I. *The LIBOR Scandal*

A. Introduction

The London InterBank Offered Rate ("LIBOR") is a leading financial benchmark, established in 1986, and used for an estimated $300 trillion worth of financial instruments.[1] On June 27, 2012, Barclays Bank ("Barclays") entered into a $360 million settlement with the United States Department of Justice ("DOJ") and the Commodity Futures Trading Commission ("CFTC") after Barclays attempted to manipulate LIBOR between 2005 and 2009.[2] Further, the United Kingdom's ("UK") Financial Services Authority ("FSA") fined Barclays $92.5 million for its attempted LIBOR manipulation.[3] Authorities have since expanded the investigation to include at least fifteen other banks.[4] On July 2, 2012, the UK Treasury appointed Martin Wheatley ("Wheatley"), the managing director of the FSA, to review LIBOR and evaluate options for reform.[5] On September 28, 2012, Wheatley released his findings in The Wheatley Review (the "Review") and determined that, although "broken," LIBOR can be reformed.[6]

This article outlines the current LIBOR framework, analyzes the Review's recommended LIBOR reforms, and discusses LIBOR's

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[1] Statement of Facts, U.S. Dept. of Justice and Barclays Bank PLC (June 26, 2012) [hereinafter DOJ and Barclays], *available at* http://www.justice.gov /iso/opa/resources/9312012710173426365941.pdf; Liam Vaughn, *Secret Libor Committee Clings to Anonymity Following Scandal,* BLOOMBERG (Aug. 21, 2012 8:53 AM), http://www.bloomberg.com/news/print/2012-08-20/secret-libor-committee-clings-to-anonymity-after-rigging-scandal.html.

[2] *Derivatives: Barclays to Pay U.S. Authorities $360M to Resolve Allegations in LIBOR Investigation*, 99 Banking Rep. (BNA) No. 11, 1 (July 3, 2012) [hereinafter BNA].

[3] *Id.*

[4] *Who Else is Under Investigation for Libor Manipulation?*, WALL ST. J. BLOG (July 9, 2012, 12:21 PM), http://blogs.wsj.com/deals/2012/07/09/ who-else-is-under-investigation-for-libor-manipulation/.

[5] Press Release, HM Treasury, The Wheatley Review (July 30, 2012) *available at* http://www.hm-treasury.gov.uk/press_68_12.htm#primary Content Full.

[6] Martin Wheatley, Managing Dir., FSA and CEO Designate, Fin. Conduct Auth. ("FCA"), Pushing the reset button on LIBOR, 1–2, (Sept. 28, 2012) [hereinafter Wheatley Speech], *available at* http://www.fsa.gov.uk/ library/communication/speeches/2012/0928-mw.shtml.

future. Part B will discuss how LIBOR is calculated, Part C will provide an overview of the LIBOR scandal and Barclays's attempted LIBOR manipulation, Part D will analyze The Wheatley Review's LIBOR reform recommendations, and Part E will discuss reactions to The Wheatley Review.

B. What is LIBOR and how is it regulated?

The British Bankers' Association ("BBA"), a UK trade association responsible for banking and financial services, created and oversees LIBOR.[7] The British government currently does not regulate LIBOR.[8] LIBOR "represents the lowest real-world cost of unsecured funding in the London market."[9] Financial institutions use LIBOR for various financial instruments including swaps, futures, options, student loans, mortgages, and credit cards.[10] The Foreign Exchange and Money Markets Committee ("FXMM") establishes the guidelines for calculating LIBOR and selects banks to serve on panels.[11] The FXMM selects contributor banks based on (1) "market activity"; (2) credit rating; and (3) expertise.[12] Panel sizes range from eighteen banks for the U.S. Dollar LIBOR to six for the Danish Krone. Barclays and at least one American bank serve on all ten panels.[13] The FXMM has been criticized for its "lack of transparency."[14] What is known about the FXMM is that it is composed of "highly experienced market participants," including

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[7] *About the BBA*, BBA LIBOR, http://bbalibor.com/about-the-bba (last visited Oct. 20, 2012); *Frequently Asked Questions (FAQs)*, BBA LIBOR, http://bbalibor.com/bbalibor-explained/faqs (last visited Sept. 23, 2012).
[8] MARTIN WHEATLEY, THE WHEATLEY REVIEW OF LIBOR: FINAL REPORT, 11 (2012) [hereinafter WHEATLEY REVIEW], *available at* http://cdn.hm-treasury.gov.uk/wheatley_review_libor_finalreport_280912.pdf.
[9] *The Basics*, BBA LIBOR, http://bbalibor.com/bbalibor-explained/the-basics (last visited Oct. 8, 2012).
[10] DOJ and Barclays, *supra* note 1, at 1.
[11] *The Basics*, *supra* note 9.
[12] *Id.*
[13] *Panels*, BBA LIBOR, http://bbalibor.com/panels (last visited Oct. 20, 2012).
[14] Vaughn, *supra* note 1 (stating FXMM's "lack of transparency is symptomatic of a self-regulated system that failed to stop traders around the world manipulating the world's most widely used benchmark interest rate for profit.").

officials from contributing banks.[15] The lack of information about FXMM's members is troubling because it precludes inquiries into whether the FXMM administers LIBOR "with complete objectivity and independence."[16]

Thomson Reuters, a financial data and news provider, acts as the LIBOR collection agent. Each business day, it collects the banks' answers to the following question: "At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 am?"[17] Once collected, the collection agent discards the highest and lowest 25% of submissions and averages the remaining submissions, in order to prevent individual banks from manipulating LIBOR.[18] Thomson Reuters conducts this process each business day to calculate LIBOR in ten currencies and for fifteen maturities "ranging from overnight to 12 month loans."[19] Importantly, banks should not base submissions on "the pricing of any derivative financial instrument," but rather on the banks' cash.[20] Banks often tie derivatives contracts to LIBOR, which creates an incentive for banks to submit false rates to move LIBOR in their favor.[21]

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[15] *Foreign Exchange and Money Markets Committee*, BBA LIBOR, http://www.bbalibor.com/governance/foreign-exchange-and-money-markets-committee (last visited Oct. 20, 2012).

[16] MARTIN WHEATLEY, THE WHEATLEY REVIEW OF LIBOR: INITIAL DISCUSSION PAPER, 16 (2012), *available at* http://www.hm-treasury.gov.uk/d/condoc_wheatley_review.pdf.

[17] *The Basics*, *supra* note 9.

[18] *Id*.

[19] *See id.* (describing the collection and publication process); *Frequently Asked Questions (FAQs)*, *supra* note 7 (stating currencies include Pound Sterling, US Dollar, New Zealand Dollar, Japanese Yen, Swiss Franc, Canadian Dollar, Euro, Danish Kroner, Swedish Kroner, Australian Dollar and maturities include overnight, one week, two weeks, and 1–12 months).

[20] DOJ and Barclays, *supra* note 1, at 3.

[21] FSA Final Notice to Barclays Bank PLC., Ref. No. 122702, 9 (June 27, 2012) [hereinafter Barclays FSA Notice], *available at* http://www.fsa.gov.uk/static/pubs/final/barclays-jun12.pdf.

C. The Scandal

The Barclays investigation revealed two types of LIBOR manipulation.[22] The first involved requests to manipulate rates for the benefit of derivatives traders.[23] The second involved submitting false rates during the financial crisis to protect Barclays's reputation.[24]

1. Requests to Manipulate Rates for the Benefit of Derivatives Traders

Between 2005 and 2009, Barclays derivatives traders attempted to manipulate LIBOR by requesting that submitters submit rates that would "benefit the traders' trading positions," instead of rates that conformed to the LIBOR definition.[25] Submitters complied with at least 70% of requests to submit false rates made by Barclays traders from January 3, 2006 to August 6, 2007.[26] Additionally, Barclays sent and complied with interbank requests for LIBOR manipulation.[27] While Barclays's manipulation of LIBOR rates internally raises concerns, the interbank collusion poses a greater threat since the likelihood of successfully manipulating LIBOR increases when "part of a coordinated effort."[28] Further, former Barclays employees made at least twelve of the requests to submit false rates.[29] In all, Barclays traders colluded with external traders to manipulate LIBOR rates on "days on which Derivatives Traders stood to benefit."[30] While the impact of Barclays's manipulation remains unclear, at the very least the manipulation benefitted

[22] *The LIBOR Scandal: The Rotten Heart of Finance*, ECONOMIST, July 7, 2012, at 4–5, *available at* http://www.economist.com/node/21558281.
[23] Janet Paskin, *'Who's Going to Put My Low Fixings In?'—Highlights from the Barclays Emails,* WALL ST. J. BLOG (June 27, 2012, 1:29 PM), http://blogs.wsj.com/deals/2012/06/27/whos-going-to-put-my-low-fixings-in-highlights-from-the-barclays-emails/.
[24] *The LIBOR Scandal: The Rotten Heart of Finance*, *supra* note 22, at 5.
[25] DOJ and Barclays, *supra* note 1, at 5.
[26] Barclays FSA Notice, *supra* note 21, at 14.
[27] DOJ and Barclays, *supra* note 1, at 10.
[28] *Id.*
[29] Barclays FSA Notice, *supra* note 21, at 19.
[30] *Id.* at 20 (describing the ways traders "co-ordinated with external traders").

Barclays traders by reducing "their losses, to the detriment of counterparties."[31]

2. Manipulation of Rates During the Financial Crisis to "Protect Barclays's Reputation"

Barclays also attempted to manipulate LIBOR by submitting "dishonestly low estimates of bank borrowing costs" leading up to and during the financial crisis in 2008.[32] Since LIBOR represents the cost at which banks can borrow funds, some market participants interpret LIBOR submissions as reflective of financial health.[33] Thus, higher submissions may signal that the bank is experiencing "liquidity problems."[34] From August 2007 to January 2009, Barclays submitted low LIBOR estimates to quell concerns about Barclays's financial health.[35] Further, after receiving negative publicity, Barclays management ordered submitters to submit estimates that fell within the top 25% but were not high enough to "draw attention to the bank."[36] During this time, some Barclays employees attempted to alert the BBA and FSA that banks were submitting dishonestly low rates.[37]

Moreover, some regulators apparently knew of and condoned the LIBOR manipulation.[38] On October 29, 2008, a Barclays manager spoke with Bank of England ("BOE") executive Paul Tucker and Barclays managers subsequently interpreted the conversation as an instruction by the BOE to "lower Barclays's LIBOR submissions."[39] Further, Timothy Geithner, then president of

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[31] DOJ and Barclays, *supra* note 1, at 14 (describing the impact that Barclays's attempted manipulation had).
[32] *The LIBOR Scandal: The Rotten Heart of Finance*, *supra* note 22, at 5.
[33] DOJ and Barclays, *supra* note 1, at 15.
[34] *Id.* at 15.
[35] *Id.*; *The LIBOR Scandal: The Rotten Heart of Finance*, *supra* note 22, at 6.
[36] DOJ and Barclays, *supra* note 1, at 15; *The LIBOR Scandal: The Rotten Heart of Finance*, *supra* note 22, at 7.
[37] DOJ and Barclays, *supra* note 1, at 18 (stating Barclays employees raised concerns that "the Dollar LIBOR fixes were too low and did not accurately reflect the market.").
[38] *Id.* at 21–22.
[39] *Id.*at 22; *The LIBOR Scandal: The Rotten Heart of Finance*, *supra* note 22, at 7.

the New York Federal Reserve, contacted BOE in June 2008 expressing concerns about the reliability of LIBOR and presenting his suggestions for improving "the rate-setting process."[40]

D. The Wheatley Review

While it remains unclear exactly what is needed to reform LIBOR and restore trust in the benchmark, Wheatley released the Review, on September 28, 2012, outlining his recommendations.[41] The review provides a "ten-point plan" for reform including regulations, reform of the submission process, new guidelines for contributing banks, and immediate changes to LIBOR.[42] Ultimately, the Review concluded LIBOR should be reformed, not replaced.[43]

1. Regulation of LIBOR

First, the Review recommended that "administering LIBOR" and LIBOR submissions be regulated under the Financial Services and Market Act 2000 ("FSMA") Order 2001[44] because the incentives to tamper with LIBOR submissions result in frequent misconduct.[45] LIBOR regulation will encompass LIBOR submissions, calculations, and publication.[46] The Review suggested regulation of LIBOR is needed to give the FSA the power to penalize violating businesses, providing "a powerful," but currently lacking, incentive for compliance.[47] The FSA will designate submission and administration

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[40] Melissa Lipman, *Geithner's Role in Libor Emerges Amid Lawmakers' Push*, LAW 360 (Sept. 17, 2012, 12:09 PM), http://www.law360.com.ezproxy.bu.edu/articles/359881/print?section=banking.
[41] Wheatley Speech, *supra* note 6; Halah Touryalai, *Will New Libor Rules Prevent Rate-Rigging?*, FORBES (Sept. 28, 2012, 3:10 PM), http://www.forbes.com/sites/halahtouryalai/2012/09/28/will-new-libor-rules-prevent-rate-rigging/.
[42] WHEATLEY REVIEW, *supra* note 8, at 8 (outlining the main points for successful reformation of LIBOR).
[43] *Id.* at 7.
[44] *See Do I Need to Be Authorised?*, FINANCIAL SERVICES AUTHORITY, http://www.fsa.gov.uk/doing/do (last visited Nov. 14, 2012) (stating the "FSMA is concerned with the regulation of financial services and markets in the UK.").
[45] WHEATLEY REVIEW, *supra* note 8, at 11–12.
[46] *Id.* at 13.
[47] *Id.* at 12.

managers as "controlled functions" to promote individual accountability and ensure that only "fit and proper" individuals, unlike under the current LIBOR framework, fill these management positions.[48] Additionally, the FSA will have the power to fine institutions and individuals that violate LIBOR regulations, which will increase confidence in the LIBOR framework because violations "will not be left unseen or unpunished."[49]

2. "Strengthening Institutions and Governance" of LIBOR

Second, the Review identified three weaknesses in the current LIBOR framework: (1) inadequate "independence of governance structures"; (2) insufficient oversight; and (3) "limited transparency and accountability."[50] Significantly, the Review concluded the BBA should cease its involvement in the LIBOR process because its close ties with contributor banks hinder its ability to credibly administer the benchmark.[51] The BBA agreed to relinquish "responsibility for LIBOR" based on the Review's recommendation, and it has announced it will immediately begin the process of selecting a private organization to administer LIBOR.[52] The new LIBOR administrator should exhibit interests distinct from contributor banks. In particular, the administrator should develop specific ideas for oversight practices and for processes promoting transparency and accountability, and focus on "fair and non-discriminatory" access to LIBOR.[53] Further, the administrator must examine and analyze all LIBOR submissions for manipulation and

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[48] *Id.* at 13–14; *See* Wheatley Speech, *supra* note 6 ("These powers [regulation] will allow the FSA to approve key individuals for these roles, ensuring that they are fit and proper to perform the job, something which is clearly lacking in the present system.").

[49] WHEATLEY REVIEW, *supra* note 8*,* at 15; *See* Wheatley Speech, *supra* note 6.

[50] WHEATLEY REVIEW, *supra* note 8, at 21.

[51] *Id.* ("[T]he BBA acts as the lobby organization for the same submitting banks that they nominally oversee, creating a conflict of interest that precludes strong and credible governance.").

[52] Press Release, British Bankers Association, BBA Statement on Wheatley Review of Libor (Sept. 25, 2012), http://www.bbalibor.com/news-releases/bba-statement-on-wheatley-review-of-libor; WHEATLEY REVIEW, *supra* note 8, at 21.

[53] WHEATLEY REVIEW, *supra* note 8, at 22.

refer irregular submissions to the independent oversight committee ("Committee").[54] Moreover, the administrator will be responsible for developing standards for banks seeking to join panels and the protocol for LIBOR submissions.[55]

The reformed framework also requires the creation of an independent oversight committee to restore credibility to the submission process and ensure representation of non-panel banks in the oversight process.[56] The Committee will define LIBOR, analyze submissions, and create a code of conduct for all parties involved in the LIBOR setting process.[57] Unlike the FXMM, the Committee will increase transparency by publishing the names of members, "declarations of conflicts of interest," and minutes of meetings.[58] A code of conduct, which the Committee and administrator will create, will formalize the submission process and establish internal procedures to prevent LIBOR manipulation. The code will further require that contributing banks keep "accurate and accessible records of transactions in inter-bank deposits" and that institutions utilize external audits to increase the credibility of submissions.[59]

3. Immediate Reforms to LIBOR

Third, the Review suggested immediate reforms to LIBOR including delaying the publication of rates, reducing the number of indexes published, and increasing panel sizes.[60] Since LIBOR "continues to function," these immediate measures serve as temporary solutions until the new administrator and UK regulators can implement the Review's long term recommendations for "comprehensive" LIBOR reform.[61] While the BBA published LIBOR daily to foster transparency and accountability, in practice it incentivized banks to submit false rates.[62] In order to reduce the

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[54] *Id.* at 24 (including "pre-publication verification checks, to avoid manifest errors in submissions, as well as post-publication scrutiny against a set of verifiable statistics . . .").
[55] *Id.*
[56] *Id.* at 25.
[57] *Id*.
[58] *Id.*
[59] *Id.* at 31–33.
[60] *Id.* at 35.
[61] Wheatley Speech, *supra* note 6.
[62] WHEATLEY REVIEW, *supra* note 8, at 37.

banks' ability to predict how submissions will affect the LIBOR rate, the Review recommended that publication of submissions be immediately delayed for "at least 3 months."[63] Further, since submissions must be "supported by transaction data" when possible, some of the 150 LIBOR indexes will no longer be published.[64] The Review recommended that over the next year, the publication of indexes lacking transaction data cease and the administrator reduce the total number of indexes published to twenty.[65] Additionally, the Review emphasized that maintaining relatively large panels increases the overall "accuracy and credibility" of LIBOR, because large panels reduce the impact any one bank can have on the LIBOR rate and increase the "representativeness" of LIBOR.[66] Bank participation on LIBOR panels is essential because otherwise, LIBOR "would eventually fail, leading to major implications for banks, institutions and financial markets."[67]

E. Reaction to the Wheatley Review

While the Review has received largely positive reactions, some question whether the suggested reforms are practicable. Though adequate in many respects, the Review leaves open the potential for LIBOR manipulation in strained financial situations when "banks do not lend to each other."[68] Although the Review suggests that submissions be based on actual data, it provides the option of using "expert judgment" when data is unavailable, the very situation that allowed for false submissions.[69] CFTC Chairman Gary Gensler has been a zealous advocate for replacing LIBOR with a

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[63] *Id.* at 38.
[64] *Id.* at 35–37.
[65] *Id.* at 36–37 (stating publication of "Australian Dollars, Canadian Dollars, Danish Kroner, New Zealand Dollars, and Swedish Kroner should be discontinued." Publication of LIBOR for 4–8, 10, and 11 months should stop, and publication of overnight, 1–2 weeks, 2 and 9 months "should also be re-considered.").
[66] *Id.* at 38.
[67] *Id.*
[68] Evan Weinberger, *Proposed Libor Fixes May Open Door To New Benchmark*, LAW 360 (Sept. 28, 2012, 06:14 PM), http://www.law360.com/articles/382575.
[69] Tim Worstall, *The Libor Reform That Doesn't Reform Libor Enough*, FORBES (Sept. 30, 2012, 11:34 AM), http://www.forbes.com/sites/timworstall/2012/09/20/the-libor-reform-that-doesn't-reform-libor-enough/.

new benchmark, specifically one that is "anchored in actual, observable market transactions."[70] Many argue the only way to create a benchmark that cannot be manipulated is to use a "market-based rate."[71]

While there does not currently appear to be a clear alternative to LIBOR, the Review provides some guidance on the criteria a viable alternative should meet.[72] LIBOR alternatives should include maturity curves for a wide range of maturities; be durable; have a "liquid underlying market"; utilize sufficient transaction data; be "transparent, simple and standardised"; and when possible feature a "historical time series."[73] Two suggested alternatives to LIBOR are overnight index rates ("OIR") and overnight index swaps ("OIS").[74] However, since the credit risk for both OIR and OIS is small, "they are not a direct substitute to LIBOR."[75] Another possible alternative is the GCF Repo Index, which is based on real "rates paid for repurchase agreements" ("repos").[76] However, repos may not be a feasible alternative either because they inadequately "reflect bank credit risk."[77] Finally, Bloomberg L.P., a financial data and analytics provider, has proposed its own proprietary alternative to LIBOR, called "Blibor." "Blibor" uses two types of data to offset the reduction in interbank transactions.[78] The first type of data is the estimated interbank borrowing rate.[79] The second type of data is "market-based quotes for credit default swap transactions, corporate bonds, commercial paper, and other sources of credit information."[80] The "Blibor" benchmark would combine estimates of interbank

[70] Ben Protess, *Gensler Calls for Overhaul of Libor*, N.Y. TIMES DEALBOOK (Sept. 24, 2012, 11:30 AM), http://dealbook.nytimes.com/2012/09/24/gensler-calls-for-overhaul-of-libor/.
[71] Weinberger, *supra* note 68.
[72] WHEATLEY REVIEW, *supra* note 8, at 46.
[73] *Id.* at 46–47.
[74] *Id.* at 47–48 ("The markets for overnight unsecured lending are fairly developed and liquid.").
[75] *Id.* at 48.
[76] Katy Burne & Matt Phillips, *Lining Up Libor Alternatives*, WALL ST. J., July 3, 2012 at C2.
[77] WHEATLEY, *supra* note 8, at 50 (discussing why repos are not a substitute for LIBOR).
[78] Daniel L. Doctoroff, *A Market Alternative to Libor*, WALL ST. J., Aug. 3, 2012, at A11.
[79] *Id.* ("The first input would follow the current LIBOR approach.").
[80] *Id.*

borrowing with "banks' real cost of credit," thereby creating an accurate and credible alternative to LIBOR.[81]

F. Conclusion

On October 17, 2012, Greg Clark, the Financial Secretary to the Treasury, confirmed the UK would implement the recommendations laid out in the Review entirely.[82] The UK government will focus on amending the Financial Services Bill to allow government regulation of LIBOR.[83] Further, the Financial Stability Board, the International Organisation of Security Commissioners, and other international regulators have begun the process of evaluating the use and integrity of "all major global benchmarks."[84] Although the future of LIBOR remains unclear, the Review serves as the first step toward restoring public trust and maintaining LIBOR integrity.

Kristen Dooley[85]

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[81] *Id.* ("Blibor will achieve accuracy and independence without recourse to potentially stultifying government regulations.").
[82] Press Release, Greg Clark, Fin. Sec'y to the Treasury, HM Treasury, Wheatley Review of LIBOR, 2 (Oct. 17, 2012), *available at* http://www.hm-treasury.gov.uk/d/wms_fst_171012.pdf.
[83] *Id*.
[84] *Id.* at 3.
[85] Student, Boston University School of Law (J.D. 2014).