

THE COST OF REGULATORY NON-COMPLIANCE TODAY? IT'S MEASURED IN BILLIONS NOW

What do American banks have in common with their European counterparts? Many suffered penalties from EU Competition Commissioner Joaquín Almunia, who recently levied the largest combined penalty—1.7 billion euros (\$2.3 billion)—ever imposed by European anti-trust regulators. And the ramifications for US financial institutions doing business globally are frightening.

EU REGULATORS FIND COLLUSION IN RATE SETTING

To build their case, the European Union regulators investigated reports of the Libor and Euribor interest rates being manipulated by the defendant financial institutions, as well as rate rigging of the Tokyo rate known as Tibor. Banks set these interbank rates (at which they lend to each other) on an unsecured basis and in a variety of currencies. In addition, these rates serve as indexes for billions of dollars' worth of consumer credit worldwide, including some US home mortgage loans.

Although there were reports over a two-year period of traders at certain banks benefiting from falsely reporting these rates, the investigation focused on the claim of collusion among the banks rather than focusing on the wrongdoing of a group of traders at any one institution. In other words, poor internal controls over employee compliance with regulations led to their employers, and not merely the violators themselves, being fined—quite heavily—for the violations.

NO DIFFERENCE BETWEEN SHORT-TERM OR LONG-TERM NON-COMPLIANCE

While the European institutions are alleged to have been in violation of the rate-setting rules during as much as a three-year period, the American banks were found to have engaged in such practices for a mere three months—at the longest. This further underscores the need for sound, constant, monitoring of global risk management factors for any overseas activity whatsoever, no matter how brief and no matter the lack of an established “pattern or practice.”

In fact, the \$108 million assessed against one US bank related to the misconduct of two former traders who traded during a one-month period in 2007.

FINES SIGNAL TOUGHER OVERSIGHT AHEAD

The investigation into the Libor and Euribor rate manipulation has also led regulators to scrutinize a number of other benchmarks used to price financial products—including the foreign exchange markets—that are now being investigated by a number of regulators around the world, including the UK's Financial Conduct Authority (FCA.) Furthermore, both US and British regulators are continuing their own investigations of global giants.

Although the European Central Bank intends to create a banking union of eurozone banks next year, it will not have supervisory authority over financial markets—an omission that may be remedied by way of legislating a single unified supervisor for European financial markets.

COULD SUCH NON-COMPLIANCE HAVE BEEN AVOIDED?

Some banking authorities have acknowledged they were aware months ago of serious flaws in their systems and controls on this issue as well as the questionable integrity of a few employees.

With today's risk-management expertise readily available to assist global financial institutions, these flaws can be identified and controls put in place or tightened. Engaging compliance professionals to identify shortcomings in system supervision is a necessary step toward identifying potential misdeeds before they occur in the first place.

THEN THERE ARE THE LEGAL FEES

So what is the real cost of regulatory non-compliance? Apparently \$2.3 billion is just the opening shot. As one writer described the legal circus surrounding the Libor scandal: “Lawyers are piling up like brain-hungry zombies to file lawsuits against banks accused of manipulating Libor.” It is not only the small banks that are suing for millions in losses due to the rate manipulation, but also state and local government entities and huge, respected hedge funds.

A Morgan Stanley research note from last July estimated that the legal costs alone for individual banks may range from \$59 million to more than \$1 billion.

With the significant rise in fines and penalties assessed by regulatory bodies both domestically and worldwide, every company, regardless of size or industry, must have in place an effective mechanism for protecting itself from adverse regulatory compliance risks.