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An Analysis of Libor Punishments[1]

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The article describes the punishments meted out to offending banks. It argues the inadequacy of the punishments and suggests how the punishments could have been handled to send a much stronger and clearer message to the offenders. More robust punishments may prevent financial scandals like the Libor manipulations from happening again in the future.

Introduction

The Libor manipulations were a surprise to regulators. The scandal highlighted regulatory blind sight as manipulation of Libor was not an offence at the time it occurred and there were hardly any legal provisions to prevent such manipulations from taking place. The nature of the scandal was an assault on the culture of trust and good faith within the financial sector and it stirred international attention as it affected global transactions worth trillions of dollars. Subsequently, the regulators intervened and enforcement authorities started investigating the matter. After the initial uproar was over, all anticipated swift and appropriate justice from enforcement authorities. The enforcement system encountered two glaring problems in administering fit and proper justice. First, the authorities faced a scarcity of available legal recourse to deal with the abuse. Second, the banks involved were mostly globally systemically important banks that could not be punished without repercussions to the economy. These two factors contributed towards the banks receiving reduced penalties giving rise to the debate on the adequacy of the Libor punishments. In this article we discuss the nature of the punishments imposed on the implicated banks. We also discuss if the punishments were justified as compared to the gravity of the offence.

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[1] This article was written prior to the levy of fines totalling a record US$2.5bn on Deutsch Bank by U.S. and U.K. regulators in April 2015.

Nature of the abuse

It is important to understand at the outset that the manipulation of Libor was a continuous phenomenon in which a number of banks participated over different periods of time.

Different jurisdictions were affected and different authorities across these jurisdictions dealt with the banks in their own ways. It is also important to understand at this point Libor was not the only international interbank interest rate that was being manipulated. Investigations in Libor manipulation uncovered manipulation of Tokyo Inter Bank Offered Rate (Tibor) and the Euro Inter Bank offered Rate (Euribor) during the period.

At the European Union level the manipulation of Libor and Euribor was considered as an example of anti-competitive behaviour characterised by banks forming cartels to achieve commonly agreed anti-competitive objectives. In the U.K. it was seen as attempts to defraud the market. The authorities were however handicapped by insufficient laws to handle such manipulations. In the U.S the manipulations were illegal as they unlawfully affected the U.S derivatives market.

Nature of the Punishments

The relevant authorities in the involved jurisdictions imposed monetary fines to punish the participating banks. Although there have not yet been any successful criminal prosecutions, some individuals did get arrested in the U.K and can be incriminated in the future for their alleged roles in manipulating Libor. In the U.K, authorities fined banks on the basis of violating market conduct principles while in the U.S., the fines came as a result of settlements reached between the banks and the enforcement authorities. The most significant fines levied by the U.S and the U.K authorities are as follows[2]:

[2] Matt Schuffham and Kirstin Ridley for the Reuters, 'Exclusive: RBS fined $612 million for rate rigging', February 2013. http://www.reuters.com/article/2013/02/06/us-rbs-libor-idUSBRE91500B20130206accessed 5 August 2014.

Bank	Fine
Switzerland's UBS AG	$1.5 billion
Britain's Royal Bank of Scotland	$612 million
Britain's Barclays Plc	$453 million

In E.U. the European Commission (EC) fined the banks for anti- competitive behaviour. The EC imposed some heavy fines on the banks for the manipulation of interest rate derivatives calculable in Yen and Euro. These amounts were later reduced by the EC in return for co-operation with investigations received from these banks. For the Euro interest rate derivatives EIRD cartels, the fines were as such[3]:

Participants	Duration of participation	Reduction under the Leniency Notice (%)	Fine (€)
Barclays	32 months	100%	0
Deutsche Bank	32 months	30%	465 861 000
SociétéGénérale	26 months	5%	445 884 000
RBS	8 months	50%	131 004 000

[3]European Commission - MEMO/13/1090 04/12/2013, 'Antitrust: Commission fines banks € 1.71 billion for participating in cartels in the interest rate derivatives industry' <http://europa.eu/rapid/press-release_IP-13-1208_en.htm> accessed 22 June 2014.

For the Yen interest rate derivatives YIRD cartels the fines imposed by the EC were as such[4]:

Participant	Duration of participation per infringement(s)	Reduction under the Leniency Notice (%)	Fine (€)
UBS (5 infringements)	1 month, 8 months, 5 months, 10 months, 1 month	100% for all infringements	0
RBS (3 infringements)	8 months, 5 months, 3 months	25% for one infringement	260 056 000
Deutsche Bank (2 infringements)	10 months, 2 months	35%, 30%	259 499 000
JPMorgan (1 infringement)	1 month		79 897 000
Citigroup (3 infringements)	1 month, 2 months, 3 months	35%, 100%, 40%	70 020 000
RP Martin (1 infringement)	1 month	25%	247 000

A final tally of the fines of all the participant financial institutions with respect to the Libor, Euribor and Tibor manipulations from different authorities looks like this:

[4]European Commission - MEMO/13/1090 04/12/2013, 'Anti-trust: Commission fines banks € 1.71 billion for participating in cartels in the interest rate derivatives industry' <http://europa.eu/rapid/press-release_IP-13-1208_en.htm> accessed 22 June 2014.

Exhibit 2
We break down known LIBOR-related penalties and payouts to date.

			Breakdown of Penalties, $m				
Bank	Date	Reference Rate	US	UK / EU	Other Global	Total Global Payouts	Comment
UBS	12/19/12	Multiple Reference Rates	$1,200	$258	$65	$1,523	$1,200m to the DOJ & CFTC, £160m to the UK FSA, and 60m CHF to the Swiss Market Supervisory Authority.
RBS	2/6/13	Multiple Reference Rates	$480	$642		$1,122	$150m to the DOJ, $325m to the CFTC, $137m to UK FSA; ~$354m to the E.U. for EURIBOR and Yen LIBOR.
Rabobank	10/29/13	LIBOR/ EURIBOR	$800	$266		$1,066	$475m to the CFTC, $325m to the DOJ, $170m to the UK FCA, and $96m to the Dutch Openbaar Ministerie.
Deutsche Bank	12/4/13	EURIBOR/ Yen LIBOR	$0	$985		$985	All to the E.U.- ~$633m for EURIBOR, ~$352m for Yen LIBOR.
Societe Generale	12/4/13	EURIBOR	$0	$605		$605	All to the E.U.
Barclays	6/27/12	LIBOR/ EURIBOR	$360	~$90		$450	$200m to the CFTC, $160m to the DOJ, ~$90m to the UK FCA.
JPMorgan Chase	12/4/13	Yen LIBOR	$0	$108		$108	All to the E.U.
Citigroup	12/4/13	Yen LIBOR	$0	$95		$95	All to the E.U.
ICAP	12/4/13	LIBOR/ Yen LIBOR	$65	$22		$87	$65m to the CFTC, $22m to the UK FCA
RP Martin	5/19/14	LIBOR	$2.3	$0.3		$2.6	$2.3m between the CFTC & UK FCA, $0.3m to the E.U.

Source: Company Reports, Bernstein Analysis, European Commission Release

Figure 1[5] (The abbreviations used in the table are explained in the footnotes[6] below).

Why are we deliberating on the adequacy of the punishments?

The banks were in a way able to buy their way out of the full force of punishment from enforcement authorities. Since enforcement actions were only limited to financial penalties there was no way to ensure the punishment may have had any deterrent effect on banks and these banks would refrain

[5] Company Reports, Bernstein Analysis, European Commission Release (as cited in) Giles Turner for The Tally – efinancialnews.com, 'A very handy chart for Libor Penalties', May 2014.
<http://thetally.efinancialnews.com/2014/05/handy-chart-libor-penalties/> accessed 5 August 2014.
[6]CFTC- Commodity Futures Trading Commission (U.S.)
CHF – Swiss Franc.
DOJ- Department of Justice (U.S)
E.U - European Union
FCA- Financial Conduct Authority (U.K)
FSA – Financial Services Authority (previous regulator) U.K.

from similar abusive behaviour in the future. There is an opinion the fines were insufficient when seen in the context of the annual income of these banks, giving the impression the punishments were ineffective. There is no way to check if there is any change in the attitude of the banks and it surely does not helps when the banks remain elusive in their defence blaming only a few staff members for the manipulations. Financial penalties allowed senior office holders to escape accountability and it is claimed that banks, as such, had nothing to do with these manipulations. To come clean, the banks even offered to disclose the information they had against its rogue staff members. An air of full co-operation with the enforcement agencies was created by blaming the whole scandal on only a few employees and ridding them from the system.

Then, there are unanswered questions on morality and ethics. The CEO, COO and the Chairman of Barclays resigned on grounds of moral responsibility thereby saving the image of the bank. In 2011, Royal Bank of Scotland sacked four employees for their role in manipulating submissions. Deutsche Bank blamed a “limited number” of staff for the manipulations of its submissions. It sacked five traders for involvement in Euribor manipulation. A valid question we may ask at this point is – why were the enforcement authorities satisfied by the scalps of only a few scapegoats? Were these employees guilty of manipulating their bank’s submissions by going against their bank’s ethical culture? Did these banks even have an ethical work culture to begin with?

Were the Punishments adequate?

We observe from the tables the enforcement authorities focussed on levying fines against the guilty banks. Though these fines are huge by ordinary standards, they become insignificant when seen in the context of the yearly and sometimes even quarterly profits of the banks. The ultimate penalty that the banks could have faced would have been losing their charters to operate in the affected jurisdictions. However, the authorities decided against this punishment as it would have negatively affected the economy. Also, to date there has been no successful criminal prosecution against any employee of any of the involved banks.

The fines imposed by the U.S. Department of Justice part of Deferred Prosecution Agreements [DPA] between involved banks and the authorities. A DPA is a settlement between the prosecutor and the prosecuted and cannot strictly be called a punishment. The different enforcement authorities across jurisdictions had various aspects of the abuse on which to focus. The authorities also had different priorities and different tools of enforcing fines. The European Commission fined the banks on the grounds of anti-competitive behaviour and not for defrauding the market. The EC gave huge immunities and concessions to the banks that had helped identify the illegal bank cartels. Consequently, focus shifted on penalizing the banks for different reasons altogether. The scandal had exposed the banking industry to be in serious danger from its own corrupt culture. But the authorities seem to have missed this inference when pronouncing punishments on rogue banks.

Could there have been alternate or additional punishments?

Authorities could have used a range of other civil enforcement actions like initiating cease-and-desist orders against the bank, removal of officers from their posts, revoking banks' deposit insurance etc. The major reason behind the discontent shown towards the punishments in the Libor case is the near absence of criminal prosecutions against individual bankers. There have been very few charges made against individual bankers to date and more importantly, no successful prosecution as yet. The reasons given behind the delay in initiating criminal proceedings against suspicious individuals were: (1) insufficient incriminating evidences, (2) improper co-ordination between multiple jurisdictions and (3) the innate complexity of the matter[7]. With the U.S. and U.K. enforcement agencies claiming good progress in collecting useful evidence against the involved individuals, we may see more criminal proceedings to be initiated in the coming future.

Criminal prosecution

In the U.K, criminally prosecuting individuals has been a difficult task for the authorities. The delay in prosecuting the involved bankers can be identified with deficiencies in the legal provisions. The details of the problem are as follows:

1. The authorities had the option of treating all the manipulations as a single whole considering it all as a one big conspiracy to defraud the market and then present the case for prosecutions. Such an arrangement would be difficult to establish in court as there are multiple parties involved with many different unconnected requests for change of submissions over different time frames. It would have been quite impractical for the authorities to follow on this plan of action[8].

[7]David Enrich and Jean Eaglesham for The Wall Street Journal Online, 'Criminal Cases Loom in Rate Rigging', June 2013 <http://online.wsj.com/news/articles/SB10001424127887324069104578529090178698664>12 August 2014.
[8] David Allan, 'Barclays' Libor Scandal –What charges may be brought?' (2012) 176 Criminal Law and Justice Weekly 428. <http://www.23es.com/wp-content/uploads/2012/07/DA-Barclays-Article.pdf> accessed 14 August 2014.

2. Midway down the time line of the manipulations, an interesting development took place with the Frauds Act coming into force in January 2006. This development gave the authorities a legal tool to deal with the violators in matters that happened after January 2006. In the matters that are covered by the Act, the authorities found Section 2 of the Act to be helpful as it dealt with 'fraud by misrepresentation'. The requirement under this section is to prove the 'fraud' involved a mis-representation of 'fact'. As the Libor submissions were estimates made by the submitters, the trick to counter this approach is to prove these estimates to be solid 'facts' instead[9].

3. For the manipulations that occurred before January 2006, *i.e* before the Frauds Act came into existence, the prosecution would have to consider other legal options from different statutes. Such options include: 'market abuse' under the Financial Services and Markets Act 2000 and 'obtaining pecuniary advantage by deception' under the Theft Act 1968. The problem with using these provisions to build their cases would be to prove some very difficult elements in the performance of the said crimes. Under the requirements of the provisions it would be difficult to prove a link between the requests made by the traders, the submissions made by the submitters and the profits that were generated as a result of these rigged submissions[10].

A contradictory viewpoint

While all that has been said above supports the most common perception and feelings towards the Libor punishments, there is a slightly contradictory view that needs to be discussed to complete a study on Libor punishments. Under this viewpoint, Libor rigging was as much a result of failure of regulators to perform their duties as it could be blamed on the banks and their lack of ethical values. The first point to make clear under this view is that no formal regulator was appointed for overseeing the process of setting of Libor. The Financial Services Authority (FSA) of the U.K did not have a clear mandate on the regulation of Libor. It could, therefore, be argued the FSA, despite receiving allegations of Libor rigging, could have been more occupied in dealing with the financial crisis than in investigating a phenomenon not strictly in its mandate of responsibilities[11]. The problem can, therefore, be sourced at the government's failure in division of responsibilities. There is

[9] Ibid
[10] Ibid
[11] Mark Scott for New York Times- DealBook, 'British Regulators Slow to Respond to Libor Scandal, Audit Says', March 2013 <http://dealbook.nytimes.com/2013/03/05/audit-faults-british-regulators-response-to-libor-scandal/?_php=true&_type=blogs&_r=0> accessed 13 August 2014.

evidence authorities in the U.S and U.K had indications to suspect manipulation of Libor as early as 2007 but the leads were not responsibly followed up[12]. In the light of these revelations it is as much possible the regulators had wilfully overlooked earlier allegations on the 'low balling' of the submissions. There was certainly callousness shown by the authorities in allowing a vulnerable process of Libor setting to exist in the first place. Additionally, if the authorities were overlooking suspicions on Libor rigging then a fair share of the blame should rest with these authorities as well. In the light of this argument would the high penalties put on the banks still be justified? Such arguments may tilt the balance of a debate on the adequacy of Libor punishments in favour of the banks. Yet, banks are supposed to be ethical in their dealings in the market. If banks wish to be treated as persons with rights, then they should act as persons with moral obligations.

Conclusion

The punishments are inadequate both in terms of quantity and quality. Since the penalties were restricted to fines alone they cannot qualify being termed 'punishments' in its popular meaning. Furthermore, the amounts levied as fines were insubstantial when compared to the profits the banks make annually. There is no surety the penalties will have any deterrence on the banks in preventing future instances of abuse of trust. A much more important issue of preserving and promoting an ethical culture in the financial sector should have been addressed and emphasised by the judiciary at this point. Neither the banks nor the regulators have come out openly to take responsibility and apologise for their mistakes, which leaves the matter morally unsettled[13]. If the banks are corrupt to their very core there is no reason to let them continue operating as they currently do. It would not only be a proper act to discipline the market but to also reinstate 'ethical values' in the heart of an otherwise blithe financial system.

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[12] Peter Gumbel for Time- Business, 'LIBOR Rigging: What the Regulators Saw (but Didn't Shut Down)', July 2012 <http://business.time.com/2012/07/16/libor-rigging-what-the-regulators-saw-but-didnt-shut-down/> accessed 13 August 2014.

[13] Gary Wright for Finextra.com, 'Responsibility and Accountability of the Libor Scanda', July 2012 http://www.finextra.com/blogs/fullblog.aspx?blogid=6767 accessed 14 August 2014.