# The British Government's Response to LIBOR Manipulation Takes Shape

By David Kovel

LIBOR (the London Interbank Offered Rate) is the world's primary benchmark for short-term interest rates, providing the settlement rate for well over $300 trillion in financial products of various types. Despite its importance, it is administered by an unregulated trade association and based on unverified quotes provided by banks whose financial interest is tied to the benchmark. These structural vulnerabilities, which have allowed for the manipulation of LIBOR, are only now being changed in an attempt to limit the benchmark's susceptibility to manipulation.

Since its inception in 1986, LIBOR has been published by Thompson Reuters in 10 currencies for 15 different maturities under the auspices of the British Bankers' Association (BBA), a London-based bank trade association. To calculate LIBOR, the BBA provides Thompson Reuters with daily submissions of interbank unsecured borrowing rates by representative panels of its member banks, organized by currency.

U.S. Dollar LIBOR has been derived only from a select panel of 16–18 of the world's largest BBA members and is the average of their middle eight submissions. The BBA requires that each submission represent the daily borrowing rate for that particular bank for unsecured funds in the London interbank market prior to 11 a.m. A bank's submitted rate should be determined without reference to the bank's trading book or any other bank's submission. The submission process is unsupervised and honor-based.

Beginning in mid-2012, international regulators revealed that, as early as 2005, some LIBOR submitting banks had manipulated LIBOR for at least two reasons. First, submitting banks had misrepresented their U.S. Dollar LIBOR rates in an effort to appear more robust than they actually were during the financial crisis. Second, some submitters had systematically manipulated LIBOR of various currencies, often in collusion, to advantage their trading positions. In June 2012, Barclays agreed to a $450 million settlement of claims brought by British and U.S. regulators for both varieties of LIBOR manipulation. On December 19, 2012, international authorities fined UBS $1.5 billion on similar grounds.

Although some efforts to reform the LIBOR process had begun in 2008, the BBA silenced these efforts by endorsing the benchmark's validity. However, after the revelations of LIBOR manipulation from the Barclays settlement, British authorities began an independent regulatory review. The review, known as the Wheatley Review, recommends greater transparency and a new independent regulatory committee to oversee submissions. It further recommends that submissions be derived from a larger pool of banks and be based on actual interbank transactions, rather than discretionary estimates. The number of published currencies and maturities would be reduced from 150 to 20, making estimates less likely. Further, there would be greater record-keeping requirements, publication of submissions after three months, and the establishment of criminal sanctions for manipulations of LIBOR.

The British government has accepted the recommendations in full, and they are expected to take effect in April or May 2013. It remains to be seen whether these structural changes will reduce the ability of unscrupulous submitters to rig the system.❖

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