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SEEING THROUGH THE LI(E)BOR: REFORMING THE LIBOR REFORMS

Bruce Gordon Luna II*

INTRODUCTION

During the height of the subprime mortgage market collapse and the beginning of the Great Recession,† market watchers began to raise questions about the integrity of the London Interbank Offered Rate (LIBOR).‡ As one of the foundations of the global financial system, LIBOR is a daily interest rate benchmark based on the interest rates at which banks borrow unsecured funds from other banks in the London wholesale money market (or interbank market), and is used as the base rate in financial transactions valued between an estimated $300 trillion to $800 trillion.§ LIBOR affects businesses seeking credit, consumers obtaining mortgages or personal loans, students obtaining educational loans, employees’ pension funds, and market participants transacting in numerous other financial contracts in the U.S. and abroad.

In 2008, financial media began to note that LIBOR, the most widely used reference rate benchmark in the world,¶ and a leading indicator of bank financial health,§§ was not as volatile as one would expect given the market turmoil.¶¶ Additionally, several leading

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economic indicators, which normally correlated positively with LIBOR, began to move in the opposite direction. The “spread” between LIBOR and the TED spread—the difference between the interest rates on interbank loans and short-term U.S. government debt—has historically been very close, but began to diverge dramatically. In addition, the rates for credit default swaps widened for certain banks while their LIBOR submissions remained steady. The LIBOR submissions of the contributing banks to the British Bankers’ Association (BBA)—the private group that oversaw LIBOR until NYSE Euronext took over in January of 2014—suggested that borrowing costs remained static during the economic upheaval, while other leading economic indicators clearly suggested the banks were experiencing significant credit deterioration.

On August 12, 2011, the numerous claims filed against LIBOR contributor banks were consolidated into a multi-district litigation before the United States District Court for the Southern District of New York. At the heart of the litigation was the contention that a cartel of banks had manipulated LIBOR, resulting in billions of dollars of damages to stock market investors, pension funds, community banks, local governments, and participants in the

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7 Id.
9 See Mollenkamp, supra note 6.
10 See Mollenkamp, supra note 6. Credit default swaps, or “CDS,” are derivatives contracts entered into by parties to hedge the risks of certain potential events, such as bankruptcies or insolvencies. See Janet Tavakoli, Introduction to Credit Derivatives and Credit Default Swaps, TAVAKOLI STRUCTURED FIN., http://www.tavakolistructuredfinance.com/cds/ (last visited June 7, 2014). CDS are typically structured similar to insurance contracts, whereby one party will pay a “premium,” typically tied to LIBOR, in exchange for future payments from the counterparty if a potential risk becomes a reality. See id.
12 See Mollenkamp, supra note 6.
commercial lending and real estate markets. In an attempt to mitigate the impending storm of litigation, banks rushed to finalize government settlements and terminated the traders implicated in the fraudulent submissions. Despite predictions, however, the wave of litigation expected by the legal and financial community failed to materialize, and several class action lawsuits were subsequently dismissed in whole or in part. Nevertheless, regulators in the US and the UK continue their long-standing investigations into LIBOR manipulation, and in certain cases have initiated criminal investigations of certain bankers. In 2012, the UK enacted a number of reforms designed to address certain failings in the LIBOR submissions process. It is unclear, however, whether these reforms will prevent any future manipulation of the benchmark. Without additional reforms of the LIBOR calculation process, including even the possibility of replacing LIBOR as the primary benchmark for international finance, the risk of future manipulation will continue to exist.
This article argues that the LIBOR calculation structure is still flawed, and that the enacted reforms will not completely reduce the risk of future manipulation. LIBOR will continue to be at risk for manipulation by traders and management at contributor banks unless the relevant regulators intervene to mandate greater transparency and provide incentives for additional reform. The first part of this article will examine the importance and extent that LIBOR plays in the financial markets. The second part of this article will analyze the status of the ongoing LIBOR scandal, including criminal investigations and litigation. Finally, this article will analyze current reform proposals and suggest specific additional regulatory regimes to limit the risk of future market manipulation. Although a majority of commercial market participants may never have heard of LIBOR, or only have the most tenuous grasp of its impact on modern finance, restoring the legitimacy of LIBOR is essential to restoring investor faith in the financial system.

I. OVERVIEW OF LIBOR

The scope of the LIBOR manipulation scandal cannot be grasped without understanding the ubiquitous presence of LIBOR in everyday commercial transactions. LIBOR was formulated in the mid-1980s in response to the development of new market instruments, specifically interest rate swap contracts, foreign currency options and forward rate agreements. These new financial instruments, although providing new areas of investment and growth opportunities, required a measure of uniformity in calculating market risk. In October 1984, the BBA established the BBA standard for interest rate swaps, or "BBAIRS." By January 1986, BBAIRS had evolved into what is now LIBOR. Currently, there are over 200 LIBOR

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21 See Kiff, supra note 4.
23 Id.
panel members, representing sixty nations.\textsuperscript{24} Even after the widespread publicity surrounding the manipulation scandal, LIBOR continues to be the benchmark for the vast majority of financial transactions.\textsuperscript{25} It is used in calculating interest rates for everything from business loans, commercial and residential mortgage loans, investment products in pension funds, derivatives contracts, and money-market funds.\textsuperscript{26}

LIBOR is intended to represent the interest rate at which large banks may borrow unsecured funds from other banks.\textsuperscript{27} Prior to the recent LIBOR reforms, there were fifteen various short-term maturities, ranging from overnight to one year, and ten currencies in which LIBOR was measured, resulting in 150 different LIBOR benchmark rates.\textsuperscript{28} Each business day, between 11 a.m. and 11:10 a.m., the contributing banks submit to Thomson Reuters, the designated calculation agent for the BBA, the interest rate they expect to pay on an unsecured loan from another bank.\textsuperscript{29} Submissions are confidential, and the rates are released to the public only after final publication of the LIBOR rates by Thomson Reuters.\textsuperscript{30} The top and bottom quartile of submitted rates are disregarded, and the average of the remaining rates becomes the LIBOR benchmark rate for that day.\textsuperscript{31} For example, with respect to three-month U.S.-dollar LIBOR, eighteen banks make up the

\textsuperscript{25} See id.
\textsuperscript{27} See The Basics, supra note 2.
\textsuperscript{28} See Waggoner, supra note 18.
\textsuperscript{29} See The Basics, supra note 2.
\textsuperscript{30} Id.
\textsuperscript{31} The BBA is an unregulated trade association representing the British banking and financial services industry comprised of 170 member banks and 70 Associate member firms. See What Is the BBA, BBA, http://www.bba.org.uk/about-us (last visited June 5, 2014). BBA defines the term LIBOR and the criteria a panel bank is required to use in making its submissions, selects the banks for the LIBOR panels for each currency, and oversees the process of LIBOR submissions and publication of LIBOR. See Bbalibor Explained, BBA LIBOR, http://www.bbalibor.com/explained (last visited June 5, 2014).
contributor panel that determines the benchmark rate. After disregarding the upper and lower quartile of submitted rates, data from only ten banks calculate the three-month U.S.-dollar LIBOR at any one time. The exclusion of the top and bottom quartiles is designed to remove outliers from the calculation process. Once published, the LIBOR rate is used to set interest rates on transactions in the lending, securities, derivatives, and currency markets. Lenders use LIBOR in pricing loans, adding an increment designed to capture the risk of default by the borrower. Collusion by contributor banks to artificially set the LIBOR benchmark rate—whether to protect their reputation during the financial crisis or to take advantage of their positions on specific financial transactions—had a significant impact on global markets.

The LIBOR scandal has its basis in built-in incentives by financial institutions and individual traders to manipulate LIBOR. The ability to manipulate the LIBOR benchmark rate, even in tiny fractions of a basis point, could lead to massive overpayments or underpayments, in certain situations, by both borrowers and lenders. Borrowing banks (and other borrowers throughout the integrated financial system) benefit from lower rates, while lending banks (and other lenders throughout the integrated financial system) benefit from higher rates. Individual contributor banks’ positions on derivatives contracts also may have motivated banks to artificially move the

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32 *US Dollar Panel*, BBA LIBOR, http://www.bbalibor.com/panels/usd (last visited June 1, 2014) (listing the banks in the U.S. dollar panel). Three-month USD LIBOR is one of the more widely used LIBOR benchmarks; see de le Merced, supra note 20.


34 See id.

35 See id.

36 See id.


38 Jensen, supra note 33.

benchmark rate. Because LIBOR is an indicator of the financial health of a contributing bank, the divergence of LIBOR marks against other economic indicators that typically correlated positively with LIBOR suggested that contributing banks were manipulating their LIBOR marks up or down to appear more financially stable than they were in reality. As a result of the contributing banks' ability to manipulate LIBOR, these false marks may have tremendously impacted global markets and market participants. Outside of shoring up a bank's public image of financial health in times of market turmoil, individual traders, with bonuses based on performance, had personal incentives to influence LIBOR rates to meet financial targets during periods of normal market activity.

A. COMMERCIAL AND MORTGAGE LENDING

LIBOR is a primary feature in commercial and mortgage lending. Rather than using long-term, fixed-rate loans, commercial banks have adopted the use of variable-rate loans based on LIBOR in order to hedge against market risks in making certain loans, including construction loans, floating rate bridge loans, and mini-permanent financing. Typically, commercial loans are set by a "spread" above LIBOR, and the rate resets periodically over the life of the loan. Manipulation of the LIBOR benchmark, therefore, means that even a small upward movement of one hundred-thousandth of an interest rate point can result in significant changes in payments by commercial obligors. Alternatively, any downward pressure on LIBOR means that significant commercial lending was mispriced.
resulting in lower returns for lenders. For example, an estimated 7,000 small and medium-sized banks lost approximately $448 million in total revenue due to understated LIBOR marks.

LIBOR is also used to determine certain borrowing rates for consumers and corporations with respect to approximately $10 trillion in commercial and residential mortgage loans. Approximately 900,000 outstanding residential home loans originated between 2005 and 2009—the period of suspected LIBOR manipulation—totaling approximately $275 billion in outstanding principal. And over the last decade, an estimated 12 million or more adjustable-rate mortgage (ARM) loans originated in the U.S., totaling over $3.5 billion. Any manipulation of these LIBOR-indexed ARM loans means that borrowers potentially paid more in interest than they should have paid. Alternatively, if LIBOR-indexed interest rates were pushed downward, then ARM mortgagees likely paid less than the appropriate market rate. With a market worth trillions, even slightly adjusted interest rates could potentially

48 See id.
52 REPUBLICAN STAFF OF THE JOINT ECON. COMM., BRIEF ON THE LIBOR SCANDAL: WHAT WE KNOW, WHAT WE DON’T, AND WHAT TO EXPECT 3 (2012) [hereinafter REPUBLICAN STAFF BRIEF], available at http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=5906a359-6ecd-4aba-ba23-ae71706575a6. Adjustable-rate mortgages, more commonly referred to as “ARMs,” are mortgage loans with interest rates that are subject to periodic change. See BD. OF GOVERNORS, FED. RESERVE SYS., CONSUMER HANDBOOK ON ADJUSTABLE-RATE MORTGAGES 4 (2012), available at http://files.consumerfinance.gov/f/201204_CFPB_ARMs-brochure.pdf. Typically, ARMs are tied to certain indexes, like LIBOR, that govern the interest rate fluctuation. See id. at 7–8. For example, a standard ARM loan would set the interest rate on the outstanding principal balance of a mortgage loan at LIBOR plus 2.0%, with the additional 2.0% representing the originating lender’s price for making the loan. See id. at 8–9. For a complete discussion on ARM loans, see generally id.
53 See Waggoner, supra note 18.
54 See id.
mean damages worth billions of dollars to both mortgagors and mortgagees.

Over a five-year period ending in January 2012, an estimated 4 million or more Americans lost their homes to foreclosure.\(^5\) With the realization that contributing banks may have manipulated LIBOR, the question arises as to how many of these former homeowners were faced with artificially increased interest payments.

B. **Financial Market Impact**

LIBOR affects the stock market in three fundamental ways: (1) the pricing of LIBOR is a signal to investors of the perceived health of individual banks, and as a result can impact the related stock prices; (2) it is the foundation for setting the interest rate on LIBOR-based investments such as money-market funds and short-term bonds; and finally (3) LIBOR is used in setting the costs relating to the futures and interest rate swap markets.\(^6\) First, banks that reported (via understated LIBOR rates) lower borrowing costs than their actual borrowing costs were indicating to the public that their internal financials were in better shape than they actually were.\(^7\) According to documents released to the public as part of the Barclays PLC (Barclays) settlement, LIBOR contributor banks felt that market turmoil created incentives to lower LIBOR submissions in order to reassure investors, governmental regulators, and counterparties that there was no problem with the interbank lending market.\(^8\) These artificially lower LIBOR submissions by certain contributor banks pressured other contributor banks to do the same.\(^9\)


\(^6\)See Republican Staff Brief supra note 52 at 3–4.


Barclays' management believed that artificially lower LIBOR submissions by the other contributor banks led both market watchers and media to assume that Barclays was having liquidity problems because the LIBOR rate it submitted was significantly higher than the rates submitted by other banks. To combat this perception, it was alleged that senior management at Barclays directed the traders responsible for LIBOR submissions to make lower submissions in order to align Barclays' submissions with the other contributor banks. As a result, between 2005 and 2009, Barclays submitted altered LIBOR rates for multiple tenors on a regular basis. That act of alteration alone may have affected how investors made decisions with respect to where they directed their banking business, as well as which bank stocks they chose to buy and sell. Following the publicized settlements, contributor banks that were fined for LIBOR manipulation have seen their individual stock prices experience sharp market declines.

Second, LIBOR affects many money-market funds and short-term bonds. Therefore, manipulations of LIBOR would have impacted the amount of interest paid on and the market value of such investments. For example, any downward manipulation of LIBOR would have decreased the amount of interest received by an investor in a money-market fund indexed to LIBOR, while any upward

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62 See Rotten Heart, supra note 43.


manipulation of LIBOR would have decreased the market value of any outstanding bonds indexed to LIBOR (as the market value of a bond tends to move inversely to subsequent changes in the relevant interest rate).  

Finally, market participants are not just affected by potentially higher or lower payments from investments in LIBOR-indexed financial products, but also by the interest rate hedges that these market participants enter to protect themselves against future swings in interest rates based on LIBOR. Interest rate swap products frequently use LIBOR for determining pricing. Any mispricing of LIBOR necessarily would result in the mispricing of interest rate swap contracts as well. Derivatives contracts during the period of alleged LIBOR manipulation fluctuated in value from $449 trillion in notional value at the end of 2009 to almost $700 trillion in notional value.

65 See id.

66 See generally JAMES J. BOUDREAUT, HEDGING BORROWING COSTS WITH EURODOLLAR FUTURES AND OPTIONS (2010), available at http://www.cmegroup.com/trading/interest-rates/files/IR-301_Hedging_Borrowing_Costs_with_ED_Futures_and_Options.pdf (providing an example on how interest rate hedges affect market participants). Interest rate swaps, also referred to as interest rate hedges, are financial contracts between counterparties looking to exchange the risks associated with a certain investment or pool of investments that they hold. See Robert T. Daigler & Donald Steelman, Interest Rate Swaps and Financial Institutions 4–5 (Nov. 1988) (unpublished manuscript), available at http://www2.fiu.edu/~daiglerr/pdf/swaps.pdf. Typically, one party holds a fixed-interest position, while the other holds a floating-rate position. See id. at 4. The fixed-rate position holder will pay the floating-rate position holder a floating-rate premium, while the floating-rate position holder will pay the fixed-rate position holder a fixed-rate premium. See id. The effect of this transaction is to essentially “swap” the risk each party is holding. See id. at 6–7. Parties enter into interest rate swap transactions when a previously held investment becomes subject to interest exposure, thereby increasing or decreasing their potential liability. See, e.g., id. at 5. Banks often act as intermediaries in these transactions, passing the related premiums between the hedge counterparties for a fee in exchange for insuring against the potential default of one of the parties. See id. at 8.


68 See id.
value at the end of 2013. Even movements of the LIBOR benchmark by a fraction of a basis point could potentially result in damages worth millions. Fundamentally, the LIBOR scandal left investors and regulators to make decisions based on incorrect data.

C. Market Confidence

The subprime mortgage crisis and subsequent taxpayer funded bailouts severely damaged the reputation of the banking industry. The addition of a scandal at the heart of the financial system—the LIBOR debacle—has the potential to contract credit and continue to damage the already battered faith that market participants have in the financial industry. Financial market participants rely on LIBOR as an agreed upon framework for entering into a variety of financial transactions. As a result, the widespread perception that LIBOR is a flawed benchmark likely has impacted the decision making of

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69 In re Barclays, supra note 58, at *1 ("According to the Bank for International Settlements (‘BIS’), over-the-counter interest rate derivatives, such as swaps and Forward Rate Agreements (‘FRAs’), comprised over $449 trillion in notional value at the end of 2009, and over $500 trillion in notional value at the end of 2011. "); Steve Denning, Big Banks and Derivatives: Why Another Financial Crisis is Inevitable, FORBES (Jan. 8, 2013), http://www.forbes.com/sites/stevedenning/2013/01/08/five-years-after-the-financial-meltdown-the-water-is-still-full-of-big-sharks/; see Letter of Final Notice from William Amos, Head of Retail Enforcement, FSA Enforcement & Crime Div., to Barclays Bank Plc (June 27, 2012) [hereinafter FSA Final Notice Barclays 2012], available at http://online.wsj.com/public/resources/documents/barclaysjFSA06272012.pdf; Daniel P. Collins, Barclays False Reports “Pervasive”, FUTURES (June 28, 2012), www.futuresmag.com/2012/06/28/barclays-false-reports-pervasive. A notional amount refers to the face amount of credit protection that is being purchased or sold. See Denning, supra. Notional amounts are then used to determine the premium payments to be paid or received by hedge counterparties. See id.


71 See Grind, supra note 64.
investors and financial institutions around the world.\textsuperscript{72} Over the past five years, since market watchers began to suspect that LIBOR was being manipulated, investors have withdrawn over $500 billion dollars in investments from the equity markets and the number of investors that state they have reduced faith in the functioning of the stock market has more than doubled.\textsuperscript{73}

Despite increased regulation and internal reforms—or perhaps because of them—there is discussion among many LIBOR contributor institutions over whether to continue to take part in the LIBOR process. In February 2013, U.K. regulators warned both BNP Paribas and Rabobank not to relinquish their membership as LIBOR contributor banks.\textsuperscript{74} LIBOR contributor banks have several reasons to consider leaving the LIBOR panel. The loss of faith in the LIBOR process itself has undermined the ability of banks to ascertain the likelihood of default when determining whether to make loans to other banks.\textsuperscript{75} A lack of liquidity between banks increases potential market instability. Moreover, regardless of a LIBOR panel member’s actual participation in the scandal, LIBOR panel members are concerned about the potential liability of being associated with the settlement process.\textsuperscript{76} The end result is that financial actors as well as investors have less trust in the banking system in a world where faith in the integrity of regulators and financial actors is critical for a fully functioning market.\textsuperscript{77}

To date, investigations into the rate-rigging scandal show no sign of abating, and it continues to affect market confidence in the banking system. Its ubiquitous use requires that faith be restored in the LIBOR calculation system as quickly as possible.

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\textsuperscript{72} See Fridson, supra note 70.
\textsuperscript{74} David Enrich, Banks Warned Not to Leave Libor, WALL ST. J., Feb. 14, 2013, at C1.
\textsuperscript{75} See id.
\textsuperscript{76} See id.
\end{flushleft}
II. THE LIBOR SCANDAL

On June 27, 2012, Barclays admitted to regulators in the U.S. and the U.K. that its traders had manipulated the LIBOR benchmark rate for a four-year period beginning as early as 2005. Barclays agreed to pay approximately $435 million in fines to U.S. and U.K. authorities and to cooperate with U.S. and U.K. authorities in their continuing investigations. Soon after, on December 19, 2012, Swiss bank, UBS AG (UBS), and its subsidiary, UBS Securities Japan Co., Ltd. (UBS Japan), were fined approximately $1.2 billion for their role in LIBOR manipulation by the U.S. Department of Justice (DOJ) and the Commodities and Futures Trading Commission (CFTC), approximately $259.2 million by the U.K.’s Financial Services Authority (FSA), and approximately $64.3 million by Swiss banking authorities. Royal Bank of Scotland (RBS) became the third major international bank to settle claims of LIBOR manipulation, settling for £87.5 million ($147 million) with U.K. regulatory authorities, $325 million with the CFTC, and $150 million with the DOJ to resolve the investigations. Almost every other

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80 See Press Release, U.S. Commodities Futures Trading Comm’n, CFTC Orders UBS to Pay $700 Million Penalty to Settle Charges of Manipulation, Attempted Manipulation and False Reporting of LIBOR and Other Benchmark Interest Rates (Dec. 19, 2012) [hereinafter CFTC UBS Press Release], available at http://www.cftc.gov/PressRoom/PressReleases/pr6472-12 (noting the $500 million fine imposed by the US DOJ in addition to the $700 million fine by the CFTC).

81 Press Release, Royal Bank of Scot., RBS Reaches LIBOR Settlements (Feb. 6, 2013), available at http://www.rbs.com/news/2013/02/rbs-reaches-libor-settlements.html. Additionally, it should be noted that all British Pound Sterling and Euro figures will be accompanied by the
LIBOR contributor is under investigation for potential manipulation of LIBOR or other related benchmarks by various international authorities. While governments around the world initiated new investigations or continued their current investigations into the LIBOR scandal, aggrieved parties commenced independent and class action suits against the alleged conspirator banks. Recently, several class action lawsuits against financial institutions for LIBOR manipulation have been dismissed in the Southern District of New York. To date, it is unclear how significantly this dismissal will inhibit or influence future litigation.

The race by governmental authorities and LIBOR contributor banks to settle claims of LIBOR manipulation on the one hand, and the move by plaintiffs to seek redress in the courts against the alleged manipulators on the other, facilitated the issuance of proposed reforms and their subsequent enactment by U.K. authorities within a year of Barclays' settlement with U.S. and U.K. authorities. It is unclear, however, whether the proposals enacted to reform the LIBOR calculation process will prevent LIBOR from future manipulation. This section of the Article will discuss how the LIBOR manipulations were discovered, the status of the governmental investigations underway in the U.S. and U.K., and review the status of current litigation in U.S. federal courts against the LIBOR contributor banks. Finally, this section will summarize currently enacted reforms. Despite the various litigations, continuing investigations into LIBOR manipulation, and rushed reforms, little of this process is devoted to substantively remedying the structural problems with the calculation and use of the LIBOR benchmark.

A. BACKGROUND

In late 2007, financial watchers began to notice irregularities in the setting of short-term interest rates, particularly with respect to the derivatives markets. LIBOR fluctuates based on market predictions

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foreign exchange rate provided by http://www.xe.com at 2:00 PM on June 7, 2014. Those rates are 1 Pound Sterling = 1.68050 USD and 1 Euro = 1.36425 USD respectively.


83 See Vaughan & Finch, supra note 39.
for future interest rates, the liquidity cost for lending, and the cost of providing credit. Specifically, certain financial analysts noted interest rate divergences between the LIBOR benchmarks, the rates banks expected to make on unsecured loans, and EURIBOR benchmarks, the rates European banks set for making loans to each other. Both theoretically, and in practice, LIBOR and EURIBOR rates tend to move in the same market direction. Starting in 2007, however, along with the subprime market turmoil and the collapse of Lehman Brothers, bankers and interest-rate swap traders began noticing LIBOR and EURIBOR benchmark rates moving away from each other: LIBOR rates moving downward, and EURIBOR rates moving upward. In addition, financial analysts also commented on the divergence between LIBOR and the TED spread as an indicator that financial institutions were hiding solvency issues. Frequently used as a method of fraud detection, the application of Benford’s Law to the LIBOR submissions also seemed to indicate manipulation of the benchmark.

In September 2007, the financial press started publishing their suspicions regarding the abuse of the LIBOR benchmark. The

84 See The Basics, supra note 2.
86 See id.
87 See id.
88 See, e.g., Paul Krugman, My Friend TED, N.Y. TIMES (Mar. 14, 2008, 4:04 PM), http://krugman.blogs.nytimes.com/2008/03/14/my-friend-ted/?_php=true&_type=blogs&_r=0. The TED Spread refers to the difference between the interest rate for the 3-month Treasury bills and the 3-month U.S. dollar LIBOR benchmark rate. Id. Typically, the TED spread is considered an indicator on the cost of money globally, as well as the financial health and liquidity of financial institutions. See Definition of Ted Spread, FIN. TIMES LEXICON, http://lexicon.ft.com/Term?term=TED-spread (last visited June 6, 2014).
89 Rosa M. Abrantes-Metz, et al., Tracking the Libor Rate, 18 APPLIED ECON. LETTERS 893, 894–95 (2011). Benford’s Law, alternatively known as the first-digit law, is a mathematical principle used to analyze the frequency and distribution of numbers in data sets. See id. at 894; see also The Scam Busters, ECONOMIST, Dec. 15, 2012, at 76.
90 See Gillian Tett, Libor’s Value is Called into Question, FIN. TIMES (Sept. 25, 2007, 9:36 PM), http://www.ft.com/intl/cms/s/0/8c7dd45e-6b9c-11dc-863b-0000779fd2ac.html#axzz2aonoEXTz ("The Libor rates are a bit
“smoking gun” for financial reporters was the sudden divergence between reported LIBOR benchmarks and the cost of credit-default swaps. At the same time, following the collapse of Bear Stearns, financial regulators and industry insiders began publicly questioning the LIBOR benchmarks at meetings of bond trading associations (and even in government publications) on the basis of market data.

B. GOVERNMENTAL INVESTIGATIONS AND LITIGATIONS

The LIBOR scandal is already global in nature: governmental investigations are ongoing in the United States, the United Kingdom, Canada, the European Union, Switzerland, and Japan. The DOJ, SEC, CFTC, and seven other international regulatory agencies have resolved investigations or are continuing to investigate more than a dozen banks on the nature and extent of LIBOR manipulation. To date, Barclays, Citigroup, Credit Suisse, Deutsche Bank, JPMorgan Chase, RBS, Bank of America, The Bank of Tokyo-Mitsubishi UFJ, Lloyds TSB, HSBC, Rabobank, Royal Bank of Canada, West LB, Norinchukin, and UBS have either settled claims of LIBOR manipulation or they continue to be under investigation by regulatory authorities.

of a fiction. The number on the screen doesn’t always match what we see . . .”)}; see also Mollenkamp & Whitehouse, supra note 6 (questioning the veracity of LIBOR).


92 See, e.g., Kwan, supra note 91; Libor Scandal: How I Manipulated the Bank Borrowing Rate, supra note 91.

93 See Rotten Heart, supra note 43; Taibbi, supra note 67 (quoting Andrew Lo, a professor of finance at the Massachusetts Institute of Technology, that the LIBOR scandal “dwarfs by orders of magnitude any financial scams in the history of markets”)


95 See Cora Currier, LIBOR Scandal Timeline: What Did the Fed Know and When Did it Know it?, PROPUBLICA (July 25, 2012, 10:41 AM),
The investigations into LIBOR rigging started with a single email from a Barclays employee in August 2007. The whistle-blower widely distributed the email, specifically including officials at the Federal Reserve Bank of New York (FRBNY). In the email, the whistle-blower noted that LIBOR contributions were lower than the rates at which the contributing LIBOR banks could actually borrow. Subsequent mass emails noting lower than expected LIBOR benchmarks continued throughout the year. Responding to these emails, FRBNY analysts began to focus on the LIBOR benchmarks and began interviewing Barclays employees. One such employee told FRBNY analysts that the lower LIBOR rates were in direct response to negative press received when “honest LIBOR” benchmarks had been submitted.

By mid- to late-2008, regulatory authorities in the U.S. and U.K. were aware of the industry concerns regarding LIBOR. Initially, regulator conduct focused directly on reforming the LIBOR submission process rather than investigating the conduct of the banks. However, little progress was made in refining the LIBOR calculation process. At the time, concerns over the stability of the financial system mandated that most of the attention be focused on restoring industry confidence in LIBOR. In June 2008, Timothy

http://www.propublica.org/special/libor-scandal-timeline-what-did-the-fed-know-and-when-did-it-know-it. A complete analysis of every government’s investigation into LIBOR manipulation is beyond the scope of this Article, which will be limited to the status of the investigations in the U.S. and U.K.

96 Libor Timeline, supra note 2.
97 See id.
98 See id.
102 See id.
103 Brooke Masters & Philip Stafford, Scandal-Plagued Libor Moves to NYSE, FIN. TIMES (July 9, 2013, 7:28 PM), http://www.ft.com/intl/cms/s/0/73322222-e87f-11e2-aead-00144feabdc0.html#a022uDMYLc2M.
Geithner, then-President of the FRBNY, emailed a list of recommendations to Mervyn King, then-Governor of the Bank of England.\textsuperscript{104} Geithner's email proposed a number of changes to the LIBOR settlement process, including the following: (1) the LIBOR calculation process should be subject to a new and credible reporting process; (2) the number and size of U.S. dollar LIBOR contributors should be expanded; (3) incentives should be added to eliminate the misreporting of LIBOR; (4) a second calculation time should be added for U.S. dollar LIBOR for the U.S. market; (5) LIBOR contributor banks should publish the transaction size for their individual LIBOR marks; and (6) LIBOR contributing banks should report those LIBOR maturities that result in a net benefit to the related reporting bank.\textsuperscript{105} The BBA's response to Geithner's suggestion was less than overwhelming; the BBA only published a consultation paper for its members to review and voluntarily implement.\textsuperscript{106}

Even though there were repeated market indicators of widespread LIBOR manipulation, U.S. and U.K. regulators consistently failed to investigate or attempt to prevent LIBOR manipulation in a timely manner.\textsuperscript{107} And, upon the initial investigation, regulators did little to prohibit the manipulation.\textsuperscript{108}


\textsuperscript{105} E-mail from Timothy Geithner, President of the Fed. Reserve Bank of N.Y., to Mervyn King, Governor of the Bank of Eng. (June 1, 2008, 10:00 PM), available at http://www.bankofengland.co.uk/publications/Documents/news/2012/nr068.pdf.

\textsuperscript{106} See id.; see also David Milliken & Timothy Ahmann, Bank of England Says it Acted on Geithner's Libor Email, REUTERS (July 13, 2012, 1:46 PM), http://www.reuters.com/article/2012/07/13/us-banking-libor-geithner-idUSBRE86C08G20120713 (quoting Angela Knight, who stated that "There is no show stopper as far as we can see").


\textsuperscript{108} See Libor Rate-Rigging: UK Regulator Failed to Act on Warnings of "Low-Balling", MERCOPRESS (Mar. 5, 2013, 4:52 PM), http://en.mercopress.com/2013/03/05/libor-rate-rigging-uk-regulator-failed-to-act-on-warnings-of-low-balling ("[T]he regulator either ignored or failed to follow up on a series of red flags highlighting problems with the rates.").
Even after becoming aware of the investigations into LIBOR manipulation, certain LIBOR contributor banks and their traders continued to engage in manipulation of the benchmark through at least 2010. At least initially, there seemed to be little concern by U.S. and U.K. regulatory authorities over the extent of the manipulation. Further, there is some indication that the management of certain LIBOR contributor banks felt that U.S. and U.K. regulatory authorities were, at the least, willing to turn a blind eye to these activities while the global economy was continuing to suffer from the fallout of the Great Recession.

To date, despite the nature and extent of these investigations and resulting litigation, the LIBOR setting process has only been incrementally reformed. Following the publication of the Wheatley Report, and the implementation of the recommended Wheatley Report reforms, governmental investigations continue to focus primarily on the nature and extent of the wrongdoing, and not enough on reforming the LIBOR rate setting process.

1. UNITED KINGDOM

The FSA began its investigation into LIBOR rigging by the contribution panel banks in March 2009, approximately two years after it was first alerted to the possibility of LIBOR misconduct. On June 27, 2012, the FSA finalized a settlement resulting from its

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109 See Vaughan & Finch, supra note 39.
110 See id.
112 See infra Part II.C.1.
113 See Protess, Geithner, supra note 111.
investigation into LIBOR manipulation by Barclays.\textsuperscript{114} In its report, the FSA disclosed the widespread nature of LIBOR manipulation, not just internally at Barclays, but in the greater banking industry as well.\textsuperscript{115} In addition to subsequent settlements with other banks, the FSA has continued its investigations into LIBOR rigging.\textsuperscript{116}

The FSA investigation into Barclays centered on transaction reporting control methodology and their failure to provide accurate transaction reports.\textsuperscript{117} Under Supervision 17 of the FSA Handbook,\textsuperscript{118} and Principle 3 of the FSA’s Principles of Business,\textsuperscript{119} banks were required to submit reportable transactions to the FSA by the close of the following business day.\textsuperscript{120} This information is used by the FSA to monitor for market abuse, such as insider trading and, of course, LIBOR manipulation.\textsuperscript{121} In the course of its investigation, the FSA discovered substantial discrepancies in the data Barclays submitted to the FSA, and its corresponding public data, between 2005 and 2009.\textsuperscript{122} As part of its investigation, the FSA discovered over 257 internal messages between Barclays’ desk traders asking for LIBOR submissions to be moved higher or lower than Barclays’ actual borrowing costs.\textsuperscript{123} Initially, LIBOR manipulation by Barclays’ traders was a response to what was perceived as negative and unfair media reporting on Barclays’ financial health due to its high LIBOR submissions.\textsuperscript{124} In internal market reports prepared by the senior LIBOR submitter for the U.S. dollar, Barclays was submitting benchmark rates higher than other banks, which were

\textsuperscript{114}See generally FSA Final Notice Barclays 2012, supra note 69 (providing the specifics of the settlement agreement).
\textsuperscript{115}Id. at 2, 3, 5, 10.
\textsuperscript{119}See FSA Final Notice Barclays 2012, supra note 69, at 39.
\textsuperscript{120}FSA Handbook Online, supra note 118, at SUP 17.2.7.
\textsuperscript{121}See id. at SUP 1A.3.1.
\textsuperscript{122}See In re Barclays, supra note 58, at *2.
\textsuperscript{123}See FSA Final Notice Barclays 2012, supra note 69, at 11.
\textsuperscript{124}See Gilbert, supra note 60.
submitting "unrealistically low" benchmarks. Media and market participants, based on Barclays' submissions, assumed that the bank was having liquidity problems. Consequently, management at Barclays directed the traders responsible for LIBOR submissions to lower their submissions with respect to the daily U.S. dollar LIBOR tenor. Internal reports indicate that the senior U.S. dollar LIBOR submitter knew that the submitted benchmarks were inaccurate and lower than the actual borrowing costs for Barclays. At the height of the financial crisis in 2007, there was little to no interbank lending as few banks were willing to lend for terms longer than one month. Despite the lack of actual rates to determine LIBOR benchmarks, it appears that Barclays continued to determine LIBOR submissions based on their concern over reputation rather than factors such as transaction size and actual transactions.

Despite being made aware of potential LIBOR manipulation as early as 2007, governmental investigation into LIBOR manipulation began in the U.S. in 2008 and approximately in March of 2009 in the U.K. As part of the investigation into LIBOR manipulation, U.S. and U.K. authorities discovered emails written by traders at Barclays that included requests to have Barclays' LIBOR contribution "kicked out" of the average. In discovered telephone

125 In re Barclays, supra note 58, at *15.
126 See Gilbert, supra note 60.
127 See Taibbi, supra note 67, at 2.
128 See FSA Final Notice Barclays 2012, supra note 69.
130 CFTC Barclays Press Release, supra note 78.
131 See Libor Timeline, supra note 2.
132 See Philip Aldrick, UK Regulators 'in Denial' Over Libor Rigging, MPs Claim, TELEGRAPH (July 17, 2012, 7:18 PM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9406965/UK-regulators-in-denial-over-Libor-rigging-MPs-claim.html ("US confidence in the London market was being severely shaken . . . by the slow reaction time of the London authorities. They had to be continuously prodded by us."); David Enrich & Max Colchester, Libor Fallout Hits Other Banks, Watchdog — Embattled FSA is Under Fire for its Policing of Rate Setting, WALL ST. J., July 6, 2012, at C1; Seven Banks, supra note 116.
133 See FSA Final Notice Barclays 2012, supra note 69, at 11.
conversations, traders responsible for the bank’s LIBOR submissions stated they would “see what [they] [could] do” with respect to requests for low LIBOR submissions. Even more damning were the frequent emails sent with explicit requests for LIBOR manipulation.

Factors other than reputation may have influenced decisions to manipulate the LIBOR benchmarks as well. Traders had significant incentives to manipulate LIBOR. Typically, banker salary structures included significant year-end bonuses based on departmental performance for the year. As performance was measured by profits, traders had every incentive to push for altered LIBOR submissions if the manipulated LIBOR rate would facilitate meeting performance goals. Rather than recognizing the significance of these activities, the FSA characterized the LIBOR manipulation as a case of “inadequate systems and controls.”

Barclays ultimately settled with the FSA for only £59.5 million ($99.9 million) after qualifying for a 30% reduction of its fines for settling quickly and cooperating with the authorities. The FSA’s final notice provided that Barclays “commit[ed] extensive resources to improve” reporting. It is unclear, however, to what extent Barclays has actually reformed its practices and procedures following the FSA’s investigation. Moreover, following the announcement of its settlement with the FSA, Barclays’ stock price actually rose by

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134 Id.

135 See id. at 11–14; see also In re Barclays, supra note 58, at *7–9 (illustrating examples of the requests, including a November 22, 2005 message from a senior trader in New York to a Trader in London included the following: “WE HAVE TO GET KICKED OUT OF THE FIXINGS TOMORROW!! We need a 4.17 fix in 1m . . . We need a 4.41 in 3m . . .”

136 See Louise Story, Wall St. Profits were a Mirage, but Huge Bonuses were Real, N.Y. TIMES, Dec. 18, 2008, at A1.

137 See id.


139 Id.

more than 7% as investors interpreted the settlement as a formal clearing of any wrongdoing.\textsuperscript{141}

Formal publication of the settlement between FSA and Barclays not only provided other banks with a roadmap for their own settlement process,\textsuperscript{142} but it also provided discoverable information for litigants.\textsuperscript{143} Soon after the Barclays settlement, Swiss bank UBS entered into settlement negotiations with regulators in the U.S., U.K., and Switzerland for LIBOR manipulation for the period between 2006 and 2009.\textsuperscript{144} Similar to the investigation of Barclays, management and traders at UBS were found to have submitted LIBOR rates at prices higher or lower than the market indicated, thereby trying to influence actual interest rates to the benefit of internal transactions.\textsuperscript{145} In particular, the investigation of UBS indicated that specific traders were responsible for the altered submissions, including attempts to influence other third-party banks to change their LIBOR submissions.\textsuperscript{146} As with Barclays, management at UBS also was found to have provided guidance to traders to submit benchmarks that would influence market and investor perception of UBS's liquidity and creditworthiness.\textsuperscript{147} UBS settled these claims for approximately $1.4 billion.\textsuperscript{148}

In February 2013, RBS was fined £87.5 million ($147 million) for manipulation of yen-denominated, U.S. dollar-denominated, and

\textsuperscript{142} Alexandra Alper & Kristin Ridley, Barclays Paying $453 Million to Settle Libor Probe, REUTERS (June 27, 2012, 11:11 PM), http://uk.reuters.com/article/2012/06/27/uk-barclays-libor-idUKBRE85Q0 PM20120627.
\textsuperscript{146} Id.
\textsuperscript{147} Id.
Swiss franc-denominated LIBOR benchmarks.\textsuperscript{149} The investigation into RBS’s LIBOR manipulation found that twenty-one bankers had been involved with over two hundred requests for altered LIBOR submissions.\textsuperscript{150} Although the investigations into RBS’s manipulation of LIBOR did not find any misconduct by RBS’s senior management, regulators attribute the amount of RBS’s fine to the improper submissions as well as the results of an earlier review by FSA in March 2011, whereby RBS submitted a false statement regarding the adequacy of its internal LIBOR systems and controls.\textsuperscript{151} The U.K. government’s ownership of RBS may explain the quick settlement by RBS with U.K. regulators.\textsuperscript{152}

In addition to regulatory fines and penalties, the U.K.’s Serious Fraud Office (SFO) pursued criminal charges against those in connection with LIBOR manipulation.\textsuperscript{153} The SFO is the U.K. regulatory authority responsible for investigating and prosecuting serious and complex frauds.\textsuperscript{154} The SFO considers a number of criteria in determining whether to bring an action for fraud, including whether the alleged fraud is a matter of public concern and whether the result of any fraud is more than £1 million ($1.68 million).\textsuperscript{155} In December 2012, the SFO arrested three men in connection with the LIBOR scandal: Thomas Hays, a former trader at UBS and Citigroup, and Terry Farr and Jim Gilmour of RP Martin, a British


\textsuperscript{150} Id.

\textsuperscript{151} Id.

\textsuperscript{152} The U.K. Treasury owns 82% of RBS following a bailout by the U.K. government during the financial crisis in 2008. See Banking: RBS Files its Defence Against £4bn Lawsuit, GUARDIAN, Dec. 14, 2013, at 46.


brokerage firm.\textsuperscript{156} All three men were charged with conspiracy to defraud.\textsuperscript{157} Hays stated that the manipulation went “much higher than me.”\textsuperscript{158} The Criminal and Antitrust Divisions of the U.S. DOJ and the FBI also have pursued criminal investigations against these individuals.\textsuperscript{159}

Unlike in the United States, litigation over the LIBOR manipulation has lagged in the U.K. Interest rate swap counterparties have sued both Barclays and Deutsche Bank AG for breach of implied representations regarding the accuracy of each bank’s LIBOR submissions.\textsuperscript{160} To date, Barclays has settled the litigation out of court, while no decision has been made in the Deutsche Bank litigation.\textsuperscript{161}

\section*{2. \textsc{United States}}

Unlike the FSA, the Treasury Department initiated its investigations into the LIBOR scandal almost immediately after FRBNY alerted them to the problem by the FRBNY.\textsuperscript{162} The FRBNY

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{159} See \textit{Libor Manipulated in 2008: FDIC Joins the Action, Sues 16}, HUE & CR: CURRENT EVENTS NOTE BLOG (Mar. 14, 2014), \url{http://huecri.wordpress.com/tag/tom-hayes/}.
\item \textsuperscript{161} See Colchester, \textit{supra} note 160.
\item \textsuperscript{162} Chris Isidore, \textit{Barclays Admitted False Libor Reports to Fed in ’08}, CNN MONEY (July 13, 2012, 9:29 AM), \url{http://money.cnn.com/2012/07/13 /investing/geithner-liborbarclays/index.htm}.
\end{itemize}
\end{footnotesize}
was aware of the LIBOR manipulation as early as September 2007. Following the collapse of Lehman Brothers, the FRBNY received reports from external sources regarding "problems with LIBOR." The FRBNY began circulating its findings to U.S. Treasury officials as early as May 2008. As market insiders continued to report LIBOR manipulation, a confidential report entitled "Market Concerns Regarding LIBOR" was distributed internally at the FRBNY and to U.S. Treasury officials on June 5, 2008. The report summarized the FRBNY's findings, its communications with the BBA, and the BBA's responses to the FRBNY's suggestions of potential reforms.

As various agencies became aware of the possibility of LIBOR manipulation by multiple LIBOR contributor banks, the CFTC began investigating the possible "lowballing" of LIBOR benchmark rates in Fall 2008. The SEC began its investigation into the LIBOR problem by early 2009.
In conjunction with its settlement with the FSA, Barclays, UBS, and RBS also have entered into settlements with the CFTC and the Department of Justice for their misconduct in manipulating LIBOR.\footnote{170} To settle charges with the CFTC and the DOJ, Barclays agreed to pay $160 million in fines in June 2012.\footnote{171} On December 19, 2012, the CFTC initiated proceedings against UBS and UBS Japan for engaging in LIBOR manipulation for profit and for issuing false LIBOR benchmarks to protect its reputation.\footnote{172} As part of the order, UBS was fined $700 million and directed to institute immediate changes to its internal controls regarding LIBOR rate submissions.\footnote{173} Concurrently with the CFTC’s order, the U.S. Department of Justice released an agreement between itself and UBS.\footnote{174} Although the DOJ contemplated criminal charges against UBS, the agency decided against it in consideration of preventing additional market upheaval.\footnote{175} In February 2013, U.S. and U.K. regulators fined RBS and RBS Japan $612 million for regulatory and criminal penalties.\footnote{176} Currently, regulators in the U.S. and the U.K. continue to investigate additional financial institutions over the rate-
rigging scandal.\textsuperscript{177} The most recent financial institutions to succumb to a LIBOR settlement are ICAP PLC, which U.S. and U.K. authorities fined $87 million in September 2013, and Dutch lender Rabobank, which U.S., Dutch, and U.K. regulators fined €774 million ($1.06 billion) in October 2013.\textsuperscript{178}

Parallel to the criminal investigations by the FSA, the Criminal and Antitrust Divisions of the DOJ has charged Alexander Hayes and Roger Darin of UBS, and Darrell Read, Daniel Wilkinson, and Colin Goodman of the brokerage firm ICAP, with felony wire fraud in connection with manipulating the LIBOR benchmark rates.\textsuperscript{179} A UBS Subsidiary, UBS Japan, has pled:

\begin{quote}
guilty to felony wire fraud and admit[ted] its role in manipulating [LIBOR] . . . .\end{quote}

\begin{quote}
... and has agreed to pay a $100 million fine. In addition, UBS AG, the parent company of UBS Japan headquartered in Zurich, has entered into a non-prosecution agreement (NPA) with the government requiring UBS AG to pay an additional $400 million penalty, to admit and accept responsibility for its misconduct as set forth in an extensive statement of facts and to continue cooperating with the Justice Department in its ongoing investigation.\textsuperscript{180}
\end{quote}


\textsuperscript{180} Press Release, Dep’t of Justice, UBS Securities Japan Co. Ltd. to Plead Guilty to Felony Wire Fraud for Long-Running Manipulation of
Similar to UBS, "RBS Securities Japan signed a plea agreement with the government in which it admitted its criminal conduct and agreed to pay a $50 million fine," and its parent company, RBS, was fined an additional $100 million. Finally, Barclays entered into an agreement with the Department of Justice to pay a $160 million penalty, accepting responsibility for its misconduct. According to the agreement, Barclays provided LIBOR and EURIBOR submissions that, at various times, were false because they improperly took into account either the trading positions of its derivative traders, or reputational concerns about negative media attention relating to its LIBOR submissions.

The CFTCs enforcement order against Barclays under the Commodity Exchange Act, which specifically stated that, "Barclays regularly attempted to manipulate and knowingly delivered false, misleading or knowingly inaccurate reports concerning U.S. Dollar LIBOR, and at times, Yen and Sterling LIBOR," provided the basis for much of the subsequent LIBOR-related litigation. LIBOR contributor banks have faced an avalanche of LIBOR-related lawsuits by investors, local governments, and state regulators under a variety of legal theories: the Sherman Antitrust Act, the Clayton Antitrust Act, civil Racketeer Influenced and Corrupt Organizations Act (RICO), the Securities Exchange Act, the Commodity Exchange Act, and various state laws, as well as allegations of common law fraud and shareholder derivative suits.

The Mayor of Baltimore, the Baltimore City Council, the City of New Britain Firefighters, and the Police Benefit Fund of Connecticut filed the first action over LIBOR rigging against the banks involved in submitting the LIBOR rates in New York federal court in August 2011. In their complaint, the plaintiffs stated that the City of


U.S. DOJ Barclays Press Release, supra note 78.

Id.

In re Barclays, supra note 58, at* 9.

Baltimore purchased hundreds of millions of dollars of derivatives tied to LIBOR while the New Britain Firefighters and Police Benefit Fund purchased tens of millions.\textsuperscript{186} In particular, the plaintiffs in the class action alleged that the member banks caused LIBOR to be calculated at artificially low rates, allowing the member banks to lower interest payments on their own investments, thus allowing the member banks to reduce their own borrowing and investment costs by billions of dollars.\textsuperscript{187} Berkshire Bank, with eleven branches in New York and New Jersey and about $881 million in assets, claimed in a proposed class-action lawsuit in the U.S. District Court in New York that the rigging of LIBOR affected “hundreds of millions, if not billions, of dollars” of loans made or sold in the Berkshire Bank’s lawsuit aimed to remove one of those hurdles of antitrust law by alleging the LIBOR banks breached the common law of fraud under New York state law.\textsuperscript{188} Small community banks also added to the wave of litigation aimed at the LIBOR contributor banks.\textsuperscript{189} The Community Bank & Trust of Sheboygan (CBTS) initiated a class-action suit against the LIBOR contributor banks on behalf of other small community banks.\textsuperscript{190} The lawsuit alleged that the LIBOR manipulation resulted in losses of over $1 billion of loans to small businesses set at artificially low rates.\textsuperscript{191} Because small banks rely more on interest income, any manipulation complaint subsequently consolidated with three other proposed LIBOR class actions accusing the LIBOR contributor banks of antitrust law violations.\textsuperscript{192}


\textsuperscript{186} \textit{See In re LIBOR-Based Fin. Instruments Antitrust Litig., 935 F. Supp. 2d 666, 681 (S.D.N.Y. 2013).}

\textsuperscript{187} \textit{See Alistair Osborne, Banks Face Billions of Dollars of Claims After Barclays Settles, TELEGRAPH (June 27, 2012, 8:45 PM), http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/9360485/Banks-face-billions-of-dollars-of-claims-after-Barclays-settles.html.}

\textsuperscript{188} \textit{Id.}


\textsuperscript{190} \textit{Id.}

\textsuperscript{191} \textit{Id.}

\textsuperscript{192} \textit{See In re LIBOR-Based Fin. Instruments Antitrust Litig., 935 F. Supp. 2d 666, 681–82 (S.D.N.Y. 2013).}
On August 12, 2011, the various class-action complaints consolidated with over forty other complaints into a multi-district litigation before Judge Naomi Buchwald in the Southern District of New York. The claims ranged from losses resulting from LIBOR-based derivatives and options contracts to retail loans tied to LIBOR. Other plaintiffs included various municipalities, commodities traders, investors, bondholders, and Charles Schwab Corporation (Schwab). On March 29, 2013, U.S. District Judge Buchwald, in a 161-page opinion, dismissed anti-trust and racketeering claims made by Schwab and two of the class actions on behalf of LIBOR-tied securities and derivatives traders. Judge Buchwald's opinion did not completely halt litigants and allowed commodities manipulation claims to proceed under the Commodity Exchange Act. In addition, Judge Buchwald seemed to endorse a potential securities fraud claim by the plaintiffs in the future. Subsequently, Schwab filed an action in San Francisco County Superior Court pleading multiple causes of action against Bank of America for several LIBOR-related damages, including fraud, breach of contract, and unjust enrichment violation of the California's trade practices statute, and federal securities law claims.

Other litigations have, to date, reached similar conclusions. Similar to the status of the antitrust and racketeering claims by Schwab, on May 13, 2013, Judge Shira Scheindlin of the Southern District of New York dismissed a securities class action against Barclays. In this litigation, plaintiffs were purchasers of American Depository Receipts (ADRs). The ADR investors alleged that Barclays manipulated the LIBOR benchmark and made material misrepresentations to the company's shareholders regarding its compliance with their operational risk management processes. In

193 In re LIBOR, 935 F. Supp. 2d at 676.
194 Id.
195 Id.
196 Id. at 685.
197 Id. at 715–19.
198 Id. at 726–27.
201 Id.
202 Id.
her holding, Judge Scheindlin found that Barclays’ statements regarding its business practices were “mere ‘puffery.’” 203 In addition, Judge Scheindlin found that even if Barclays’ statements regarding LIBOR were not puffery, the plaintiffs failed to connect the bank’s statements to its LIBOR settlement processes. 204 Unlike Judge Buchwald, Judge Scheindlin did not grant the plaintiffs leave to amend their complaint. 205

Despite the rulings in the federal courts, over thirty states’ attorneys general are investigating whether to pursue state law claims against the LIBOR contributor banks. To date, the state attorneys general of Connecticut, Massachusetts, and New York have submitted legal notices to RBS, HSBC, Barclays, Citigroup, Deutsche Bank, JP Morgan, and UBS that they are under investigation for LIBOR manipulation. 206 Other local governments have been keenly following the status of these litigations and continue to consider potential lawsuits. 207 Freddie Mac and Fannie Mae, U.S. government-sponsored entities responsible for the expansion of the mortgage secondary market, have sued over a dozen LIBOR contributor banks, as well as the BBA, for $800 million in damages in connection with LIBOR rigging. 208


204 See id.

205 Gusinsky, No. 12-cv-5329.

206 See Seven Banks Subpoenaed in Libor Investigation, CNBC (Aug. 15, 2012, 5:33 PM), http://www.cnbc.com/id/48678563 (“UBS filed a report with regulators on 31 July saying that agencies, including state attorneys general, were weighing whether it and other banks had tried to manipulate the rate. Citigroup and JPMorgan Chase also declined to comment.”); Chris Isidore & Logan Burruss, States Weighing Libor Scandal Suits, CNN MONEY (July 16, 2012, 1:07 PM), http://money.cnn.com/2012/07/16/news/economy/libor-states/.

207 State and municipality litigation looks likely to be a result of local government investment in derivatives. In America, 40 states allow municipalities to enter into swap agreements. Randall Dodd, Municipal Bombs, FIN. & DEV., June 2010, at 33. The IMF calculated the market was worth up to $500 billion in 2010. Id.

Despite claims that LIBOR litigation could very well become "the asbestos claim of this century," it is unclear how far the remaining LIBOR-related litigations will proceed. The dismissal of the class-action suits against contributor LIBOR banks has slowed the wave of litigation with respect to LIBOR manipulation. Nevertheless, every month seems to bring new investigations, settlements, and lawsuits over the scandal. As of the writing of this article, ICAP has become the most recent financial institution to be fined for its involvement in the scandal. Lost in the discussions over the status of LIBOR litigation is the reform to date of the LIBOR process. Although recently enacted changes to the regulation of the LIBOR settlement process have increased transparency to a certain extent, without additional changes to the LIBOR calculation and review processes, LIBOR manipulation will continue to be a risk for market participants, potentially impacting anyone with a credit card balance, small business loan, or mortgage. Moreover, despite settlements with U.S. and U.K. regulatory authorities, it is uncertain whether the eventual settlement and litigation costs will be high enough to create a self-policing culture at the banks.

C. LIBOR REFORMS

1. THE WHEATLEY REPORT

Following the settlement by Barclays, the U.K. Treasury appointed Martin Wheatley, the managing director of the FSA, to review the LIBOR settlement process and evaluate potential options for reforming the LIBOR system. On September 28, 2012, the "Wheatley Report" was issued. The report included a ten-point plan...
for immediately reforming the LIBOR system rather than abolishing LIBOR as a benchmark entirely.\textsuperscript{212} The ten-point plan of the Wheatley Report can be broken down into three major areas of reform: (1) increasing regulation of LIBOR and providing for criminal sanctions in the case of manipulation; (2) strengthening the governance and oversight of the LIBOR settlement process; and (3) strengthening the LIBOR mechanism with immediate reforms to the LIBOR settlement process.\textsuperscript{213}

First, because LIBOR submissions were not regulated activities under the Financial Services and Market Act 2000 (FSMA), the Wheatley Report proposed the formulation of new criminal and civil sanctions for manipulation or attempted manipulation of LIBOR, thereby including LIBOR manipulation within the scope of market abuse for the first time.\textsuperscript{214} The Wheatley Report analyzed the current state of the FSMA, providing the FSA with the power to prosecute certain criminal offenses. In particular, Section 397 of the FSMA allowed the FSA to prosecute parties for misleading statements and practices.\textsuperscript{215} However, the Wheatley Report concluded that the manipulation and attempted manipulation of LIBOR (or any other benchmarks) would not constitute an offense under Section 397 of the FSMA because the misleading statements or practices had to be undertaken either for the purpose of inducing another to take certain specific steps in relation to certain agreements or investments, or with recklessness as to whether that will be the result.\textsuperscript{216} The Wheatley Report thereby concluded that it would be unlikely that Section 397 of the FSMA could apply to any manipulation or attempted manipulation of LIBOR submissions because the LIBOR manipulation affected pre-existing contracts, or was done to avoid negative publicity regarding the liquidity of the offending party.\textsuperscript{217} Accordingly, the Wheatley Report recommended that the U.K. Parliament amend Section 397 of the FSMA to address benchmark manipulation.\textsuperscript{218}

\textsuperscript{212} Id.
\textsuperscript{213} Id. at 5.
\textsuperscript{214} Id.
\textsuperscript{215} Id. at 18–19.
\textsuperscript{216} Id.
\textsuperscript{217} Id.
\textsuperscript{218} Id.
Second, the Wheatley Report made several recommendations designed to strengthen the institutions governing the LIBOR process. Noting the BBA’s close ties with the LIBOR contributor banks, the Wheatley Report recommended that a new and independent private administrator be selected through a transparent tendering process.\textsuperscript{219} In order to improve transparency, the new administrator would be responsible for: (1) collecting and distributing LIBOR submissions; and (2) scrutinizing LIBOR contributor banks to guarantee the integrity of their LIBOR submissions.\textsuperscript{220} In addition to the new administrator, the Wheatley Report also recommended the establishment of an independent oversight committee, which would verify LIBOR submissions via input from additional market participants.\textsuperscript{221} This new oversight committee would be responsible for creating a new code of conduct for all parties involved in the LIBOR settlement process.\textsuperscript{222} The new code of conduct would formalize the LIBOR setting process and establish internal controls to prevent future LIBOR manipulation.\textsuperscript{223} To increase transparency, the new oversight committee would also publish the names of LIBOR contributor members, their declared conflicts of interests, and the minutes of any meetings.\textsuperscript{224}

Finally, the Wheatley Report recommended an array of immediate reforms designed to restore confidence in the LIBOR submission process. To limit the ability of the member banks to predict LIBOR submissions, and therefore reduce the possibility of manipulation, the Wheatley Report recommended that the publication of all LIBOR submissions be delayed for a period of at least three months.\textsuperscript{225} In order to increase transparency and improve the integrity of the LIBOR submissions process, the Wheatley Report emphasized that the contributor banks consider actual transactions when calculating their LIBOR submissions.\textsuperscript{226} Examples of this transactional information include intervals between transactions and times of transaction submission.\textsuperscript{227} For those currencies and tenors

\textsuperscript{219} \textit{Id.} at 22–23.
\textsuperscript{220} \textit{Id.}
\textsuperscript{221} \textit{Id.}
\textsuperscript{222} \textit{Id.} at 24.
\textsuperscript{223} \textit{Id.} at 25.
\textsuperscript{224} \textit{Id.} at 32.
\textsuperscript{225} \textit{Id.} at 38.
\textsuperscript{226} \textit{Id.} at 28.
\textsuperscript{227} \textit{Id.} at 35.
where there is insufficient data to corroborate submissions, the Wheatley Report proposed ceasing submissions. The Wheatley Report also recommended that market participants review current contracts for adequate contingency provisions in case LIBOR benchmarks become unavailable. In the event that LIBOR benchmarks are unavailable, it recommended that other industry associations, such as the International Swaps and Derivatives Associate and the Loan Market Association, provide for market contingencies, including the use of other non-LIBOR benchmarks.

To address the market's lack of confidence in the accuracy of the LIBOR benchmark, the Wheatley Report recommended an increase in the number of banks contributing to the LIBOR panel. Under the pre-scandal regime, on any given day, the LIBOR submissions of between eight and ten banks governed the final U.S. dollar LIBOR benchmark. Expanding the number of banks contributing to the U.S. dollar LIBOR calculation process would, theoretically, make collusive behavior between banks more difficult to achieve. In addition, more banks contributing to the LIBOR calculation process would add additional data of market costs, and would theoretically make the final LIBOR benchmark reflect actual transaction costs.

Another proposed change, designed to increase confidence that LIBOR submissions would be less susceptible to manipulation, was to keep all LIBOR submissions confidential for a three-month period. This silent period is designed to limit potential collusion between individual bankers, as well as prevent the possibility of reputational concerns influencing daily LIBOR submissions.

On October 17, 2012, the Financial Secretary of the U.K. Treasury, Greg Clark, stated that the Wheatley Report Reforms

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228 Id. at 38.
229 Id. at 39.
230 Id. at 39.
231 Id. at 38.
232 See The Basics, supra note 2.
234 See THE WHEATLEY REVIEW, supra note 3, at 38.
would be implemented.\textsuperscript{236} Although outside the scope of this article, the Wheatley Report is widely used as a framework for benchmark reform in other jurisdictions as well.\textsuperscript{237}

2. LEGISLATIVE AND MARKET REFORMS

As the LIBOR contributor banks, lawyers, and litigants struggle with lawsuits and legal settlements over damages resulting from LIBOR manipulation, U.K. regulatory authorities and the BBA have moved to enact portions of the Wheatley Report.\textsuperscript{238} The Wheatley Report proposals were enacted in order to: (1) reform the LIBOR calculation process itself; (2) prevent related future market calamity; and (3) restore market confidence.\textsuperscript{239} On April 1, 2013, the Financial Services Act 2012 went into effect, which replaced the FSA in early 2014 with a new regulatory body, the Financial Conduct Authority (FCA).\textsuperscript{240} The objective of the FCA is to promote effective competition in the financial services markets and to protect consumer interests.\textsuperscript{241} To do this, the FCA has the power to intervene temporarily in the financial markets to block imminent financial product launches or to stop existing financial products.\textsuperscript{242} If it is in the interests of consumers, the FCA can require companies to immediately withdraw or amend any misleading financial


\textsuperscript{238} This portion of the Article will not address criminal and civil penalties for LIBOR fraud enacted by the U.K.


\textsuperscript{240} Financial Services Act, 2012, c. 21, Part 1(A) (U.K.) (amending the FSMA).

\textsuperscript{241} Id. at Part 1(B).

\textsuperscript{242} Id.
promotions.243 The FCA will publicize its enforcement proceedings against companies for violating or failing to comply with financial rules.244

Following the recommendations of the Wheatley Report, the Financial Services Act 2012 has amended certain provisions of the FSMA in order to address the actions of traders and bankers with respect to the LIBOR scandal.245 First, the Financial Services Act 2012 amended Section 22 and Schedule 2 of the FSMA to include benchmark-related activities as “regulated activities” under the FSMA.246 In particular, new provisions that specifically address the offense of providing misleading statements that give benchmark-related impressions have replaced Section 397 of the FSMA.247 The new provision criminalizes the following: (1) any person who knowingly or recklessly makes a false or misleading statement to another with the intention that the statement is used for setting a relevant benchmark; and (2) any person who, by a course of conduct, intends to, and knowingly or recklessly does, create a false or misleading impression as to the price of any investment or transaction with an interest rate that may affect the setting of a relevant benchmark.248 At present, LIBOR is the only benchmark specifically subject to this new provision.249

243 See id.
244 Id.
245 See id.
246 Id. at Part 2, (7)(1)(a) (defining a regulated activity to mean “an activity of a specified kind which is carried on by way of business and relates to (a) information about a person’s financial standing, or (b) the setting of a specified benchmark”).
247 Id. The previous Section 397 of the FSMA addressed market abuses, allowing the FSA to take criminal action against parties for making misleading statements or engaging in conduct designed to induce another person to take action (or not) in a specific way in connection with certain agreements or investments. See Financial Services and Markets Act, 2000, c. 8, § 397 (U.K.). Misleading statements include reckless statements that likely lead to the same result. But see THE WHEATLEY REVIEW, supra note 3 (considering the former iteration of Section 397 to be too narrowly designed to cover benchmark manipulation).
249 The U.K. Treasury is responsible for determining which benchmarks will be subject to regulation. See Financial Services & Markets Act, 2000, c. 22 (U.K.). In addition to LIBOR, benchmarks subject to future regulation
The FCA has the power to review the systems and controls for LIBOR of all LIBOR contributor banks.\textsuperscript{250} As part of the reforms, the FCA requires banks to appoint an individual, to be approved by the FCA, who will be responsible for compliance with the new LIBOR procedures.\textsuperscript{251} The FCA rules require the new LIBOR compliance officer to contact the FCA immediately upon any discovery of manipulation, or attempted manipulation, of a benchmark.\textsuperscript{252} In addition, LIBOR contributor banks will implement new internal policies and procedures to prevent future manipulation.\textsuperscript{253} These new policies include: (1) establishing an internal code of conduct relating to appropriate LIBOR submissions; (2) appointing an oversight committee to administer and review LIBOR submissions; (3) creating a process for managing conflicts of interest relating to LIBOR submissions; (4) keeping a five-year record of all LIBOR submissions; and (5) appointing an independent auditor that will review the bank’s compliance procedures and make annual reports to the FCA.\textsuperscript{254}

Following the implementation of the Wheatley Report reforms, the HM Treasury, the U.K.’s economic and finance ministry, and the FCA selected NYSE Euronext Rate Administration, a subsidiary of NYSE Euronext, as the successor to the BBA.\textsuperscript{255} In January 2014, the BBA formally divested itself from the ownership and regulation of LIBOR and transfer the structural management of LIBOR to NYSE Euronext.\textsuperscript{256}

\textsuperscript{250} See FIN. CONDUCT AUTH. HANDBOOK MAR 8.2 (2014) [hereinafter FCA HANDBOOK], available at http://media.fshandbook.info/content/FCA/MAR/8/2.pdf.
\textsuperscript{251} Id. at MAR 8.2.3.
\textsuperscript{252} Id. at MAR 8.2.9.
\textsuperscript{253} Id. at MAR 8.2.
\textsuperscript{254} Id.
\textsuperscript{255} See David Enrich et al., NYSE Euronext to Buy LIBOR, WALL ST. J., July 10, 2013, at Cl.
\textsuperscript{256} Id.
III. UNINTENDED CONSEQUENCES OF THE NEW LIBOR SYSTEM

Although the enacted Wheatley Report reforms and the new ownership of the LIBOR-setting process may increase transparency, it is uncertain whether these changes can truly prevent future manipulation or restore market confidence in the LIBOR calculation process. This section of the Article will discuss the enacted reforms that may have negative, unintended consequences, or will not result in increasing certainty in the LIBOR calculation process. Specifically, this section of the article will review the following reforms: (1) the discontinuation of certain tenors from the LIBOR calculation process; (2) the mechanisms used to tie LIBOR to actual transaction costs; (3) the transfer of LIBOR oversight from the BBA to NYSE Euronext; and (4) the three-month period of confidentiality before the public release of LIBOR benchmarks. Following an analysis of each of these specific changes to the LIBOR process, this section of the Article will propose additional reforms or changes necessary to meet the goals of increased certainty and transparency in the LIBOR methodology.

A. DISCONTINUED CURRENCIES AND TENORS

The Wheatley Report recommended a significant reduction in a number of LIBOR currencies and tenors that had little to no value in global markets or are prohibitively difficult to assess in comparison to actual market rates. By eliminating these LIBOR calculations, the Wheatley Report drafters hoped to move market actors into tenors with meaningful market activity, resulting in fewer rate quotes and greater accuracy with respect to actual market costs. As a result, the BBA has discontinued eight LIBOR tenors: the two-week, four-month, five-month, seven-month, eight-month, nine-month, ten-month, and eleven-month tenors. In addition, the BBA has stopped quoting LIBOR in the following currencies and indexes:

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257 THE WHEATLEY REVIEW, supra note 3.
258 Id.

Although the reason for the discontinuance in certain currencies and tenors may be to increase efficiency and to limit the submissions in tenors that are difficult to affirm, there are several negative consequences that may affect market participants. First, the contractual documentation for existing transactions that are tied to these existing tenors will likely need to be amended. If the underlying transaction documents already provide for the use of an alternative reference rate when LIBOR becomes unavailable, then this may never be an issue for those parties with well-prepared documents. Prior to the widespread notoriety of the LIBOR scandal, however, it is unclear to what extent parties prepared for alternative benchmarks in their documentation. As a result, an unknown cost of due diligence and additional negotiations may accrue in order to switch to a new benchmark. Moreover, with respect to certain market participants, counterparties may interpret any change to the LIBOR benchmark in their documents as a materially adverse effect, allowing counterparties to select whether to honor contractual obligations.\footnote{See Guy C. Dempsey Jr., LIBOR Discontinuation Guidance from ISDA, CORP. & FIN. WKLY. DIG. (Mar. 29, 2013), http://www.corporatefinancialweeklydigest.com/2013/03/articles/otc-derivatives/libor-discontinuation-guidance-from-isda/\footnote{See Guidance Note, ISDA, LIBOR Currency/Maturities Discontinuation (March 25, 2013) (showing that the ISDA, the International Swaps and Derivatives Association, has released this guidance letter to parties using their standardized interest rate swap documentation), available at http://www2.isda.org/search?headerSearch=1&keyword=libor (follow "LIBOR Discontinuations Guidance" hyperlink). In this guidance note, ISDA specifically provides that each counterparty has to agree to the proposed form amendment drafted in response to these changes in tenors and maturities. See id.}. As a result, certain market participants fear that the LIBOR reforms risk invalidating their contracts.\footnote{id} To date, industry groups have provided several unsatisfactory options for market participants affected by these changes.\footnote{id} With respect to those agreements where the tenor used has been eliminated, it has been suggested that market participants select the "closest" remaining
tenor. For those market participants using LIBOR set to terminated currencies, the suggested options are rather stark: agree to a substitute rate, or terminate the transactions entirely.

Finally, there has been very little consideration regarding whether it is appropriate to limit market participants’ freedom to contract around these tenors, or any other type of benchmark. Removing wholesale currencies from the calculation of LIBOR forces market participants to trade or hedge their risks in currencies they may not desire, or that do not actually represent the underlying risks in the related transaction. Market rates and currencies are not static objects, and what may be a “stable” tenor today may not be so stable tomorrow. Moreover, the prohibition or limitation of any benchmark from use by private financial actors is likely to stifle innovation in developing new financial products and limit competition. Either of these results could increase consumer costs in the future.

Rather than providing a three-month to six-month period for terminating these tenors and currencies, market participants should be allowed to “opt-in” to continued LIBOR reports in these currencies and tenors, and to waive any associated risks. Given the types of currencies and tenors being eliminated due to a lack of widespread use, it seems likely that parties using these currencies and tenors are sophisticated financial institutions. Similar to the use of

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264 Id.

265 Id.

266 The value and popularity of a currency are constantly changing factors, typically dependent on a country’s economic and political stability, its current account surplus or deficit, as well as the amount of debt it has issued. See Eswar Prasad & Lei Ye, The Renminbi’s Prospects as a Global Reserve Currency, 33 CATO J. 563 (2013). Reserve currencies are an example of how currencies gain and lose popularity over time. A reserve currency is the chosen currency used and held by governments and financial institutions for international transactions. See Eduardo Porter, Tremors and Trepidation: Imagining the Dollar Without Its Privilege, N.Y. TIMES, Oct. 16, 2013, at B1. Prior to the development of the U.S. dollar as the primary international reserve currency, the British Pound held the role. See id. Economists and political scientists frequently contemplate the Chinese Renminbi, or Yuan; or even the cryptocurrency, the Bitcoin, as potential future reserve currencies. See id.; Mark T. Williams, Bitcoin Will Crash To $10 by Mid-2014, BUS. INSIDER (Dec. 17, 2013 5:18 PM), http://www.businessinsider.com/williams-bitcoin-meltdown-10-2013-12.
the "accredited investor" standard used in private securities transactions,²⁶⁷ parties can use a certification and waiver, if those parties prefer to use LIBOR tied to these currencies and tenors. This suggested reform has the benefit of allowing financial institutions and investors the choice of keeping their documentation the same, or going through the process of amending their documentation and the associated costs, rather than forcing these parties to adopt new and unexpected risks and costs. In addition, the use of a waiver provides little in the way of additional expense.

Although a certification and waiver process may be the easiest resolution for the unintended consequences of terminating certain LIBOR currencies and tenors, NYSE Euronext should move to make the transition away from these terminated LIBOR currencies and tenors easier for those financial institutions and investors that are facing new risks associated with this change. For any of those borrowers, lenders, and hedge counterparties who rely on the terminated LIBOR currencies and tenors, a more orderly transition would be beneficial. A greater transition period, perhaps as long as one-to-five years, should be provided to reflect the term length of these contracts. Providing a longer transition period to the remaining LIBOR currencies and tenors would limit the negative costs associated with sudden, and perhaps terminal, changes made to the relevant financial actors.

²⁶⁷ Accredited Investors, U.S. SEC. & EXCH. COMM’N, http://www.sec.gov/answers/accred.htm (last visited June 6, 2014) (showing in general, the accredited investor rule is a U.S. securities rule designed to prohibit any investor other than an “accredited investor” from purchasing securities that are exempt from registration under the Securities Act of 1933 (public registration under the act theoretically providing to all investors, accredited or otherwise, all of the information material to an investment decision)). An accredited investor is a person (i) whose individual net worth or joint net worth with that person’s spouse, at the time of his or her purchase of a private security, exceeds $1,000,000 (excluding the value of his or her primary residence); or (ii) who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person’s spouse in excess of $300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year. In exempt, or non-public, securities offerings, accredited investors are required to certify that they fulfill the requirements of being an accredited investor. Id.
B. **SETTING LIBOR TO ACTUAL MARKET RATES**

In order to restore the credibility of the banking system and the LIBOR calculation process, the Wheatley Report recommended that market participants use a new or revised benchmark based on actual lending data to set LIBOR. As part of a new LIBOR calculation process, the FCA requires LIBOR contributor banks to confirm LIBOR’s correlation with other financial data. Setting LIBOR to corresponding lending data would, theoretically, allow market participants to borrow and lend money at honest and accurate prices. However, this raises two fundamental questions: (1) what are “actual market rates;” and (2) how are these actual market rates collected and calculated?

To date, it is unclear what exact changes NYSE Euronext, as the new manager of LIBOR, may require from banks when setting LIBOR. However, NYSE Euronext has indicated that it will require future LIBOR calculations to be “anchored” to actual market rates. Market watchers have suggested several options for tying LIBOR to real market costs. For example, it has been recommended that contributor banks use the overnight index swap rate, which reflects the overnight rate at which banks lend to each other, as a data set for LIBOR calculations. Alternatively, banks also could utilize rates used for short-term secured financings between banks and commercial borrowers.

These suggestions have received mixed reactions from banks. Certain financial analysts have critiqued resistance by contributor

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268 *The Wheatley Review*, *supra* note 3.
banks to this change as suspicious. However, one weakness in this proposal is that there are certain situations where market pricing for lending in certain tenors is difficult to base on actual transactions. Obviously, the Wheatley Report and related FCA reforms have tried to address this concern by eliminating tenors and currencies that have little to no market impact. However, tying LIBOR to actual market rates may become problematic during periods of high volatility or in certain markets where there is little to no trading. In addition, moving to actual market data may create market disruptions while contributor banks create a consensus on the new market methodologies for a reality-based LIBOR. One solution is to make LIBOR benchmarks contingent, rather than based, on actual market data. Rather than making LIBOR a "Frankenstein" benchmark put together from a variety of transaction data, LIBOR submissions could simply be contingent on the existence of actual trading data. This might involve further elimination of any tenors or currencies where no trading or markets exist, which creates its own unintended consequences. As this reform requires extensive knowledge of the markets and types of transactions that rely on LIBOR benchmarks, it seems appropriate that this potential reform be the responsibility of NYSE Euronext working with the LIBOR panel banks.

Rather than completely eliminating expert judgment by the banks when setting LIBOR, banks could use a variety of options. First, proposed rates by the banks could be arbitrated against market rates. This would allow banks to continue to use their judgment when initially setting their LIBOR benchmarks; using the market arbitrage as a hedge to prevent speculation or inappropriate exuberance from pushing the LIBOR benchmark beyond what the actual market would allow. The process of "interpolation or extrapolation from available data" should become public and market-standard among each contributor bank. For example, the LIBOR contributor banks could, in addition to eliminating the upper and lower quartile of proposed benchmarks, use a limit on the amount by

274 See id.
275 See THE WHEATLEY REVIEW, supra note 3, at 6, 43-44 (recommending "actual trade data" when setting future LIBOR benchmarks).
276 See THE WHEATLEY REVIEW, supra note 3, at 28.
which the final LIBOR benchmark for a given day deviates from actual market data. This deviation could be measured in basis points, or full percentage points, as determined by NYSE Euronext. In addition, the deviation should be flexible, dependent on transaction size and tenor.

Additional factors that influence the calculation of actual market rates include the size of the markets measured, the types of transactions used as marks, and the timing of the measurements. Including more financial actors in the setting of LIBOR could potentially increase accuracy. Rather than the limited number of contributor banks used to date, NYSE Euronext could include an application or review process designed to add additional contributor banks. Including more banks in the submission and calculation of LIBOR would reduce the impact of any future individual fraudulent submissions, as well as provide a more accurate picture of the financial markets as of the date of the submissions.

Another method for creating additional certainty would be to add another factor in calculating LIBOR. Rather than simply using tenor and currency as factors, LIBOR calculations could also include the amounts being loaned as an indicator of lending costs. Adding the loan amounts would help add certainty that LIBOR benchmarks were more indicative of the actual market. Finally, another factor that could be included to increase certainty in the LIBOR benchmark would be the timing of the loans. In today's 24-hour global markets, significant movements in lending prices occur based on which markets are active. Rather than the current model of using 11:00 AM GST as the time for submissions, additional LIBOR benchmarks could be used to take into account the time that other markets are actually open and trading. For example, 11:00 AM EST and 11:00 AM Tokyo time could be used as additional factors in determining certain LIBOR benchmarks. Factoring additional considerations of more contributor banks, loan size, and timing would increase market participant faith in future LIBOR benchmarks.

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C. **SUBJECTIVE FACTORS STILL INFLUENCE LIBOR SUBMISSIONS**

Until the adoption of the Wheatley Report's proposal of removing responsibility for LIBOR setting from the BBA, LIBOR setting was largely self-regulated.\(^{278}\) To date, reaction to the movement of LIBOR from the BBA to NYSE Euronext has largely been favorable.\(^{279}\) In addition, the enacted Wheatley Report reforms have significantly increased the level of government oversight over the LIBOR calculation process. However, it is unclear whether the enacted Wheatley reforms will prevent future manipulation or restore market confidence in the banking system. Specifically, the ability of regulators to evaluate the accuracy of LIBOR is questionable given that LIBOR is a benchmark and not necessarily tied to any actual transaction data, even with new requirements that LIBOR be tied to objective criteria. Moreover, even with additional regulatory oversight, subjective criteria can still influence the rates, leaving the potential for future manipulation.

The overdue regulatory attention to the LIBOR settlement process is welcome. However, there is an underlying issue regarding the extent regulatory authorities can actually monitor and enforce compliance on a benchmark that is "the rate at which banks do not lend to each other . . . [and] is not a rate at which anyone is actually borrowing."\(^{280}\) LIBOR is, after all, a benchmark based on a hypothetical cost of lending between banks and not an actual interest rate. The FCA has implemented guidelines for how LIBOR contributor banks are to calculate an "accurate" LIBOR submission. Pursuant to MAR 8.2.6 of the new FCA Handbook:

> A benchmark submitter must:

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\(^{278}\) See Alex Barker & Kara Scannell, *EU Libor Plan that Ends Era of Self-Regulation*, FIN. TIMES (June 6, 2013, 11:24 PM), http://www.ft.com/intl/cms/s/0/4184a0d8-ceb3-11e2-ae25-00144feab7de.html#axzz2wBM7KNE5.


(1) ensure that its benchmark submissions are determined using an effective methodology to establish the benchmark submission on the basis of objective criteria and relevant information; and
(2) review this methodology as and when market circumstances require, but at least every quarter, to ensure that its benchmark submissions are credible and robust.

An effective methodology for determining benchmark submissions in addition to quantitative criteria may include the use of qualitative criteria, such as the expert judgment of the benchmark submitter.\textsuperscript{281}

It is not difficult to imagine that even with increased regulatory oversight, LIBOR will not be an accurate indicator of lending costs. How does a benchmark submitter ensure its submissions are "credible and robust," especially when the process for setting LIBOR allows the individual judgment of the benchmark submitter?\textsuperscript{282}

Regardless of potential, subjective influences in the rate-setting process, markets fluctuate daily, and in periods of financial crisis it is easy to see situations where the LIBOR benchmark may not align with market costs, even without manipulation by self-interested parties. Rather than making benchmark submissions a zero-sum game of objective versus subjective determination, the new rules tread the line between a set of accurate data and reflecting the variable nature of trading between financial institutions in multiple currencies, tenors, and transaction sizes. Over the long-term, it is unclear whether the end result of this reform will actually prevent future benchmark manipulation.

To limit the temptation of personal or reputational concerns to impact the subjective judgment of benchmark submitters, LIBOR contributor banks and regulatory authorities should move to eliminate the specific incentive for traders to influence the LIBOR benchmark—their bonuses. Rather than involve regulatory action over private remuneration, the NYSE Euronext can propose that LIBOR contributor banks hold bonuses to individuals that have the ability to influence the LIBOR benchmark for a certain period of

\textsuperscript{281} FCA HANDBOOK, supra note 250, at MAR § 8.2.6.

\textsuperscript{282} Id.
time. The bonus hold period would be a sufficient period of time for the related LIBOR contributor bank to use new compliance procedures to confirm that the individual traders had taken no inappropriate action. Acknowledging and addressing the incentives of individuals to submit false LIBOR benchmarks is critical for preventing future manipulation.

D. ELIMINATING THE CONFIDENTIALITY OF LIBOR SUBMISSIONS

One reform made by the BBA to the LIBOR calculation is making the submission of the LIBOR benchmarks confidential to the public for a three-month period.\(^{283}\) Although this may seem counterintuitive, it is widely believed that the public nature of the LIBOR submissions by each contributor bank created the incentive among banks to move their LIBOR submissions in order to keep up with their peers and limit public perception of the related contributor banks’ financial distress.\(^{284}\) By removing LIBOR from the public eye, banks will no longer be tempted to push their individual LIBOR benchmarks downward in order to conceal their negative financial conditions. Without public scrutiny, the theory goes, banks will be prevented from comparing recent LIBOR benchmarks from their competitors; consequently, this information will not affect their own LIBOR benchmark submissions. Therefore, confidentiality will force banks to rely solely on themselves when submitting their quotations.

The obvious unintended consequence of such confidentiality is the removal of one leading indicator of a financial institution’s health from the public. Although there may be an argument for making LIBOR submissions confidential, preserving negative financial information should not be one of them. Moreover, the reasoning behind keeping LIBOR submissions confidential fails to take into account a primary motivation behind the LIBOR manipulation. Individual profit, rather than protecting the reputation of their financial institution, motivated many of the bankers involved. An analysis of email exchanges between bank traders and LIBOR submitters indicate that profit was a motive for moving rates, not just


\(^{284}\) Hay, supra note 63.
protecting the reputation and stock price of the banks.\textsuperscript{285} Allowing for a three-month quiet period creates the risk of bad actors using confidentiality as a screen for future manipulation.

Another issue relating to preserving the confidence of banks’ LIBOR submissions for a three-month period is that it may well prevent the discovery of future manipulation. The initial discovery of collusion and manipulation of LIBOR came not from the LIBOR administrator or regulatory authorities, but from financial watchers who were observing the daily LIBOR submissions. Those financial observers were able to surmise quickly how LIBOR diverged from typical submissions that were inconsistent with other market factors. By allowing a three-month period of silence, it seems likely that any future manipulation would be more difficult to pinpoint, and when discovered would already be at least three months after the fact.

For these reasons, NYSE Euronext should consider eliminating the three-month confidentiality period. Although this period of “quiet” may reduce certain risks associated with LIBOR manipulation, it comes at the cost of additional public oversight of the submissions, and adds an additional risk for LIBOR manipulation without quick discovery.

IV. CONCLUSION

The first steps toward repairing the LIBOR calculation process have begun. Many of the enacted reforms to the LIBOR calculation process proposed by the Wheatley Report are substantial improvements over the previous self-regulated system. Unfortunately, there is still a long way to go before confidence is fully restored. In addition to the already enacted reforms, regulators

\textsuperscript{285} One of the more amusing communications between traders and LIBOR submitters revealed by the Barclays investigation included the following:

Trader: What do you think you’ll go for in 3 months?
Submitter: I am going 90 although 91 is what I should be posting.
Trader: When I retire and write a book about this business, your name will be written in golden letters.
Submitter: I would prefer not to be in any book!

should consider additional changes to the calculation process including a certification or waiver process for LIBOR marks in rarely traded tenors and currencies, eliminating the confidentiality period for LIBOR submissions, and tie individual benchmark submitter’s salary structures to the market data reforms already enacted. Addressing these unintended consequences with additional amendments to the LIBOR calculation will help restore at least some of the integrity lost by the financial institutions involved in the LIBOR scandal and keep the recovery heading in the right direction.