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### The Lie in Libor: Seeds of a Cartel?

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### I. INTRODUCTION

The LIBOR (London Inter-Bank Offered Rate) is one of the world's most significant interest rate benchmarks used to set payments on financial transactions worldwide with a combined value running into the trillions of dollars. This summer the banking world was shocked by the news that LIBOR appeared to have been subject to prolonged and systemic manipulation by a number of the panel banks involved in the rate-setting process.

The LIBOR scandal has so far seen the resignation from Barclays of former chief executive Bob Diamond and two of his closest aides. Moreover, the unfortunate suggestion that the Bank of England encouraged the suppression of LIBOR during the financial crisis period lingers on. In the United Kingdom, reforms intended to "clean up" LIBOR are being pushed through at an accelerated pace. However, it is the alleged involvement of numerous other banks around the globe, and corresponding regulatory investigations worldwide, which have caused allegations of a suspected cartel to surface.

This article considers revelations that make it impossible to dismiss such allegations with any degree of certainty and considers whether the Wheatley reforms will safeguard against future cartel behavior.

### II. BACKGROUND

LIBOR is a short-term interest rate, designed to reflect the cost of borrowing between banks. A panel of banks submits estimates daily to the British Bankers' Association (essentially a trading organization made up of banks). These estimates are then averaged out by Thomson Reuters for each LIBOR currency and tenor (duration), with the highest and lowest submissions discarded. The rate is then used to set interest rates for a vast array of financial products around the globe, from complex derivatives to consumer loans and mortgages.

In June 2012, Barclays' was fined a record £290 million by the Financial Services Authority ("FSA"), U.S. Department of Justice ("DOJ"), and the U.S. Commodity Futures Trading Commission ("CFTC") for various regulatory breaches relating to the setting of LIBOR going back at least as far as 2005. Regulatory authorities found that derivatives traders at Barclays made requests to their own rate submitters to fix LIBOR at certain levels and, on occasion, went so far as to try to influence the LIBOR submissions of other panel banks. Even more damning were the findings that instructions were given by Barclays' management to submitters within the bank to lower LIBOR submissions during the financial crisis due to concerns over negative media comments about the bank's liquidity.

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### III. LIBOR “CARTEL”

While the LIBOR scandal still has a long way to run, the idea that banks acted in collusion with one another when manipulating LIBOR cannot be dismissed as frivolous. Certainly, revelations that have come to light in recent months point to the possibility of a cartel or cartels operating in respect of LIBOR. Barclays has taken the first hit, but more is inevitably yet to come.

Aside from the fines already levied by the U.K. and U.S. regulatory authorities on Barclays, the European Commission has stated that investigations into LIBOR- and EURIBOR-<sup>2</sup> fixing “have top priority”<sup>3</sup> due to the potential harm to competition worldwide. In the meantime, regulators in jurisdictions around the globe including Japan, Switzerland, Germany, the Netherlands, France, Canada, and Singapore continue with their own LIBOR investigations.

### IV. A HIGHER POWER: THE BANK OF ENGLAND

The Bank of England was dragged into the heart of the LIBOR manipulation scandal ahead of Bob Diamond’s appearance in front of the Parliamentary Treasury Select Committee in July. On May 28, 2008, an email titled “LIBOR,” from Paul Tucker, Deputy Governor of the Bank of England, to Bob Diamond stated: “[h]ave spoken to HSBC, Stuart and Jonny. Sense similar across all three of you. I encourage contact amongst Mark Dearlove peer group.”<sup>4</sup>

The importance of this email is that Mark Dearlove happened to be a member of Barclays’ staff responsible for submitting LIBOR rates. This appears to be more than a coincidence. Although, this email is not quite perhaps a smoking gun, it does appear to show encouragement of collusion by the Bank of England. Was this a cartel sanctioned at the highest level?

### V. THE “SECRET COMMITTEE”

Every two months, representatives from the world’s largest banks meet at an undisclosed location to review LIBOR. Yet the identity of those who sit on the British Bankers’ Association’s (“BBA”) Foreign Exchange and Money Markets Committee is a secret. The functions of the Committee include the design of the benchmark, the decision as to which banks sit on the panels that determine LIBOR, and ongoing scrutiny of the published LIBOR rates. However, the members of this incredibly influential yet mysterious Committee are unknown and its meetings are not minuted. The BBA has thus far protected the anonymity of its members. One thing is clear—under the cloak of invisibility, this Committee provided a golden opportunity for representatives of panel banks to align their rates during the financial crisis.

### VI. RBS “SCAPEGOAT”

Tan Chi Min, a Singapore-based trader, is one of four traders who were sacked by Royal Bank of Scotland plc (“RBS”) over LIBOR manipulation. Since then, Mr. Tan has brought a case for wrongful dismissal. The court proceedings in Singapore are drawing a lot of unwanted

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<sup>2</sup> The Euro Interbank Offered Rate (Euribor) is a daily reference rate based on the averaged interest rates at which Eurozone banks offer to lend unsecured funds to other banks in the euro wholesale money market. It is set slightly differently to LIBOR with a larger panel of banks involved in the rate-setting process.

<sup>3</sup> *Libor scandal: EU probe into ‘shocking’ rate rigging includes Japan, says Joaquin Almunia*, THE TELEGRAPH, (November 16, 2012)

<sup>4</sup> Email, May 28, 2008 – Treasury Select Committee documents.

attention for RBS, and information leaked into the public domain is no doubt damaging for the bank. Mr. Tan alleges that RBS managers condoned collusion among staff to maximize profits by manipulating LIBOR.

Interestingly, on August 19, 2007, Mr. Tan sent a trader based at Deutsche Bank this message: "[i]t's just amazing how LIBOR-fixing can make you that much money or lose it if opposite...it is a cartel now in London." Was this a sentiment that was shared across staff in panel banks? Again, time will tell.

## VII. EUROPE GETS SERIOUS

The European Commission has given the LIBOR and EURIBOR collusion probe "top priority" due to the potential harm to competition worldwide. This creates a strong inference that the European Commission believes that the setting of LIBOR and EURIBOR was subject to cartelized behavior.

Furthermore, Deutsche Bank, UBS, and a third bank have applied for and been granted leniency under the European Commission's leniency program. This program is designed to encourage whistleblowers involved in anticompetitive activity to approach the Commission and disclose relevant information. In order to be granted leniency, an applicant must provide a detailed description of the alleged cartel arrangement, the names and addresses of all the undertakings that participated in the alleged cartel, and other evidence that may help the Commission prove infringement. In return, the Commission will grant immunity to the applicant from any fine that would otherwise have been imposed. Therefore, for those banks that have applied for leniency and been granted leniency, this is effectively an admission of involvement in a cartel.

## VIII. WHEATLEY REFORMS: SAFEGUARD FOR FUTURE?

Martin Wheatley, managing director of the FSA, was given the mighty task of establishing an independent review into a number of aspects of the setting and usage of LIBOR ("the Wheatley Review"). The final recommendations and conclusions were published in September 2012. Three particular reforms are worth considering in terms of future safeguards against prospective cartel behavior.

First, the publication of individual LIBOR rate submissions alongside the final LIBOR rate has likely facilitated the manipulation of LIBOR, as panel banks can easily monitor one another's submissions (and could therefore keep tabs on any other bank's "compliance" with an agreement to fix LIBOR submissions at a certain level). The Review therefore recommended that the publication of individual submissions be delayed by a period of at least three months. Although such a reform would make it harder for submitting banks to monitor others' LIBOR submissions, this would not prevent future cartelists from sharing LIBOR submissions behind closed doors in "secret committees."

Second, Wheatley was of the view that larger panel sizes for LIBOR could benefit the accuracy and credibility of the benchmark. Larger panels would arguably ensure that individual submissions have a more limited impact on the published LIBOR rate; this would hopefully discourage manipulation of LIBOR and, in turn, would safeguard against future cartels to the

extent that any false submissions of banks would be diluted by the presence of more banks across larger panels.

Third, the FSA would be granted more extensive powers to ensure that regulators can take action in relation to proposed new criminal offenses of LIBOR manipulation (and attempted manipulation). The threat of prosecution and/or regulatory censure for such conduct should, in theory, deter any would-be cartelists in the banking sector.

## IX. WHAT NEXT?

There is an abundance of circumstantial evidence to suggest that a cartel existed among LIBOR panel banks and that further evidence will come to light as the FSA and other regulatory authorities conclude their investigations. However, the unknown length of investigations makes this a tormenting wait. With an RBS settlement likely to be pending, a fresh wave of debate will soon commence. Any further evidence arising out of future settlements is likely to serve to strengthen what already appears to be a credible case. In the meantime, with no imminent limitation concerns, lawyers involved in the case have time on their hands to strategize and consider the complex economics involved.

As to the manipulation of LIBOR, the potential levels of loss incurred by corporate entities, municipalities, and individuals due to the manipulation are vast. In the first half of 2011 alone, the notional amount outstanding on over the counter (“OTC”) derivatives contracts was approximately \$554 trillion.<sup>5</sup> There is a lot at stake for the losers of LIBOR. As more and more investigations come to an end, banks will not only be paying out for fines, but have exposed themselves to ongoing civil liability. As this saga unfolds further, law firms are bracing themselves for the biggest litigation in banking and finance in recent years. Who will come out on top? This remains to be seen.

Some have already taken the fight to the banks. Hausfeld LLP has filed one of the biggest antitrust class actions in the United States, on behalf of the Mayor of New York and the City of Baltimore Council. In London, Guardian Care Homes have won the right to take their LIBOR claims against Barclays to the High Court. These cases are significant in that they are the first of their kind. If successful, the floodgates will open up for many.

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<sup>5</sup> Bank of International Settlements.