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CLYDE&CO

# LIBOR bulletin

## LIBOR manipulation press coverage

### Investigations and regulator action

The Dutch lender Rabobank has confirmed in a press release that it is being investigated in connection with the LIBOR and EURIBOR setting process and that, based on the facts currently known and the publicly announced outcome of other banks' investigations, a settlement is likely. No details have been given as to the likely amount (which is said by Rabobank not to be capable of reliable estimation at present) or timing of any settlement. If Rabobank were to be fined by regulators for LIBOR or EURIBOR manipulation, it would follow three banks which have already had financial penalties imposed on them: Barclays, UBS and Royal Bank of Scotland (RBS).

David Green, director of the UK's Serious Fraud Office, has pledged "very significant progress" within the next three months in the investigation into the manipulation of benchmark rates. Although he has not explained further what is meant by this, the SFO is also doubling (to 60) the size of the team working on its criminal investigation into the manipulation of LIBOR.

Meanwhile, the EU Competition Commission is investigating suspected rigging of various benchmark interest rates, including LIBOR. TIBOR and EURIBOR, which may have affected derivatives in Euro, Yen and Swiss Francs, and has described its investigations in this area as an "absolute priority". It has been reported that EU regulators will offer banks the opportunity to settle cases in return for reduced fines. If a bank resists and the EU finds it guilty of manipulation, it could face a fine equivalent to up to 10 per cent of its annual turnover.

In Japan, the Securities and Exchange Surveillance Commission has released a statement dated 5 April 2013 indicating that it has recommended that the Financial Services Agency take administrative action against RBS Securities Japan Ltd following an SESC inspection. The notice cites inappropriate conduct as follows: firstly, for around four years an RBS trader and his colleagues continuously approached Yen LIBOR submitters and made requests to change Yen LIBOR submissions in the trader's favour; secondly, the COO of RBS Securities received non-public customer information on the Tokyo branches of RBS and ABN Amro that were consolidated. In a statement issued on 5 April, RBS apologised for the issues which had led to the recommendation and said that it took the recommendation very seriously and would take appropriate steps to address the issues raised.

It has been reported that a number of authorities internationally are reviewing benchmark rates and the manner in which they are set and/or regulated. For example, Norway's banking regulator has recently announced that there should be stricter regulation of the NIBOR interbank lending rate, but it has found no evidence that NIBOR rates were manipulated. The Hong Kong Monetary Authority (HKMA) has also announced a package of reforms to the rate-setting process of HIBOR. These changes include, amongst other things, the transfer of administrative responsibility for the rate to the Treasury Markets Association (TMA), the phasing out of certain HIBOR rates for which there is little market demand, and the development of a Code of Conduct for reference banks.

Meanwhile, the FSA has published an Internal Audit report entitled "A review of the extent of awareness within the FSA of inappropriate LIBOR submissions", following a review, commissioned by FSA chairman Lord Turner, in which the FSA's knowledge and actions in the period January 2007 to May 2009 were examined. The report concludes that the FSA should have taken certain further action when indications emerged in 2007 and 2008 that banks were submitting artificially low LIBOR rates. It states that the FSA's focus on dealing with the implications of the financial crisis for the capital and liquidity positions of firms, and the fact that administering or contributing to LIBOR were not then 'regulated activities', caused the FSA to be "too narrowly focused" in its handling of information about LIBOR. A Management Response to the report has been published which, amongst other things, notes that, given the unprecedented financial stability issues at the relevant time, it was appropriate for the FSA to focus its resources on the wider causes of dislocation and the implications for the financial stability and safety and soundness of regulated institutions.

This month the Financial Services Authority (FSA) was replaced by three new bodies: the Financial Policy Committee (FPC), the Financial Conduct Authority (FCA), and the Prudential Regulation Authority (PRC) under the Financial Services Act 2012. On 2 April 2013, the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2013 (SI 2013/655) also came into force which makes providing information in relation to a specified benchmark, or administering a specified benchmark a regulated activity under FSMA. The only specified benchmark at present is LIBOR. Amendments have been made to the FCA Handbook in relation to the new regulated activities. Finally, under section 91 of the Financial Services Act 2012, offences have been created in relation to making false or misleading statements in relation to a relevant benchmark and to engaging in a relevant course of conduct.

The British Bankers' Association (BBA) has published a statement noting that until a new LIBOR administrator is appointed (see below) the part of the BBA responsible for the benchmark has become regulated, which is a significant step in the implementation of the Wheatley Review's recommendations. The BBA has been streamlining the number of currencies and maturities and has announced that Euro LIBOR rates and Euro same-day LIBOR rates will no longer be published on UK bank holidays. A further recommendation of the Wheatley Review of LIBOR stated that: "The BBA should publish individual LIBOR submissions after three months to reduce the potential for submitters to attempt manipulation, and to reduce any potential interpretation of submissions as a signal of creditworthiness." The BBA has indicated that it will be fully implementing this recommendation with effect from 1 July 2013, meaning that from this date individual LIBOR submissions from banks will no longer be immediately viewable.

## Industry response

Following the imposition on RBS of fines totalling approximately USD 612 million for misconduct in relation to LIBOR, executives of RBS – namely John Hourican, former Chief Executive Officer of Markets and International Banking; Peter Nielsen, Chief Executive Officer, Markets, RBS Group; and Johnny Cameron, former Chairman of Global Banking and Markets – have given evidence to the UK Parliamentary Commission on Banking Standards. Amongst other things, during the executives' evidence: Mr Hourican gave as an explanation for the failure to spot and address LIBOR manipulation in 2008 and 2009 the fact that other issues faced by the bank, which had suffered a "cardiac arrest", at that time were prioritised; Mr Nielsen stated that, on presently available information, it could not be said that the bank (as opposed to individual traders) benefited financially from LIBOR manipulation, and indeed the bank might have been worse off as a result of this activity; and Mr Cameron stated that it did not occur to anyone at the relevant time that LIBOR was a rate which could be manipulated.

Following the recent vote by members of the BBA formally to relinquish responsibility for the administration of LIBOR, HM Treasury has announced the membership of the independent committee which will be responsible for recommending a new administrator for LIBOR. The committee is chaired by Baroness Hogg and its members include Martin Wheatley, the chief executive of the new Financial Conduct Authority (FCA), which as from 1 April has regulatory oversight of LIBOR rate-setting (as to which see further above). The committee has also issued a pre-tender questionnaire for potential bidders to complete.

The Australian Financial Markets Association (AFMA) has indicated that it proposes to bypass the panel that sets its benchmark interbank borrowing rates, and implement a new system that will see the country's bank bill swap rates (BBSW) set using prices directly from brokers and electronic markets rather than asking a panel of banks. The change is subject to technical requirements although AFMA hopes that it will be achievable within a few months. The change would remove the requirement for a BBSW panel and remove the compliance and ancillary costs that exist for panellist banks. It is reported that this would be the first developed economy to replace its rate-setting regime following the benchmark rate rigging scandal. Financial analysts in the country have reported that this type of change from a system based on a panel of banks to an externally observable system is the first of its kind they are aware of and will likely be well-received by regulators around the world.

# Litigation

In *Deutsche Bank and others v Unitech Ltd and others*, Mr Justice Cooke, sitting in the High Court in London, has refused permission to the defendants to add LIBOR manipulation allegations to their pleadings. The claimants are claiming against the defendants in relation to a credit facility agreement and a related interest swap agreement, following alleged failures to pay instalments due and other events of default. The credit facility agreement and the swap provided for payment of interest by reference to LIBOR. The defendants alleged that Deutsche Bank had manipulated the Yen LIBOR and possibly other LIBOR rates (denied by the claimants). The defendants sought to amend their pleadings to allege that a number of misrepresentations had been made by the claimants which induced the defendants to enter into the agreement and the swap, and that the representations were made negligently and dishonestly, and that an implied warranty had been given that the representations were true. The implied misrepresentations alleged to have been made were that: (1) LIBOR was a genuine average of the estimated rate at which the Panel could borrow from each other in a reasonable market prior to 11am London time on any given day; (2) the LIBOR rate was based on Panel member banks' submissions that were good faith accurate estimates of the rate at which they could borrow from each other; (3) Deutsche Bank had not acted, was not acting, and had no intention of acting in a way that was likely to undermine the integrity of LIBOR; and (4) Deutsche Bank was not aware of any conduct (of its own or of other banks on the Panel) that would be likely to undermine the integrity of LIBOR.

Cooke J noted that the test for an implied representation having been made is whether a reasonable person in the position of the first defendant would reasonably have understood that an implied statement was being made in the terms alleged. The fact that Deutsche Bank was a LIBOR panel bank and entered into a swap or agreement that was linked to LIBOR was not enough to found the implied representations alleged. In addition, Cooke J held that the documentation made clear that Deutsche Bank was acting on an arms length basis, not as an adviser, and was not making any recommendation in relation to the transaction. Rather, it was the defendants' own responsibility to understand and assess the transaction. Both the swap and the agreement referred to a LIBOR rate that appeared on a screen at a particular time, and there was no basis for a representation to be spelt out about the way in which the figure came to be calculated. Cooke J held that the first two implied representations alleged by the defendants were too wide and uncertain to arise, as they placed in the mouth of one bank a statement about the overall integrity of the system and the parts played by every bank in it. The second two implied representations, Cooke J noted, at least related to Deutsche Bank's own acts, intentions or knowledge. However, Cooke J held that there was a difference between an implied term of the contract that a party will not manipulate the specific LIBOR rate referred to in it, and a separate non-contractual representation that nothing has been done or is now being done to impact on any of the many LIBOR rates calculated.

Mr Justice Cooke noted that he had reached a contrary decision to that of Mr Justice Flaux in *Graiseley v Barclays Bank* (October 2012), in which amendments to add claims for fraudulent misrepresentation against Barclays in relation to LIBOR were allowed, but noted that every case would turn on its own facts.

The decision of Cooke J in *Deutsche Bank v Unitech* is however, under appeal.

In the US, a number of defendant banks have been successful in motions to dismiss a series of lawsuits brought against them by private investors in relation to LIBOR manipulation. In a number of consolidated cases, US District Judge Naomi Reice Buchwald, in the Southern District of New York, ruled on 29 March that the cases must be dismissed due to, amongst other things, the inability of the plaintiffs to show that they were harmed as a result of the alleged rate-fixing, although certain commodities-manipulation claims were allowed to proceed.

The plaintiffs include various municipalities, commodities traders, investors, bondholders and Charles Schwab. The allegations are that the defendants submitted artificial rates to the BBA, resulting in LIBOR rates that were artificial, and that the plaintiffs suffered loss as they held positions in various financial instruments that were adversely affected. The Judge dismissed the plaintiffs' antitrust claims on the basis that the plaintiffs had not alleged an antitrust injury. It was held by the Judge that it was not enough that the plaintiffs paid more due to the defendants' collusion, the collusion in question must have been anti-competitive. In this case there was no competition. The plaintiffs' theory that the banks had competed normally in the interbank loan market but agreed to lie about the rates that they were paying was, according to the Judge, one of misrepresentation and possibly of fraud, but not of failure to compete. The RICO (Racketeer Influenced and Corrupt Organizations Act) claims were dismissed on the basis that the claims were barred by the PSLRA (Private Securities Litigation Reform Act) amendments to RICO that provide that a RICO claim cannot be brought in respect of conduct that would have been actionable as securities fraud. In addition, it was held that the RICO claim was based on an impermissible extraterritorial application of RICO following *Morrison v National Australia Bank*. Certain claims that the defendants had manipulated Eurodollar futures contracts in contravention of the Commodities Exchange Act were allowed to proceed. However, some of the claims were held to be time-barred, and the Judge expressed doubts about whether plaintiffs would ultimately be able to demonstrate that they had sold or settled their Eurodollar contracts at a loss as a result of defendants' conduct.

The Judge noted in the conclusion to her judgment that it might be unexpected that a large portion of the claims were being dismissed given the large penalties paid to regulatory agencies. However, the Judge noted that there were requirements that private plaintiffs must satisfy under the relevant statutes that did not apply to government agencies, as the focus of public and private enforcement is different.

Elsewhere, it has also been reported that Freddie Mac, the US government-owned mortgage financier, has sued over a dozen banks over alleged manipulation of LIBOR rates in a federal court in Virginia. It has also been reported that the suit names the BBA as a defendant, and reports suggest that this is the first reported instance of the BBA being named as a defendant in this way.

Finally, it has been reported that a New York realty company, 7 West 57th Street Realty Co., has filed a lawsuit in the US District Court, Southern District of New York, against a number of banks in respect of LIBOR manipulation. The lawsuit, led by Sheldon H. Solow (who assigned his claims to 7 West), alleges that after Solow purchased and pledged a portfolio of USD 450 million worth of municipal bonds as collateral for LIBOR-linked loans, banks knowingly made false LIBOR submissions, which led to the rate being artificially inflated. Citigroup then declared the portfolio to be inadequate security, declared a default on the loans and seized and sold the collateral at low prices, resulting, it is alleged, in Solow having to pay a judgment of USD 100 million.

## Comment

Coverage of recent LIBOR developments has picked up a number of interesting issues and there have been a number of key developments. An internal UK FSA audit report has suggested that the FSA may have been too narrowly focussed on dealing with the financial crisis when indications emerged in 2007 and 2008 that banks were submitting artificially low LIBOR rates. Providing information in relation to LIBOR or administering LIBOR has this month become a regulated activity in the UK, and we have finally said goodbye to the FSA with three new bodies in its place (the Financial Policy Committee, the Financial Conduct Authority, and the Prudential Regulation Authority). There have also been developments in relation to litigation, with claimants against banks meeting difficulties with their claims in relation to LIBOR manipulation in both the UK and the US.

**Further information**
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