DISCUSSION CASE: The LIBOR Scandal: Is It Ok If Everyone Does It?

On June 27, 2012, as part of a U.S. Department of Justice Investigation, Barclays Bank admitted to manipulating and reporting fraudulent interest rates used in international financial markets. Barclays, a multinational financial services and banking firm headquartered in London, was fined more than $450 million dollars (U.S.) by both U.K. and U.S. regulators. Evidence showed that Barclays had regularly manipulated the LIBOR (London InterBank Offered Rate) since at least 2005, in order both to profit from large trades and to falsely portray the bank as financially stronger than it was.

The LIBOR is the rate at which major London banks report that they are able to borrow. This rate then serves as the benchmark at which interest rates are set for countless other loans, ranging from credit cards to mortgages and interbank loans. It also acts as a measure of market confidence in the bank; if a bank must pay a higher rate to borrow than others do, then markets must have less confidence in the institution's financial strength.

The LIBOR is established in a surprisingly simple manner. Each morning at 11 a.m. London time, members of the British Bankers Association (BBA) report to the financial reporting firm of Thomson Reuters the rates at which they would expect to pay for loans from other banks. Discarding the highest and lowest quartiles, Thomson Reuters then calculates a daily average, which becomes the daily LIBOR benchmark. Within an hour, Thomson Reuters publicizes this average worldwide, along with all of the individual rates reported to them. This benchmark is then used to settle short-term interest rates as well as futures and options contracts. By one estimate, the LIBOR is used to set interest rates for global financial transactions worth more than $500 trillion. The individual rates also provide an indirect measure of the financial health of each reporting institution—the lower their rates, the stronger their financial position.

Evidence shows that as early as 2007, before the major financial collapse of Lehman Brothers and the economic meltdown that followed, regulators in both the United States and the United Kingdom were aware of allegations that Barclays was underreporting their rates. In the early days of the 2008 financial collapse, the *Wall Street Journal* published a series of articles questioning the integrity of LIBOR reporting and suggested that banks were intentionally misreporting rates to strengthen public perception of their financial health. Timothy Geithner, U.S. Secretary of Treasury under President Obama, acknowledged that in 2008 when he was chairman of the New York Federal Reserve Bank, he recommended that British regulators change the process for setting the LIBOR. In testimony to the U.S. Congress in July 2012, Geithner said "We were aware [in 2008] of the risks that the way this was designed created not just the incentive to underreport, but also the opportunity to underreport."

Internal documents and e-mails showed that traders, compliance officers, and senior management at Barclays were aware of and approved the underreporting. An e-mail sent from a Barclays employee to his supervisor in 2007 said: "My worry is that we are being seen to be contributing patently false rates. We are therefore being dishonest by definition and are at risk of damaging our reputation in the market and with the regulators. Can we discuss urgently please?"

Evidence also showed that Barclays employees were in regular communication with traders who would explicitly ask that Barclays report specific higher or lower rates in order to benefit their trades. For example, Derivative traders, who would stand to gain or lose millions of dollars depending on the rate, would communicate directly with their Barclays banking contacts and request that certain rates be reported. The tone of their communication demonstrates the familiarity that existed between these parties: "Dude. I owe you big time! . . . I'm opening a bottle of Bollinger," wrote one trader to his Barclays contact. "Pls set 3m libor as high as possible today," wrote another. Yet another, "Dude, what's up with ur guys . . fix this . . .tell him to get it up!

Investigations into the LIBOR scandal showed widespread intentional fraud among many individual employees and executives at Barclays. But from the earliest days of the scandal, allegations were being made that other banks were equally involved. While admitting guilt, Barclays denied that they were the only bank involved in misreporting data. In a recorded interview, one Barclays employee told investigators that "We did stick our head above the parapet last year, got it shot off, and put it back down again. So, to the extent that, um, the Libors have been understated, are we guilty of being part of the pack? You could say we are. . . . Um, so I would, I would sort of express us maybe as not clean clean, but clean in principle." In a conversation between a senior executive at Barclays' and a representative of the British banking Administration, which was reported by the U.S. investigation, the Barclays employee defended the bank, saying "We're clean, but we're dirty-clean, rather than clean-clean."

The BBA representative responded: "No one's clean-clean."

By the end of August 2012, the investigation had spread to include allegations of fraudulent LIBOR reporting by HSBC and royal bank of Scotland, the two other largest banks in the United Kingdom, as well as more than a dozen other international banks.

The scandal even spread to the British government. Barclays CEO Bob Diamond testified that at the height of the financial collapse in fall 2008, he received a call from Paul Tucker, deputy governor of the Bank of England. According to Diamond, Tucker called on behalf of "senior Whitehall" figures and put pressure on Mr. Diamond to lower his reported LIBOR rates. The allegation is that the higher rates would undermine confidence in Barclays at a time that financial markets needed boosting, and it increased the likelihood that the British government would need to bail out Barclays as it already had done for other failing banks. Mr. Tucker claims that he was misunderstood by Mr. Diamond.

DISCUSSION QUESTIONS

1. What ethical issues are involved in this case?
2. Who are the stakeholders in this case? Who would be hurt by rate fixing?
3. What responsibilities did senior executives at Barclays have to prevent fraud in circumstances that, in Timothy Geithner's words, "created not just the incentive to underreport, but also the opportunity to underreport"?
4. If the LIBOR scandal is as widespread as ongoing investigations suggest, are there ethical issues involved in this case that are different from those that would be involved if only Barclays was guilty? What are they?
5. Who is responsible for the ethical integrity of such institutional practices as the LIBOR? Is anyone at fault for this fraud other than the individuals involved in reporting false information?