sunderland: Chips down for casino banks | Business | The Observer	22 March 2009	GU52
The Guardian	RBS faces probe over 'threats' to directors | Business | The Observer	22 March 2009	GU53
The Guardian	Dan Roberts on the British and American approaches to the banking ...	24 March 2009	GU54
The Guardian	Watchdogs that must be taught to bark in the boardroom | Business ...	27 March 2009	GU55
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The Guardian	This is how we let the credit crunch happen, Ma'am ... | UK news ...	26 July 2009	GU56
The Guardian	Bank regulation reform 'needs to be more radical' | Business | The ...	27 July 2009	GU57
The Guardian	Alistair Darling calls on banks to do more for small businesses ...	27 July 2009	GU58
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The Guardian	Bernie Madoff: Just rewards | Editorial | Comment is free | The ...	30 June 2009	GU59
The Guardian	Banks own the US government | Dean Baker | Comment is free ...	30 June 2009	GU60
The Guardian	The new Conservatism can create a capitalism that works for the ...	02 July 2009	GU61
The Guardian	The banking white paper: what the experts say | Business ...	08 July 2009	GU62

The Guardian	Facing economic facts | Ken Livingstone | Comment is free ...	09 August 2009	GU63
UKT2	Walker Review	26 November 2009	
The Guardian	Sir David Walker: 'I'm a man of the people, not a City grandee ...	26 November 2009	GU64
The Guardian	Walker review urges bank chairmen to stand up to chief executives ...	26 November 2009	GU65
The Guardian	Walker report on banks a 'crashing disappointment' | Business ...	26 November 2009	GU66
The Guardian	Campaigners attack Sir David Walker's report on banking | Business ...	26 November 2009	GU67
The Guardian	Banks forced to reveal numbers of millionaire staff | Business ...	26 November 2009	GU68
The Guardian	Name, shame, blame the bankers, if you like. But they're the wrong ...	26 November 2009	GU69
The Guardian	Observer Business, Media & Cash | Business | guardian.co.uk	29 November 2009	GU70
The Guardian	Bankers' bonuses: Time for a windfall tax | Comment is free | The ...	04 December 2009	GU71
The Guardian	Private equity shows signs of new life | Business | guardian.co.uk	09 December 2009	GU72
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The Guardian	Interview: Niall Ferguson | Books | The Guardian		GU72
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The Guardian	Dan Roberts on the British and American approaches to the banking ...	24 March 2009	GU73
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The Guardian	Bank of America pays $33m to settle Merrill case | Business ...		GU74
EC5	Report of the de Larosiere Group	25 February 2009	
The Guardian	European banking bail-outs threaten common market, finance baron ...		GU75
The Guardian	Brussels looks at Europe-wide bank regulation | Business | The		GU76
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
The Guardian	The new G20 – how will it work? | World news | guardian.co.uk	25 September 2009	GU77
The Guardian	World leaders relaunch G20 as top economic forum | World news ...	25 September 2009	GU78
THE WALL STREET JOURNAL			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
The Wall Street Journal	U.K. Prepares Outline for New Finance Rules	18 March 2009	WSJ50
The Wall Street Journal	U.K. Proposes Regulatory Overhaul	19 March 2009	WSJ51
The Wall Street Journal	Hedging the Blame	20 March 2009	WSJ52
The Wall Street Journal	The Return of the 'Governor's Eyebrows'	20 March 2009	WSJ53
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The Wall Street Journal	none		
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The Wall Street Journal	Banks Still Vulnerable, BOE Warns	26 June 2009	WSJ54
The Wall Street Journal	Regulatory Rumble	10 July 2009	WSJ55
UKT2	Walker Review	26 November 2009	
The Wall Street Journal	Goldman Takes Offensive on Pay	04 December 2009	WSJ56
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The Wall Street Journal	Moody's CEO Warned Profit Push Posed a Risk to Quality of Ratings	23 October 2008	WSJ57
The Wall Street Journal	U.K. Will Continue Ban on Short Selling	23 October 2008	WSJ58
The Wall Street Journal	Manila Eases Mark-to-Market Rules	24 October 2008	WSJ59
The Wall Street Journal	SEC's Cox Backs Merger of Agency With CFTC	24 October 2008	WSJ60
The Wall Street Journal	Japan Cracks Down on Naked Short Selling	28 October 2008	WSJ61
The Wall Street Journal	How Best to Restore Confidence in Our Markets?	28 October 2008	WSJ62
The Wall Street Journal	FSA on track for record U.K. regulator levies fines as it steps up oversight of markets	29 October 2008	WSJ63
The Wall Street Journal	What Were All Those Highly Paid Directors Doing?	30 October 2008	WSJ64
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The Wall Street Journal	Regulator Weakness Cited in Report	18 March 2009	WSJ65
The Wall Street Journal	George Soros: All This New Regulation Is Just 'Tinkering'	24 March 2009	WSJ66
The Wall Street Journal	We Need Honest Accounting	24 March 2009	WSJ67
The Wall Street Journal	On Wall Street, Talk of Trust and Civil War	25 March 2009	WSJ68
The Wall Street Journal	SEC Seeks Expanded Authority Over Hedge Funds	26 March 2009	WSJ69
The Wall Street Journal	PE Regulation: Clear As Fog	26 March 2009	WSJ70
The Wall Street Journal	Geithner Calls for Tougher Standards on Risk	26 March 2009	WSJ71
The Wall Street Journal	Geithner Draws Ire Of Venture Capital	26 March 2009	WSJ72
The Wall Street Journal	SEC to Step Up Money Fund Oversight	26 March 2009	WSJ73
The Wall Street Journal	Treasury Maps New Era of Regulation	27 March 2009	WSJ74
The Wall Street Journal	SEC's New Top Cop Faces Challenges	30 March 2009	WSJ75
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The Wall Street Journal	SEC Votes to Propose Rules That Will Ban 'Pay to Play'	24 July 2009	WSJ76
The Wall Street Journal	In a Flash, Schumer Warns SEC	28 July 2009	WSJ77
The Wall Street Journal	Should You Invest In Toxic Assets?	29 July 2009	WSJ78
The Wall Street Journal	U.S. Issues New Rules on Short-Selling	29 July 2009	WSJ79
The Wall Street Journal	The Schumer Proxy	31 July 2009	WSJ80
The Wall Street Journal	Dark Pools Fire Back at Call for Ban	31 July 2009	WSJ81
The Wall Street Journal	What's Behind High-Frequency Trading	01 August 2009	WSJ82
The Wall Street Journal	House Passes Bill to Curb Executive Pay	01 August 2009	WSJ83
The Wall Street Journal	The SEC vs. CEO Pay	04 August 2009	WSJ84
The Wall Street Journal	PE Industry To SEC: 'Please Stop All This Nonsense'	04 August 2009	WSJ85
The Wall Street Journal	SEC Charges Traders Over 'Naked' Shorts	06 August 2009	WSJ86
EC5	Report of the de Larosiere Group	25 February 2009	
The Wall Street Journal	EU Panel Urges a New Body to Monitor Financial Risk	26 February 2009	WSJ87
The Wall Street Journal	EU Adviser: Some Central Banks Failed to Do Their Jobs	10 March 2009	WSJ88
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
The Wall Street Journal	FSB Releases Report on Bank Compensation	25 September 2009	WSJ89
The Wall Street Journal	FSB to Link Bank Pay to Capital, Refrain From Caps	25 September 2009	WSJ90
The Wall Street Journal	G20 Leaders Tout Progress on Bank Regulation, But Big Issues Remain	26 September 2009	WSJ91

The Wall Street Journal	London Bankers Shrug Off Short-Term Threat to Pay	29 September 2009	WSJ92
WASHINGTON POST			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
The Washington Post	Britain's Financial Watchdog Urges Broad Regulatory Changes in ...	19 March 2009	WP26
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The Washington Post	none		
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The Washington Post	none		
UKT2	Walker Review	26 November 2009	
The Washington Post	none		
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The Washington Post	Greenspan and Co. Describe Wall Street 'Tsunami' - Washington Post ...	23 October 2008	WP27
The Washington Post	Hedge Fund Industry's Role in Wall St. Crisis - washingtonpost.com	25 October 2008	WP28
The Washington Post	Allan Sloan - Don't Blame Mark-to-Market Accounting ...	28 October 2008	WP29
The Washington Post	Christopher Cox - Reinventing A Markets Watchdog - washingtonpost.com	04 November 2008	WP30
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The Washington Post	SEC Chairman to Ask for Greater Control - washingtonpost.com	25 March 2009	WP31
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The Washington Post	On the Hill, Finance Officials Draw Battle Lines on Reform ...	25 July 2009	WP32
The Washington Post	Jane Bryant Quinn - Pulling Money-Market Funds Into Proper ...	02 August 2009	WP33
The Washington Post	The Hearing - Making Financial Regulation Work: The Supreme ...	03 August 2009	WP34
EC5	Report of the de Larosiere Group	25 February 2009	
The Washington Post	none		
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
The Washington Post	none		
NEW YORK TIMES			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
The New York Times	Regulators Worldwide Look at Bankers' Pay - NYTimes.com	19 March 2009	NYT17
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The New York Times	none		
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The New York Times	U.B.S.raises Another $3.5 Billion - New York Times	27 June 2009	NYT18
UKT2	Walker Review	26 November 2009	
The New York Times	none		
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The New York Times	Greenspan, Snow and Cox on the Hill - DealBook Blog - NYTimes.com	23 October 2008	NYT19
The New York Times	Greenspan concedes error on regulation - The New York Times	23 October 2008	NYT20
The New York Times	Fair Game - They're Shocked, Shocked, About the Mess - NYTimes.com	24 October 2008	NYT21
The New York Times	Federal Regulation - New York Times	26 October 2008	NYT22
The New York Times	Debating the Merits of Mark-to-Market - DealBook Blog - NYTimes.com	29 October 2008	NYT23
The New York Times	In Modeling Risk, the Human Factor Was Left Out - NYTimes.com	04 November 2008	NYT24
The New York Times	Former Bear Stearns Risk Manager Turns Up at Fed - DealBook Blog ...	05 November 2008	NYT25
The New York Times	High and Low Finance - In Financial Rules, Mr. Obama, Proceed With ...	06 November 2009	NYT26
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The New York Times	Administration Seeks Increase in Oversight of Executive Pay ...	21 March 2009	NYT27
The New York Times	As Banks Flounder, the Perks Play On - DealBook Blog - NYTimes.com	25 March 2009	NYT28
The New York Times	S.E.C. Chief Tries to Stake Out Role in Overhaul - NYTimes.com	26 March 2009	NYT29
The New York Times	Hedge Funds Fret About Proposed Rules - DealBook Blog - NYTimes.com	27 March 2009	NYT30
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The New York Times	S.E.C. Moves to Curb Abusive Short-Selling - NYTimes.com	27 July 2009	NYT31
The New York Times	Wealth Matters - In Search of Competent (and Honest) Financial ...	31 July 2009	NYT32
The New York Times	Britain Scrutinizes High-Frequency Trades - NYTimes.com	03 August 2009	NYT33
The New York Times	S.E.C. Starts Crackdown on 'Flash' Trading - NYTimes.com	04 August 2009	NYT34
The New York Times	High-Frequency Trading - The New York Times	05 August 2009	NYT35
EC5	Report of the de Larosiere Group	25 February 2009	
The New York Times	EU proposes tighter banking regulation - The New York Times	25 February 2009	NYT36
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	
The New York Times	none		
THE ECONOMIST			
FSA6	Turner Review: A regulatory response to the financial crisis	15 March 2009	
The Economist	Houses versus shares | The Economist	18 March 2009	TE3
UKP3	House of Commons Treasury Committee: Banking Crisis: Reforming corporate governance and pay in the	24 July 2009	
The Economist	none		
BOE2	Financial Stability Report: Building a more resilient financial system	26 June 2009	
The Economist	none		
UKT2	Walker Review	26 November 2009	
The Economist	none		
SEC2	Lessons from the Credit Crisis for the Future of Regulation	23 October 2008	
The Economist	The Securities and Exchange Commission: Growing insecurities | The ...		TE4
SEC5	Testimony Concerning Lessons Learned in Risk Management Oversight at Federal Financial Regulators	18 March 2009	
The Economist	none		
SEC16	Testimony Concerning Regulation of Systemic Risk	23 July 2009	
The Economist	none		
EC5	Report of the de Larosiere Group	25 February 2009	
The Economist	none		
BIS2	Improving Financial Regulation: Report to the G20 Leaders	25 September 2009	

The Economist	none

N.B. News articles that appear to be missing from the sequence (e.g. FT110, FT111) were removed from the sample because they were a re-publication of an earlier report, or tangential to the episode. These articles were mistakenly captured by the search engines and removed during data analysis.

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