House of Commons Library

BRIEFING PAPER

Number 06376, 26 July 2014

LIBOR, Public Inquiries & FCA disciplinary powers

By Timothy Edmonds

Inside:

1. LIBOR
2. The Regulators' findings
3. Official responses
4. FSA/FCA disciplinary powers & criminal sanctions

www.parliament.uk/commons-library | intranet.parliament.uk/commons-library | papers@parliament.uk | @commonslibrary

Contents

Summary **3**

1. LIBOR **4**

2. The Regulators' findings **7**
2.1 Barclays: Formal findings 7
2.2 Summary 10
2.3 Formal findings: UBS 11
2.4 Formal findings: RBS 12
2.5 Formal findings: Lloyds Bank 12
2.6 The EU competition investigation 13
2.7 Consequences of manipulation 14
2.8 Barclay's record 14

3. Official responses **17**
Fines 17
Wheatley Review 17

4. FSA/FCA disciplinary powers & criminal sanctions **22**

Cover page image copyright: Threadneedle Street, City of London by Keith Braithwaite. Licensed under CC BY 2.0 / image cropped.

Summary

This note summarises some of the key points relating to the LIBOR scandal. In the UK, seven institutions have been fined so far for LIBOR related activity.

UK Regulatory action connected with LIBOR activity

Institution	£million	Activity	
Barclays	59.5	Libor	Euribor
UBS	160.0	Libor	Euribor
RBS	87.5	Libor	
ICAP Europe	14.0	Libor	
Rabobank	105.0	Libor	
Martin Brokers (UK) Limited	0.6	Libor	
Lloyds Banking Group	105.0	Libor	Repo

Source FCA press release

Other banks have been fined in parallel enquiries by the US and EU authorities.

The note looks at the now enhanced role of the FSA's – now FCA's disciplinary powers with respect to 'benchmark' activities.

1. LIBOR

LIBOR is short for the London Interbank Offered Rate. It is the benchmark (guide) interest rate at which banks will theoretically lend to each other on the overnight market.

Banks are huge, complex organisations which have literally millions of debits and credits appearing on their accounts daily, as well as their own ongoing financing needs that change daily as borrowings require repayment or loans are repaid. At the end of each day, these debits and credits are netted off leaving a net financing position which can be either a surplus or a deficit. The interbank market is where they can either deposit excess funds or borrow to cover shortfalls. Depending on a range of factors such as how much they borrow or the perceived credit standing of the bank, the cost of borrowing, the interest rate, for one bank will not necessarily be the same as the cost for another. It is this range of rates which ultimately contributes to the average LIBOR benchmark rate. A British Bankers Association (BBA) briefing explains the mechanics of the rate setting process:

> Thomson Reuters is the designated calculation agent for LIBOR. Data submitted by panel banks into the libor process is received and processed by Thomson Reuters and the data is calculated using guidelines provided by the FX&MM Committee.
>
> Each cash desk in a LIBOR contributor bank has a Thomson Reuters application installed allowing that institution to confidentially submit rates. Each morning between 1100 and 1110 a named individual responsible for cash management at each panel bank formulates their own rates for the day and inputs them into this application, which links directly to a rate setting team at Thomson Reuters. A bank cannot see other contributor rates during the submission window - this is only possible after final publication of the LIBOR data. Thomson Reuters run a collection of automated and manual tests on the submitted rates before they are sent to the calculation engine, and after calculation, the data is released to the market via Thomson Reuters and other licensed data vendors.[1]

It continues:

> Every contributor bank is asked to base their libor submissions on the following question:
>
> ***"At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?"***
>
> Therefore, submissions are based upon the lowest perceived rate at which a bank could go into the London interbank money market and obtain funding in reasonable market size, for a given maturity and currency.
>
> Libor is not necessarily based on actual transactions, as not all banks will require funds in marketable size each day in each of the currencies/ maturities they quote and so it would not be feasible to create a suite of LIBOR rates if this was a requirement. However, a bank will know what its credit and liquidity risk profile is from rates at which it has dealt and can construct a curve to predict accurately the correct rate for currencies or maturities in which it has not been active.
>
> "*Reasonable market size*" is intentionally left broadly defined: it would have to be constantly monitored and in the current conditions would have to be changed very frequently. It would also vary between currencies and maturities, leading to a considerable amount of confusion.
>
> The current definition was adopted as the standard after a review in 1998. Up until this point, submissions from panel members were based upon the following: *"At what rate do you think interbank term deposits will be offered by one prime bank to*

[1] BBA website

> *another prime bank for a reasonable market size today at 11am?"* The new definition enables accountability for the rates.
>
> All libor rates are quoted as an annualised interest rate. This is a market convention. For example, if an overnight Sterling rate from a contributor bank is given as 2.00000%, this does not indicate that a contributing bank would expect to pay 2% interest on the value of an overnight loan. Instead, it means that it would expect to pay 2% divided by 365.

In the light of the findings regarding LIBOR at Barclays, it is important to note that there are many contributors to the process. According to the BBA, "the euro panel has 15 banks; the sterling panel has 16; the US dollar panel has 18".[2] This large number of contributors limits the ability of one bank to actually affect the stated rate. A single bank's influence is further diluted by the mathematical conversion of the individual bids to a 'trimmed average'. This is explained below:

> Every libor rate produced by Thomson Reuters is calculated using a trimmed arithmetic mean. Once Thomson Reuters receive each contribution submission they rank them in descending order and then exclude the highest and lowest 25% of submissions - this is the trimming process. The remaining contributions are then arithmetically averaged to create a libor quote. This is repeated for every currency and maturity, producing 150 rates every business day.[3]

Obviously, if a bank artificially raised or lowered its submission by a significant amount in order to influence the final rate, this submission would have a greater chance of being excluded anyway (it would either be in the highest or lowest 25% of submissions). Hence, purely from the point of view of tactics, a bank has a greater chance of influencing the rate if it made a smaller misrepresentation than if it made a large one, but the impact of a small representation would be correspondingly smaller too.

Another technical feature of the rate setting process which contributed to the manipulation of rates is the fact that after the rate is set, individual submissions to the panel are published in full. This means that other participants can see what the other banks posted. Part of the finding of the American Commodity Futures Trading Commission (CFTC) regulator was that:

> The CFTC Order also finds that Barclays, acting at the direction of senior management, engaged in other serious unlawful conduct concerning LIBOR. In late 2007, Barclays was the subject of negative press reports raising questions such as, "So what the hell is happening at Barclays and its Barclays Capital securities unit that is prompting its peers to charge it premium interest in the money market?" Such negative media speculation caused significant concern within Barclays and was discussed among high levels of management within Barclays Bank. As a result, certain senior managers within Barclays instructed the U.S. Dollar LIBOR submitters and their supervisor to lower Barclays' LIBOR submissions to be closer to the rates submitted by other banks and not so high as to attract media attention.
>
> According to the Order, senior managers even coined the phrase "head above the parapet" to describe high LIBOR submissions relative to other banks. Barclays' LIBOR submitters were told not to submit at levels where Barclays was "sticking its head above the parapet." The directive was intended to fend off negative public perceptions about Barclays' financial condition arising from its high LIBOR submissions relative to the submissions of other panel banks, which Barclays believed were too low given the market conditions.[4]

Normally, greater transparency in activities is associated with less secret manipulation. In this case, it appears as though it was a prime motive.

---

[2] BBA briefing
[3] BBA website
[4] CFTC press release 27 June 2012

LIBOR matters. Interest rates on a number of financial products from complex derivatives to mortgage rates and credit card rates are one way or another, linked to LIBOR. The BBA notes that:

> Libor is the primary benchmark for short term interest rates globally. It is used as the basis for settlement of interest rate contracts on many of the world's major futures and options exchanges (including CME Group and NYSE Euronext LIFFE) as well as most Over the Counter (OTC) and lending transactions such as mortgages.[5]

LIBOR is big. One academic wrote that "$350 - $400 trillion dollars of contracts, instruments and transactions are referenced to it".[6] In its *Order* against Barclays, the CFTC say "interest rate derivatives, such as swaps and Forward Rate Agreements, comprised over $449 trillion in notional value at the end of 2009, and over $500 trillion in notional value at the end of2011."[7]

It should be noted that with many banks contributing to the LIBOR process, several others are also being investigated for potential misconduct.

---

5 BBA website: LIBOR FAQs

6 *Why & How Should the Libor be Reformed?*, Rosa M Abrantes Metz, June 26, 2012, p1

7 CTFC, Order instituting proceedings, June 27 2012, p1

2. The Regulators' findings

The first investigation carried out was done jointly by the Financial Services Authority (FSA) in the UK and the American Commodity Futures Trading Commission (CFTC). It focussed on Barclays Bank. The following section provides a detailed guide to their findings, section 2.2 provides a far shorter summary.

2.1 Barclays: Formal findings

On 27th June 2012, both regulators published the findings of a long joint investigation into LIBOR rate setting. The FSA *Final Notice* to Barclays of its findings is the most detailed UK 'charge sheet' publicly available. Key extracts are shown below:

> **Inappropriate submissions following requests by derivatives traders**
>
> 8. Barclays acted inappropriately and breached Principle 5 on numerous occasions between January 2005 and July 2008 by making US dollar LIBOR and EURIBOR submissions which took into account requests made by its interest rate derivatives traders ("Derivatives Traders"). At times these included requests made on behalf of derivatives traders at other banks. The Derivatives Traders were motivated by profit and sought to benefit Barclays' trading positions.
>
> 9. The definitions of LIBOR and EURIBOR require submissions from contributing banks based on borrowing or lending in the interbank market. The definitions do not allow for consideration of derivatives traders' positions. It was inappropriate for Barclays to make US dollar LIBOR and EURIBOR submissions which took its Derivatives Traders' positions (or the positions of traders at other banks) into account. Barclays did not therefore observe proper standards of market conduct when making US dollar LIBOR and EURIBOR submissions.
>
> 10. Barclays also breached Principle 5 on numerous occasions between February 2006 and October 2007 by seeking to influence the EURIBOR (and to a much lesser extent the US dollar LIBOR) submissions of other banks contributing to the rate setting process.
>
> 11. Where Barclays made submissions which took into account the requests of its own Derivatives Traders, or sought to influence the submissions of other banks, there was a risk that the published LIBOR and EURIBOR rates would be manipulated. Barclays could have benefitted from this misconduct to the detriment of other market participants. Where Barclays acted in concert with other banks, the risk of manipulation increased materially.
>
> **Inappropriate submissions to avoid negative media comment**
>
> 12. Barclays acted inappropriately and breached Principle 5 on numerous occasions between September 2007 and May 2009 by making LIBOR submissions which took into account concerns over the negative media perception of Barclays' LIBOR submissions.
>
> 13. Liquidity issues were a particular focus for Barclays and other banks during the financial crisis and banks' LIBOR submissions were seen by some commentators as a measure of their ability to raise funds. Barclays was identified in the media as having higher LIBOR submissions than other contributing banks at the outset of the financial crisis. Barclays believed that other banks were making LIBOR submissions that were too low and did not reflect market conditions. The media questioned whether Barclays' submissions indicated that it had a liquidity problem. Senior management at high levels within Barclays expressed concerns over this negative publicity.
>
> 14. Senior management's concerns in turn resulted in instructions being given by less senior managers at Barclays to reduce LIBOR submissions in order to avoid negative media comment. The origin of these instructions is unclear. Barclays' LIBOR

> submissions continued to be high relative to other contributing banks' submissions during the financial crisis.[8]

Detailed descriptions of the activities of the Barclay's traders can be found later in the Note:

> 54. The misconduct involving internal requests to the Submitters at Barclays was widespread, cutting across several currencies and occurring over a number of years. The Derivatives Traders discussed the requests openly at their desks. At least one Derivatives Trader at Barclays would shout across the euro Swaps Desk to confirm that other traders had no conflicting preference prior to making a request to the Submitters.
>
> 55. Requests to Barclays' Submitters were made verbally and a large amount of email and instant message evidence consisting of Derivatives Traders' requests also exists. At times, requests made by email alone were sent by the Derivatives Traders nearly every day. For example, requests were made by Barclays' US dollar Derivatives Traders on 16 out of the 20 days on which Barclays made US dollar LIBOR submissions in February 2006 and on 14 out of the 23 days on which it made US dollar LIBOR submissions in March 2006.
>
> 56. The FSA has identified that:
>
> between January 2005 and May 2009, at least 173 requests15 for US dollar LIBOR submissions were made to Barclays' Submitters (including 11 requests based on communications from traders at other banks);
>
> between September 2005 and May 2009, at least 58 requests for EURIBOR submissions were made to Barclays' Submitters (including 20 requests based on communications from traders at other banks); and
>
> between August 2006 and June 2009, at least 26 requests for yen LIBOR submissions were made to Barclays' Submitters.
>
> 57. At least 14 Derivatives Traders at Barclays made these requests. This included senior Derivatives Traders. In addition, trading desk managers received or participated in inappropriate communications on, at least, the following occasions:
>
> on 22 March 2006, Trader A (a US dollar Derivatives Trader) stated in an email to Manager A that Barclays' Submitter "*submits our settings each day, we influence our settings based on the fixings we all have*". Manager A took no action as a result of this email;
>
> on 5 February 2008, Trader B (a US dollar Derivatives Trader) stated in a telephone conversation with Manager B that Barclays' Submitter was submitting "*the highest LIBOR of anybody […] He's like, I think this is where it should be. I'm like, dude, you're killing us*". Manager B instructed Trader B to: "*just tell him* to *keep it, to put it low*". Trader B said that he had "*begged*" the Submitter to put in a low LIBOR submission and the Submitter had said he would "*see what I can do*"; and
>
> in July 2008, euro Derivatives Traders sent emails to Manager C indicating that they had spoken to Barclays' Submitter about the desk's reset positions and he had agreed to assist them. This followed instructions from Manager C for the traders to speak to the Submitter.[9]

The FSA fined Barclays £59.5 million in accordance with section 206 of the *Financial Services and Markets Act 2000*. This is the largest fine ever imposed by the FSA.

The CTFC Order instituting proceedings was published on the same day. Extracts are shown below:

> Barclays' violative conduct involved multiple desks, traders, offices and currencies, including United States Dollar ("U.S. Dollar"), Sterling, Euro and Yen. The wrongful

[8] FSA Final Notice 27 June 2012
[9] Ibid

conduct spanned from at least 2005 through at least 2009, and at times occurred on an almost daily basis.

Barclays' conduct included the following:

(1) During the period from at least mid-2005 through the fall of2007, and sporadically thereafter into 2009, Barclays based its LIBOR submissions for U.S. Dollar (and at limited times other currencies) on the requests of Barclays' swaps traders, including former Barclays swaps traders, who were attempting to affect the official published LIBOR, in order to benefit Barclays' derivatives trading positions; those positions included swaps and futures trading positions; this same conduct occurred with respect to Barclays' Euribor submissions for the period of at least mid-200S through mid-2009

(2) During the period from at least mid-2005 through at least mid-2008, certain Barclays Euro swaps traders, led by a former Barclays senior Euro swaps trader, coordinated with, and aided and abetted traders at certain other banks to influence the Euribor submissions of multiple banks, including Barclays, in order to affect the official published Euribor, and thereby benefit their respective derivatives trading positions; and

(3) During the volatile, global market conditions of the financial crisis of late August 2007 through early 2009 (the "financial crisis period"), Barclays lowered its LIBOR submissions in order to manage what it believed were inaccurate and negative public and media perceptions that Barclays had a liquidity problem based in part on its high LIBOR submissions relative to the low submissions of other panel banks that Barclays believed were too low given market conditions. Pursuant to a directive by certain members of Barclays' senior management, Barclays submitted lower rates for U.S. Dollar LIB OR, and at limited times Yen and Sterling LIB OR, than what it had determined to be the appropriate rates reflecting the costs of borrowing unsecured funds in the relevant markets.

Barclays' lack of specific internal controls and procedures concerning its submission processes for LIBOR and Euribor and overall inadequate supervision of trading desks allowed this conduct to occur.

Specifically, during the period from at least mid-2005 through the fall of2007, and sporadically thereafter into 2009, interest rate swaps traders, primarily located in Barclays' New York and London offices, regularly requested that the Barclays' employee(s) responsible for determining and submitting Barclays' daily LIBORs and Euribors ("submitters") submit a particular rate or adjust their submitted rates higher or lower in order to affect the daily, official published LIBOR and Euribor. Barclays' swaps traders were improperly attempting to benefit Barclays' derivatives trading positions and the profitability of their particular trading books and desks. Barclays' swaps traders also facilitated former Barclays swaps traders' requests to alter LIBOR or Euribor submissions by passing along the former traders' requests to the Barclays LIBOR or Euribor submitters as if they were their own. The Barclays submitters routinely based their LIBOR and Euribor submissions on the traders' requests in furtherance of the attempts to manipulate LIBOR and Euribor. The majority of Barclays' violative conduct involved U.S. Dollar LIBOR and Euribor, but also, at limited times, involved Yen and Sterling LIBOR submissions.

In addition, during the period from at least mid-2005 through mid-2008, certain Barclays Euro swaps traders, led by a former Barclays senior Euro swaps trader, coordinated with and aided and abetted traders at certain other banks in attempts to manipulate Euribor. The Barclays swaps traders coordinated with traders at other banks on the rates to be submitted by their respective Euribor submitters in order to benefit their bank's derivatives trading positions. These Barclays Euro swaps traders agreed to ask, and did ask, the Barclays submitters for rates that benefited the trading positions of the traders at the other banks. The Barclays swaps traders made these requests as if they were their own requests and were to benefit Barclays' trading positions. The submitters routinely accommodated those requests. The Barclays Euro swaps traders also made similar requests to the traders at the other banks in order to benefit Barclays' derivatives trading positions.

> A bank's derivatives trading positions or profitability are not legitimate or permissible factors on which to base a bank's daily LIBOR and Euribor submissions. By basing its LIBOR and Euribor submissions on Barclays' derivatives traders' requests, and thereby on Barclays' derivatives trading positions, Barclays' LIBOR submissions were not consistent with the BBA's definitions and criteria for LIBOR submissions. Instead, Barclays conveyed false, misleading or knowingly inaccurate reports that its submitted rates for LIBOR and Euribor were based on and solely reflected the costs of bon-owing unsecured funds in the relevant interbank markets.
>
> Accordingly, Barclays regularly attempted to manipulate and knowingly delivered, or caused to be delivered, false, misleading or knowingly inaccurate reports concerning U.S. Dollar LIBOR and Euribor, and at times, Yen and Sterling LIBOR, which are all commodities in interstate commerce.
>
> During the financial crisis period, Barclays believed that the market and media inaccurately perceived Barclays as having liquidity problems in part because the rates submitted for LIBOR by Barclays were significantly higher at times than the rates submitted by other banks. Barclays contended the other banks' submissions were inappropriately low given the realities of the market conditions and lack of transactions occurring in the interbank markets. To manage public perceptions that its higher LIBOR submissions meant Barclays was a weaker institution, Barclays' senior management directed the Barclays submitters to lower Barclays' submissions in order to be closer to the rates submitted by the other banks, and thus, be a less noticeable outlier from the rest of the banks. The Barclays submitters complied with the management directive by submitting artificially lower rates than they would have otherwise submitted and that were inconsistent with the definition and criteria for submitting LIBOR. As a result, Barclays did not submit rates reflecting or relating to borrowing of unsecured funds in the relevant interbank markets.
>
> The management directive impacted at least Barclays' U.S. Dollar LIBOR submissions in multiple maturities ("tenors") on a regular basis throughout the financial crisis period. The directive, on occasion, also impacted Barclays' Sterling and Yen LIB OR submissions. Concerns for one's reputation or negative market or press reports are not legitimate or permissible factors upon which a bank may base its daily LIBOR submissions. Accordingly, during the financial crisis period, Barclays, through its submissions, knowingly delivered, or caused to be delivered, false, misleading or knowingly inaccurate reports that affected or tended to affect LIBOR, a commodity in interstate commerce.[10]

A footnote to the last paragraph above states:

> While Barclays typically was one of the highest submitters of the LIBOR panel banks during the financial crisis period, Barclays' submissions, at times, were part of the calculation of the official published LIBOR. However, the Commission has not found evidence that Barclays lowered its LIBOR submissions in response to the management directive during the financial crisis period with the intent to affect the official published LIBOR.[11]

The CFTC fined Barclays $200 million.

2.2 Summary

Both regulators concluded that Barclays had submitted false interest rates (contributor rates) over a period of time in a number of LIBOR related markets.

The first point to note is that the regulators did not find that the problems were due to the 'rogue trader'. These events happened over a long period of time, in various markets and involved multiple members of staff, in different parts of the organisation, some at management level.

---

[10] CFTC, Order instituting proceedings, June 27 2012, p 2-4

[11] Ibid

The second point to note is that there are two distinct motives for the manipulation at different, but overlapping, periods of time:

- 2005 – 2007/8 manipulations were made largely for the financial benefit of Barclay's trading book.
- 2007 - early 2009 manipulations were made largely to manage Barclay's 'negative public and media perceptions'.

The third point is that in the first phase of manipulation, requests for financial assistance from traders were both high and low.[12] This makes it virtually impossible to calculate the 'cost' of such manipulation such as it affects mortgages, credit cards etc. At some point (assuming that the manipulation worked) rates would have been lower than they ought, to the benefit of borrowers. At other times, they would have been higher – to borrowers' detriment. In the second, 'reputational' phase of manipulation, the bias was downwards, so if the false submissions did have an effect it would have been to reduce interest rates.

2.3 Formal findings: UBS

On 19 December 2012, the FSA issued a final notice against the bank UBS for "extensive and widespread" misconduct connected with LIBOR and EURIBOR. It fined the bank £160 million, its largest ever fine. The accompanying press release noted:

> UBS's breaches of the FSA's requirements encompassed a number of issues, involved a significant number of employees and occurred over a period of years in a number of countries. Between 1 January 2005 to 31 December 2010 the misconduct included:
>
> - UBS's traders routinely making requests to the individuals at UBS responsible for determining its LIBOR and EURIBOR submissions to adjust their submissions to benefit the traders' trading positions.
> - Giving the roles of determining its LIBOR and EURIBOR submissions to traders whose positions made a profit or loss depending on the LIBOR / EURIBOR fixes. This combination of roles was a fundamental flaw in organisational structure given the inherent conflict of interest between these two roles.
> - Colluding with interdealer brokers in co-ordinated attempts to influence Japanese Yen (JPY) LIBOR submissions made by other panel banks. Corrupt brokerage payments were made to reward brokers for their efforts to manipulate the LIBOR submissions of panel banks.
> - Colluding with individuals at other panel banks to get them to make JPY LIBOR submissions that benefited UBS's trading positions.
> - Adopting LIBOR submissions directives whose primary purpose was to protect the bank's reputation by avoiding negative media attention about its submissions and speculation about its creditworthiness.
>
> The misconduct was extensive and widespread. At least 2,000 requests for inappropriate submissions were documented – an unquantifiable number of oral requests, which by their nature would not be documented, were also made. Manipulation was also discussed in internal open chat forums and group emails, and was widely known. At least 45 individuals including traders, managers and senior managers were involved in, or aware of, the practice of attempting to influence submissions. The routine and widespread manipulation of the submissions was not detected by Compliance or by Group Internal Audit, which undertook five audits of the relevant business area during the relevant period.

[12] See para 58 Ibid

Even when the trading and submitting roles were split in Autumn 2009, UBS's systems and controls did not prevent traders from camouflaging their requests as "*market colour*". Given the widespread and routine nature of the requests to change LIBOR and EURIBOR and the nature of the control failures, the FSA found that every LIBOR and EURIBOR submission, in currencies and tenors in which UBS traded during the relevant period, was at risk of having been improperly influenced to benefit derivatives trading positions.

The misconduct occurred in various locations around the world including Japan, Switzerland, the UK and the USA.[13]

2.4 Formal findings: RBS

In February 2013, the FSA fined RBS £87.5 million. Part of the FSA's Market notice is shown below:

Between October 2006 and November 2010, RBS often made JPY and CHF LIBOR submissions that took into account requests made by its Derivatives Traders. Derivatives Traders were motivated by profit and sought to benefit RBS's derivatives trading positions. Derivatives Traders made requests in person, in writing and over the phone. By way of illustration, between December 2008 and November 2010, Derivatives Traders made at least 96 written requests to Primary Submitters with respect to JPY and CHF LIBOR. Of the 96 requests, 43 related to JPY LIBOR and 53 related to CHF LIBOR. In addition, Derivatives Traders made at least 5 written requests to influence RBS's USD submissions during the Relevant Period (although it does not appear that these requests were taken into account). Further, JPY and CHF Derivatives Traders often made requests to each other to be passed on to Primary Submitters ("Non-Submitter Requests") for particular submissions. As well as in-person requests, there were at least 129 written Non-Submitter Requests relating to RBS's JPY LIBOR submissions and at least 2 written Non-Submitter Requests relating to RBS's CHF LIBOR submissions.[14]

2.5 Formal findings: Lloyds Bank

In July 2014 Lloyds Banking Group was fined £105million by the FCA for "serious LIBOR and other benchmark failings".[15] As reported in the *Financial Times* 29 July 2014 this was part of an overall fine of £225.8million to UK and US regulators.

The FCA news release outlined what Lloyds had done. It noted that the REPO rate manipulation – done to reduce the cost of taxpayer support to Lloyds itself was a 'first'.

Repo Rate manipulation

Between April 2008 and September 2009, the firms manipulated their Repo Rate submissions in order to reduce the fees payable by them to the Bank of England for participation in the taxpayer-backed SLS. The Repo Rate, a now discontinued benchmark rate, was published daily by the BBA until December 2012. Repo Rate panel banks submitted the rates, across a range of maturities, at which they were prepared to trade in the repo market.

By artificially inflating their Repo Rate submissions, the firms sought to narrow the Repo Rate-LIBOR spread and thereby reduce the fees properly payable to the Bank of England for their participation in the SLS. A total of four individuals (a manager and a trader at each firm) colluded with each other in the manipulation of the firms' Repo Rate submissions without any oversight or challenge.

This was an extremely serious failing, with the potential to reduce the fees due to the Bank of England from all the firms that participated in the SLS.

---

13 FSA Website 19 December 2012
14 FSA website, 6 February 2013
15 FCA press release 28 July 2014

Lloyds Banking Group has paid the Bank of England £7.76 million in compensation for the reduction in the amount of Special Liquidity Scheme (SLS) fees received by the Bank (from all users of the SLS) as a result of manipulation by Lloyds and BoS of their submissions to the BBA GBP Repo Rate.

Failings related to LIBOR

LIBOR is based on daily estimates of the rates at which LIBOR panel banks borrow funds from one another. In relation to LIBOR, the firms' misconduct between May 2006 and June 2009 included:

•The firms making GBP, USD and JPY LIBOR submissions that took into account the profit and loss (P&L) of their money market trading books;

•Lloyds colluding with Rabobank to seek to influence JPY LIBOR to benefit their respective trading positions;

•The firms engaging in "forcing LIBOR" to influence the GBP LIBOR submissions of other LIBOR panel banks to benefit trading positions; and

•BoS manipulating its GBP and USD submissions as a result of at least two directives from a manager to avoid negative media comment and market perception in respect of its financial stability during the financial crisis.

This meant that the firms' affected LIBOR submissions, and some of the LIBOR submissions made by other panel banks, did not fairly reflect the cost of inter-bank borrowing. This undermined the overall integrity of the LIBOR benchmark.

Sixteen individuals at the firms, seven of whom were managers, were directly involved in, or aware of, the various forms of LIBOR manipulation, including one manager who was also involved in the Repo Rate misconduct.[16]

2.6 The EU competition investigation

Concurrent with the US and UK investigations the EU competition authorities mounted their own investigation. It reported in December 2013. The fines it levied are shown in the table below:

EU Competiton Authority LIBOR fines

	Cartel participants	Total fines	
Euro-Libor activities		€'000s	£'000s
	Barclays	0	0
	Deutsche Bank	465,861	383,031
	Societe Generale	445,884	366,606
	RBS	131,004	107,711
Yen - Libor activities			
	USB	0	0
	RBS (3 counts)	260,056	213,818
	Deutsche Bank (2 counts)	259,499	213,360
	JPMorgan	79,897	65,691
	CitiGroup (3 counts)	70,020	57,570
	RP Martin	247,000	203,083
Total		1,959,221	1,610,872

Note: various firms received discounts for co-operating with the investigation. Barclays and UBS received 100% discounts.

Source: EU Commission

16 FCA press release 28 July 2014

2.7 Consequences of manipulation

Ever since the issue became apparent, commentators have tried to determine who, if anyone had suffered by the manipulation and if so by how much. Part of the FSA press release outlining the UBS penalty included the following conclusion on this point:

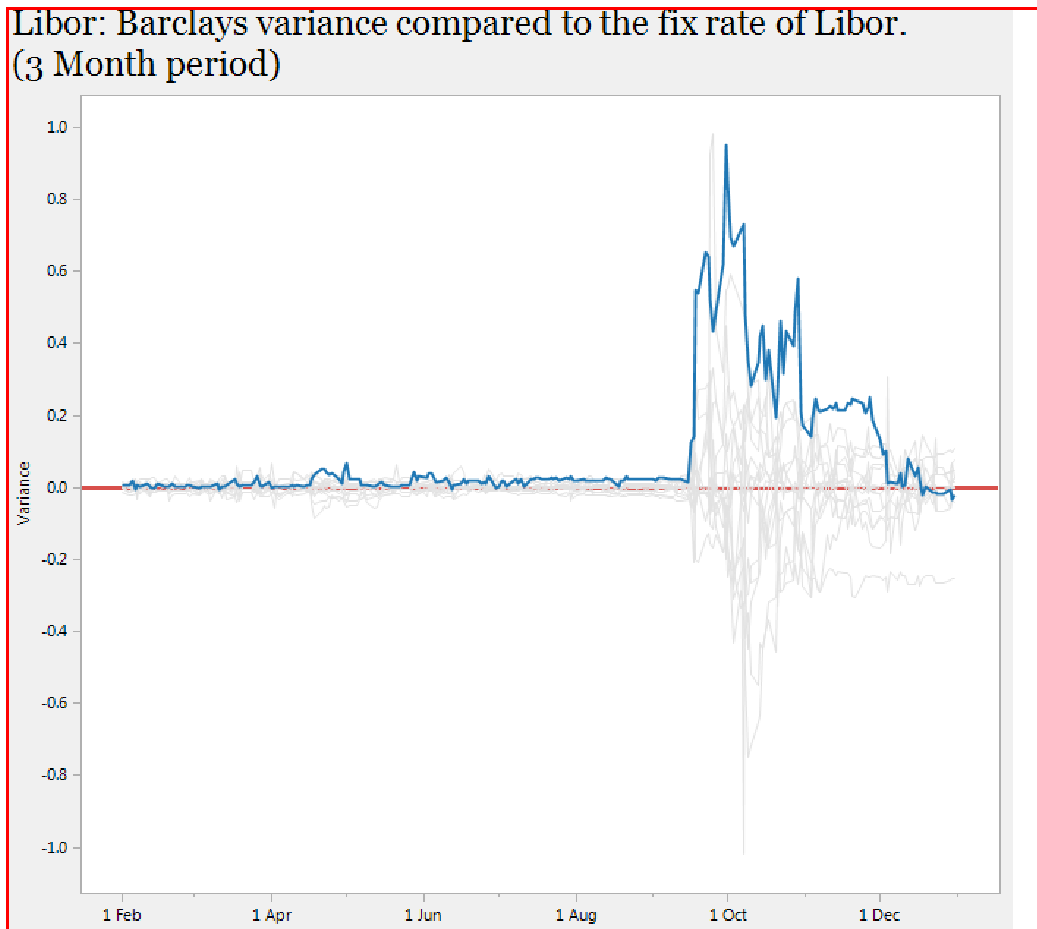
> The direct impact of actual manipulation of the LIBOR and EURIBOR fix on UK retail consumers is likely to be minimal:
>
> - Retail products in the UK are typically linked to base rate, rather than LIBOR. For example, retail mortgages pegged to GBP LIBOR are a niche product;
> - The traders were dealing in contracts in various currencies valued in the hundreds of millions. They were seeking to influence the fix by fractions of a basis point (1 basis point is 100th of 1%) where small movements would have a material financial impact on those high value contracts. In contrast, the economic impact of a fraction of a basis point movement up or down on a much lower value retail contract would be minimal;
> - Furthermore, even if a retail contract was linked to LIBOR, it would only be impacted if the link was to the specific LIBOR currency concerned, in the specific tenor (eg three month Japanese yen LIBOR) for the specific fixing date; and
> - The manipulation of submissions was, at times, for higher and, at times, for lower submissions. Therefore, even if there was an impact on the relevant LIBOR fix, it could have had the effect of making the product more or less expensive to the retail consumer concerned (albeit by a minimal amount).[17]

2.8 Barclay's record

An excellent visual guide to Barclay's rate submissions can be found on the Guardian website. The graphic is fairly self explanatory, allowing the user to compare Barclays with other rate setters or with the average LIBOR fix rate. The graphic below is taken from this site.

The graph compares Barclay's submitted rate with the average LIBOR fix rate over the calendar year 2008. In normal circumstances, one would expect a bank like Barclays to be both above and below the average at different times and not far from that average at all times. 2008, however, was not a normal time. Its submitted rate is nearly always above the average and during the peak of the crisis considerably so.

[17] FSA Website 19 December 2012



The inference of having a higher rate than other banks is that the bank is finding it difficult to borrow in the market. At the time of the crisis, this equated to doubts over a bank's viability. Whilst the UK Government had 'bailed out' both Lloyds and the Royal Bank of Scotland, Barclays was determined to maintain its independence and did not have direct government funding. Instead, it was seeking to raise funds from the Middle East. It was, in a sense therefore, more sensitive to market judgement than some other banks were.

The financial impact of the regulatory fines on Barclays is likely to be dwarfed by other developments. Both the Chairman, Marcus Agius, and the Chief Executive of the bank, Bob Diamond have resigned, together with a senior official, Jerry del Missier, implicated in giving instructions to lower submitted rates in the second phase. The bank has also announced its own review into what happened with promises of improved performance and behaviour in the future. In a letter to all Barclay's staff written before his resignation, Mr Diamond wrote:

> The Board has agreed to launch an audit of our business practices.
>
> This audit will be led by an independent third party reporting to Sir Michael Rake and a panel of Non-Executive Directors.
>
> It will have three objectives:
>
> • To undertake a root and branch review of all of the past practices that have been revealed as flawed since the credit crisis started and identify implications for our business practices and culture going forward;
>
> • To publish a public report of its findings;
>
> • To produce a new, mandatory code of conduct that will be applied across Barclays.

We will use the output of that review to adjust our HR processes so that the standards that emerge play a material role in hiring and induction; assessment and development; and reward. That will start with Executive Management.

We will establish a zero tolerance policy for any actions that harm the reputation of the bank.

We will also put in place an enforced governance process to ensure that we comply with these standards over time.

I am committed to ensuring that the recommendations from this review are implemented in full.

3. Official responses

In a statement on LIBOR following the FSA's findings, the Chancellor, George Osborne, announced the steps he was taking:

> Last week, I said that we wanted to ensure that all future fines paid by the financial services industry should go to the taxpayer. Today, I can confirm that we will propose amendments to the Financial Services Bill in the autumn to make that happen. The new arrangement will apply to fines received from 1 April 2012, so the measure will include the Barclays penalty. From now on, the multi-million pound fines paid by banks and others who break the rules will go to the benefit of the public and not to other banks.
>
> That brings me to the urgent changes needed to the regulation of LIBOR to prevent this ever happening again and to ensure that in future the authorities have the appropriate powers to prosecute those who engage in market abuse and manipulation. I have today asked Martin Wheatley, the chief executive designate of the Financial Conduct Authority, to review what reforms are required to the current framework for setting and governing LIBOR. This will include looking at whether participation in the setting of LIBOR should become a regulated activity, at the feasibility of using actual trade data to set the benchmark, and at making initial recommendations on the transparency of the processes surrounding the setting and governance of LIBOR.
>
> The review will also look at the adequacy of the UK's current civil and criminal sanctioning powers, with respect to financial misconduct and market abuse with regard to LIBOR. It will also assess whether those considerations apply to other price-setting mechanisms in financial markets, to ensure that these kinds of abuses cannot occur elsewhere in our financial system.

[...]

> As the Prime Minister said, we propose that Parliament establish an enquiry into professional standards in the banking industry. The Government will in the coming days lay before both Houses a motion to establish a Joint Committee, drawn from the Commons and the Lords. It should be chaired by the Chair of the Treasury Select Committee, my hon. Friend the Member for Chichester (Mr Tyrie). He and his Committee have already been quick off the mark in investigating the issue, and we certainly want their hearings this week to proceed.[18]

Progress on these pledges is set out below:

Fines

A government amendment to the Financial Services Bill during the Report stage of the Lords proceedings was agreed to. It will end the current practice of FSA fines on authorised companies from being 'recycled' within the regulatory structure. The measure affects all FSA fines from 1 April 2012 and all future fines of the FCA and PRA.[19]

Wheatley Review

The Wheatley Review of LIBOR reported in September 2012. It recommended:

> **Regulation of LIBOR**
>
> 1 The authorities should introduce statutory regulation of administration of, and submission to, LIBOR, including an Approved Persons regime, to provide the assurance of credible independent supervision, oversight and enforcement, both civil and criminal (see Chapter 2).
>
> **Institutional reform**

---

[18] HC Deb 2 July 2012 c613
[19] HL Deb 12 November 2012 c1386

2 The BBA should transfer responsibility for LIBOR to a new administrator, who will be responsible for compiling and distributing the rate, as well as providing credible internal governance and oversight. This should be achieved through a tender process to be run by an independent committee convened by the regulatory authorities (see Chapter 3, paragraphs (3.5 to 3.16).

3 The new administrator should fulfil specific obligations as part of its governance and oversight of the rate, having due regard to transparency and fair and non-discriminatory access to the benchmark. These obligations will include surveillance and scrutiny of submissions, publication of a statistical digest of rate submissions, and periodic reviews addressing the issue of whether LIBOR continues to meet market needs effectively and credibly (see paragraphs 3.17 to 3.38).

The rules governing LIBOR

4 Submitting banks should immediately look to comply with the submission guidelines presented in this report, making explicit and clear use of transaction data to corroborate their submissions (see paragraphs 4.5 to 4.13).

5 The new administrator should, as a priority, introduce a code of conduct for submitters that should clearly define:

- guidelines for the explicit use of transaction data to determine submissions;
- systems and controls for submitting firms;
- transaction record keeping responsibilities for submitting banks; and
- a requirement for regular external audit of submitting firms.

(see Chapter 4, paragraphs 4.14 to 4.31)

Immediate improvements to LIBOR

6 The BBA and should cease the compilation and publication of LIBOR for those currencies and tenors for which there is insufficient trade data to corroborate submissions, immediately engaging in consultation with users and submitters to plan and implement a phased removal of these rates (see Chapter 5, paragraphs 5.3 to 5.13).

7 The BBA should publish individual LIBOR submissions after 3 months to reduce the potential for submitters to attempt manipulation, and to reduce any potential interpretation of submissions as a signal of creditworthiness (see paragraphs 5.14 to 5.18).

8 Banks, including those not currently submitting to LIBOR, should be encouraged to participate as widely as possible in the LIBOR compilation process, including, if necessary, through new powers of regulatory compulsion (see paragraphs 5.19 to 5.28).

9 Market participants using LIBOR should be encouraged to consider and evaluate their use of LIBOR, including the a consideration of whether LIBOR is the most appropriate benchmark for the transactions that they undertake, and whether standard contracts contain adequate contingency provisions covering the event of LIBOR not being produced (see paragraphs 5.29 to 5.39).

International co-ordination

10 The UK authorities should work closely with the European and international community and contribute fully to the debate on the long-term future of LIBOR and other global benchmarks, establishing and promoting clear principles for effective global benchmarks (see Chapters 6 and 7).[20]

The Government announced that it "fully endorses every one of the Wheatley Review recommendations"[21]

[20] Wheatley Review of LIBOR, pp8-9
[21] Treasury press release

The recommendations were taken forward by amendments to the *Financial Services Bill* during its Report stage in the Lords.

The amendments would

- Bring any benchmark activities such as LIBOR and, any other benchmarks, to be brought within the scope of regulation.
- create a series of new offences including a new criminal offence for making false or misleading submissions in connection with the determination of a benchmark.
- provide the FCA with new rule-making powers to require banks to submit to LIBOR and other appropriate benchmarks.

Lord Sassoon gave some background to the amendments:

> Amendments 70 to 73 enable benchmark-related activities to be specified as regulated activities under FiSMA. Amendment 70 inserts,
>
> "the setting of a specified benchmark"
>
> as a class of activity which is able to become a regulated activity under FiSMA. Amendment 71 defines "benchmark" as an "index, rate or price", which is defined from time to time by reference to the state of the market, and is used for the purposes of determining sums due under contracts, determining the value of investments, or measuring the performance of investments. A benchmark will be capable of being regulated only if it meets this definition, but the definition has been drafted in such a way as to be able to capture many possible benchmarks, potentially including inter-bank interest rate benchmarks such as LIBOR, equity or bond price indices, commodity benchmarks, and so on. Amendment 73 sets out the scope of activities related to the setting of benchmarks that may become regulated activities. The activities covered include, among other things, the determination of a benchmark, the provision of information to a benchmark and the administration of a benchmark.
>
> The precise activities and the range of benchmarks which will be brought within regulation will be specified in secondary legislation. Regulation of these activities will enhance and strengthen the FCA's ability to make rules on benchmark-setting as well as the regulator's ability to supervise directly and take regulatory action against persons involved in benchmark-setting processes.
>
> The Wheatley review recommended that banks, including those not currently contributing to LIBOR, should be encouraged to participate as widely as possible in the LIBOR compilation process. Participation in LIBOR is currently voluntary; at present a total of 23 banks are members of different LIBOR currency panels. It is important that banks continue to play an active role in the process of submitting to LIBOR. In the absence of banks' submissions, LIBOR would lack sufficient evidence to be an accurate reflection of bank borrowing costs and could eventually cease to be an authoritative benchmark. In an extreme scenario, the rate may not be able to be published. The failure or absence of LIBOR-given the vast number and variety of contracts that reference the benchmark-would lead to severely disruptive implications for banks, other institutions and international financial markets. While the benefits of LIBOR are enjoyed by all banks, only a small number of banks contribute to LIBOR. Some large banks do not currently submit to LIBOR.
>
> While it may not be necessary for the FCA to use this power immediately-if at all-should the number of LIBOR-contributing banks fall, then the use of this power could be considered. To that end, the power outlined in Amendment 80 allows the FCA to impose requirements on authorised persons to participate in a benchmark, including by reference to any code or other document published by the person responsible for the setting of the benchmark, such as the benchmark administrator. This ensures that the precise detail of what information is required to be provided-in what format, to

> whom and at what time-can be determined by the administrator through their code, and not directly by the FCA.[22]

When the LIBOR scandal first became known, the lack of clear capacity of the FSA to prosecute in some cases became more apparent. Lord Sassoon explained how the amendments would change this:

> The Wheatley review recommended the creation of a new criminal offence to provide an appropriate sanction for those who attempt to manipulate benchmarks, such as LIBOR. While such attempts to manipulate LIBOR could constitute a criminal offence under legislation other than FiSMA, the FSA, and subsequently the FCA, are not in a position to investigate and effectively prosecute such conduct. The Government agree with the conclusion of the Wheatley review that there is a strong case that the body responsible for supervising the conduct of firms in the financial services sector-that is, the FCA-should be able to investigate and prosecute misconduct in this area. Furthermore, the Wheatley review also recommended that the Government review the workability of the existing offences under Section 397 of FiSMA.
>
> To this end, the proposed amendments repeal the existing Section 397 and create provisions for three separate criminal offences. In particular, Amendment 114 repeals Section 397, and Amendments 108 to 110 create the new criminal offences. Amendment 108 recreates the existing offence of making a false or misleading statement in Section 397(2), with modernised language because that offence originally dates back to 1939.
>
> Amendment 109 widens the existing offence in Section 397(3) of misleading practices to include creating a false or misleading impression as to the market in, or price or value of, an investment for the purposes of making a profit or avoiding a loss. Amendment 110 creates a new criminal offence related to misleading statements and practices in respect of specified benchmarks, such as LIBOR. Amendment 111 deals with penalties for the new offences and replicates the penalties for existing offences under Section 397; that is, a person found guilty of these offences may face a prison sentence of up to seven years and an unlimited fine.[23]

He concluded by saying that:

> The detail of the activities which are to be regulated under FiSMA and the investments, activities and benchmarks to which the new criminal offences apply need to be set out in secondary legislation. This secondary legislation will be subject to the draft affirmative procedure, so the prior approval of this House and another place will be required.[24]

The amendments were supplemented by the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013.[25] This Order has introduced a regulated activity for firms providing information in order to determine a specified benchmark. Only firms listed in it are authorised to carry out the activity of providing information in relation to a specified benchmark. Currently the only benchmark is Libor. Given this new regulated activity the FSA, and now FCA, have consulted about how they will regulate it. The FCA's conclusions were published in a policy document – *The regulation and supervision of benchmarks* - the key points of the new regime are shown below:

> In summary, we proposed that benchmark administrators must:
>
> implement credible governance and oversight measures, including an oversight committee and the establishment of practice standards;
>
> monitor and survey benchmark submissions, to identify breaches of practice standards and/or potentially manipulative behaviour;

---

22 HL Deb 20 November 2012 c1732
23 HL Deb 20 November 2012 c1734
24 HL Deb 20 November 2012 c1734
25 *The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013,* SI2013/655

maintain sufficient financial resources to ensure it can cover operating costs of six months, plus a buffer period of three months; and

appoint an individual, who is FCA-approved, to oversee the firm's compliance with the FCA's requirements for benchmark administration.

We also proposed that benchmark submitters must:

maintain effective internal governance and oversight procedures for providing information to benchmarks they submit to;

put in place organisational arrangements for managing conflicts of interest within their firm;

have an effective methodology, based on objective criteria, for determining their submissions to benchmarks;

keep all relevant records for five years and appoint an external auditor on an annual basis to report to the FCA on the submitter's compliance with the submission requirements;

notify the FCA of any suspicions in relation to manipulation, attempts to manipulate, or potential collusion to manipulate the benchmark; and

appoint an individual, who is FCA-approved, to oversee the firm's compliance with the FCA's requirements for benchmark submission.[26]

[26] FCA; PS13/6

4. FSA/FCA disciplinary powers & criminal sanctions

The FSA (now FCA) has very wide powers given to it by sections 205 – 211 of the *Financial Services & Markets Act 2000* (FSMA) to impose disciplinary measures on regulated individuals and firms who break its rules. These include fines and withdrawal of authorisation from working within the regulated sector and in some cases criminal prosecutions. Major fines levied during 2013 are (rounded figures) shown below:

11 December 2013 Lloyds TSB Bank, for failings in supervision of financial incentives to sales staff £28 million.

29 October 2013 Rabobank for misconduct related to London Libor market £105 million.

25 September 2013 ICAP Europe Ltd for misconduct related to London Libor market £14 million

24 September 2013 Clydesdale Bank for failing to treat mortgage customers fairly £9 million

18 September 2013 JP Morgan failure to control 'London whale' trades £137.5 million

2 September 2013 Aberdeen Asset Management for client money control failures £7 million

27 March 2013 Prudential Assurance for failing to deal fairly with the FSA £16 million and £14 million for listing rules breaches

6 February 2013 UBS AG failings in sale of AIG fund £9.5 million

6 February RBS for misconduct related to London Libor market £87.5 million.[27]

As stated above FSMA has been amended by Part 7 of the Financial Services Act 2012 to make it easier to prosecute misconduct connected with 'benchmark' related activities.

[27] Source: FCA Fines Table 2013

The House of Commons Library research service provides MPs and their staff with the impartial briefing and evidence base they need to do their work in scrutinising Government, proposing legislation, and supporting constituents.

As well as providing MPs with a confidential service we publish open briefing papers, which are available on the Parliament website.

Every effort is made to ensure that the information contained in these publically available research briefings is correct at the time of publication. Readers should be aware however that briefings are not necessarily updated or otherwise amended to reflect subsequent changes.

If you have any comments on our briefings please email papers@parliament.uk. Authors are available to discuss the content of this briefing only with Members and their staff.

If you have any general questions about the work of the House of Commons you can email hcinfo@parliament.uk.

Disclaimer - This information is provided to Members of Parliament in support of their parliamentary duties. It is a general briefing only and should not be relied on as a substitute for specific advice. The House of Commons or the author(s) shall not be liable for any errors or omissions, or for any loss or damage of any kind arising from its use, and may remove, vary or amend any information at any time without prior notice.

The House of Commons accepts no responsibility for any references or links to, or the content of, information maintained by third parties. This information is provided subject to the conditions of the Open Parliament Licence.

BRIEFING PAPER
Number 06376, 26 July 2014