INTERNATIONAL ASSOCIATION OF YOUNG LAWYERS

Banking in the crosshairs: Investigations by financial regulators and competition authorities in the banking industry – Libor, Forex, what next?

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Certain episodes of benchmark manipulation (Libor, Forex, etc) have generated global doubt and concern with regard to the integrity of many benchmarks, undermining the integrity of the system and legal and commercial certainty, and resulting in major losses for investors.

1. **Have the authorities from your jurisdiction proposed or adopted any measures to ensure the necessary integrity of the market and of its benchmarks, guaranteeing that they are not distorted by any conflict of interest, that they reflect economic reality and that they are used correctly? (i.e.: measures better to protect investors, reinforce confidence, address unregulated areas, and/or to ensure that supervisors are granted adequate powers to fulfil their tasks)**

Following the London Interbank Offered Rate (**"LIBOR"**) fixing scandal of 2012, and related investigations into LIBOR which started around 2009, the authorities in the United Kingdom (**"UK"**) have adopted a number of measures to ensure the integrity of the market and its benchmarks.

The Wheatley Review

In July 2012 the Chancellor of the Exchequer commissioned an independent review into the structure and governance of LIBOR and the corresponding criminal sanctions regime. This review was conducted by Martin Wheatley, managing director of the Financial Services Authority (the **"FSA"**) at the time and now Chief Executive of the Financial Conduct Authority (the **"FCA"**), the successor to the FSA. The Wheatley Review of LIBOR was published in September 2012 and made various recommendations about how LIBOR could be improved and greater controls could be implemented to prevent the future distortion of benchmarks. The UK Government promptly accepted all of the recommendations in the Wheatley Review and implemented legislation to bring the recommendations into effect.

Changes to primary legislation

The Financial Services Act 2012 (the **"FS Act"**) extended the scope of the UK's financial services regulatory regime to cover certain activities relating to specified benchmarks. As a consequence, any person who provides information in relation to, or administers, a specified benchmark will be carrying on a regulated activity in the UK under the Financial Services and Markets Act 2000 (**"FSMA"**) and will need to be authorised by the FCA.

In addition, the FS Act inserted a new section into FSMA which makes it a criminal offence to knowingly or deliberately make false or misleading statements in relation to relevant benchmarks.

Regulated benchmarks in the UK

At present, the only specified or relevant benchmark in the UK is LIBOR. However, a further seven benchmarks will be brought within the scope of the UK's new regime from 1 April 2015 following recommendations from the ongoing Fair and Effective Markets Review, about which more details are given below. The seven additional benchmarks are:

- **WM/Reuters London 4pm Closing Spot Rate**, being the dominant global foreign exchange benchmark.
- **London Gold Fixing** and the **LBMA Silver Price**, which determine the price of gold and silver in the London market.
- **ISDAFIX**, being the principal global benchmark for swap rates and spreads for interest rate swap transactions.
- **SONIA** (Sterling Overnight Index Average) and **RONIA** (Repurchase Overnight Index Average), which both act as reference rates for overnight index swaps.
- **ICE Brent Index**, traded on the ICE Futures Europe (IFEU) exchange, which acts as the crude oil futures market's principal financial benchmark.

Amendments to the FCA's rules

As a result of the increased scope of regulation, the FCA also had to amend its Handbook of Rules and Guidance (the **"FCA Rules"**). In particular, the FCA inserted a new chapter into its Market Conduct Handbook (**"MAR"**), which sets out organisational and governance requirements for regulated benchmark administrators and benchmark submitters. More information on the new rules in MAR is set out in the response to Question 5 below.

MAR imposes enhanced requirements on benchmark submitters, requiring them to have effective conflict management procedures in place, as well as requiring them to notify the FCA immediately should they suspect any manipulation of benchmarks. Benchmark administrators must appoint a benchmark administration manager, establish an oversight committee and make daily reports to the FCA on the data which underlies the benchmarks it sets.

The Fair and Effective Markets Review

The Bank of England is also carrying out its Fair and Effective Markets Review which is intended to reinforce confidence in the fairness and effectiveness of wholesale financial market activity conducted in the UK. This review adopts a wide approach and will cover various aspects of the fixed income, currency and commodities markets, and will make suggestions on how to promote fairness and improve standards across the financial services sector, including in the setting of benchmarks. A consultation paper was released in October 2014 outlining the approach which the review will take and the final review will be published in June 2015.

European legislative proposals

As many will be aware, the European Commission is also currently considering legislation to regulate the setting of financial benchmarks at a European level. It is possible that the EU legislation will further increase the scope of the UK's regulatory framework in relation to benchmarks.

2. **Which authority monitors financial bodies in your jurisdiction?**

From 1 April 2013, the UK financial services regime has operated under a tri-partite system. The key regulatory authorities are:

- **The Financial Policy Committee (FPC)**, which is a committee of the Bank of England and is generally responsible for identifying and monitoring systemic risks to the UK financial system and utilising new tools with the aim of preventing financial crises in the future. It is able to direct the PRA and the FCA on matters relating to these issues.

- **The Prudential Regulation Authority (PRA)**, which is responsible for the prudential regulation of (broadly) those financial institutions deemed to pose a systemic risk to the stability of the UK financial system, namely banks, insurance companies and the largest investment firms.

- **The FCA**, which is responsible for the conduct of business and prudential regulation of all other authorised firms, as well as the conduct of business of those firms that are regulated by the PRA (for prudential purposes).

The Treasury and Bank of England also have important roles to play in the UK financial services industry.

In relation to the various benchmark manipulation scandals, the FCA has generally led on the investigations into market participants' conduct. This is partly because the FCA has an overall statutory objective to ensure markets work well. It is also because the FCA has wide powers to penalise banks in the UK, many of which are implicated in allegations of manipulating benchmarks. The FCA was the authority best placed to investigate and enforce sanctions and this was enhanced by its CEO's role in preparing the Wheatley Review. Since benchmarks are used in a wide range of markets for reference purposes – to determine sums payable in relation to investments, the price at which investments are bought or sold or to measure the performance of investments, for example – tackling benchmark manipulation falls squarely within the FCA's remit. However, the FCA has not acted alone. It has worked in conjunction with other international regulatory authorities and national authorities, such as the UK Treasury, the Bank of England and the UK Serious Fraud Office (**"SFO"**), the latter of which has brought a number of criminal cases against individuals involved in the LIBOR rigging scandal.

3. **[For EU and EFTA member states] has your country completed the transposition of Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments ("MiFID II")? If not, when will transposition be completed?**

Transposition has not yet been completed, however the industry and UK regulators have already started discussions concerning the implementation of MiFID II. It is expected that MiFID II will be implemented in the UK in accordance with the EU timetable by early 2017. The proposed legislation and rules which will implement MiFID II into UK law are expected to be published by the Treasury and the FCA for consultation and discussion imminently. However the final UK national rules are not expected until 2016.

4. **Have the authorities in your jurisdiction conducted any inquiry on leading banks or institutions in relation [to] anti-trust practices with regard to essential financial information and/or the clearing system?**

The authorities in the UK have not approached the manipulation of benchmarks from an anti-trust or competition perspective. Instead the FCA has focused on targeting any bank which has been involved in fixing financial benchmarks. Due to the wide nature of the FCA's jurisdiction and powers, it has been possible for the FCA to impose fines for benchmark manipulation for breaches of the FCA's Principles for Businesses. Under these rules, firms must comply with certain standards of conduct. So far, FCA fines for benchmark manipulation have been based on firms breaching these standards. Examples of breaches include not taking reasonable care to organise and control their affairs responsibly with adequate risk management systems and failing to observe proper standards of market conduct.

However, the EU Competition Commission has issued fines amounting to a total of €1.7bn for engaging in illegal cartels related to benchmark interest rates. The fines included various discounts for co-operation and for agreeing to settle and the whistle blowers avoided fines altogether. This was one of Europe's quickest cartel settlements (the case opened and settlements were reached within a year). Certain banks did not settle and therefore remain under investigation. The EU Commission findings may open the door for potential damages "follow on" actions under domestic English competition law. Under English law, the EU Commission infringement decisions are binding on UK Courts thereby establishing liability leaving damages to be proved. However, the evidential hurdles for establishing causation/loss may still prove high.

5. Which new requirements have been established in order to reinforce governance and oversight and to introduce measures sanctioning those responsible for LIBOR and other index manipulation?

As noted in the response to Question 1 above, the UK has implemented various new requirements to reinforce governance and oversight, as well as introducing measures sanctioning those responsible for benchmark manipulation.

Reinforcing governance and oversight

The FCA's rules in MAR are one example of how the UK's new requirements reinforce governance and oversight. These rules impose new requirements on benchmark administrators and benchmark submitters.

a. Benchmark administrators

Benchmark administrators are required to:

- implement credible governance and oversight measures. This includes an oversight committee and the establishment of practice standards to ensure robust administration of the benchmark;
- monitor, scrutinise and keep records of benchmark submissions to identify breaches of practice standards and/or potentially manipulative behaviour and to ensure a proper audit trail;
- maintain sufficient financial resources to ensure the administrator can cover operating costs for up to nine months to ensure viability and continuity of benchmarks; and
- provide to the FCA, on a daily basis, all benchmark submissions it has received relating to the benchmark it administers.

The oversight committee must comprise representatives of benchmark submitters, market infrastructure providers, users of the specified benchmark and at least two non-executive directors of the benchmark administrator. The oversight committee has powers of review and must develop a published code of practice for use within the benchmark administrator. These measures are intended to reinforce governance and oversight over benchmarks in the UK.

b. **Benchmark submitters**

Benchmark submitters are required to:

- maintain adequate and effective governance over the process of making benchmark submissions, including having appropriate oversight of the submission process and periodic internal reviews;
- appoint a benchmark manager with responsibility for compliance with the whole of chapter 8.2 of MAR;
- ensure that its benchmark submissions are determined using an effective methodology and review that methodology at least every quarter to ensure its data are credible and robust;
- notify the FCA without delay if it suspects any person is manipulating or attempting to manipulate a benchmark, or if any person is colluding in the manipulation of a benchmark;
- keep records about its benchmark submissions and the data behind those submissions for at least five years; and
- appoint an independent auditor to report to the FCA on their compliance with the requirements of 8.2 of MAR.

Sanctions for benchmark manipulation

Now that activities relating to certain benchmarks are regulated by the FCA, any authorised firm which breaches the FCA Rules may face a raft of sanctions, from private to public censure, financial penalties and ultimately having their permission cancelled. Individuals could also face regulatory action, which typically results in personal fines and/or bans from the UK financial services industry.

As noted above, it is now also a criminal offence under FSMA to knowingly or deliberately make false or misleading statements in relation to relevant benchmarks. The penalties for breach of this provision of FSMA can lead to up to seven years' imprisonment and/or a fine.

6. Has any similar scandal-malpractice affected your jurisdiction? Have penalties been imposed? and/or administrative or criminal sanctions? If not, which sanctions are foreseen in your jurisdiction for this type of misconduct?

The LIBOR and other scandals have directly impacted the UK financial services industry. Regulators have taken action, criminal cases have been brought against individuals and even civil actions by companies against certain firms involved.

Regulatory fines and sanctions

Some of the penalties and sanctions imposed by the FCA and its predecessor organisation, the FSA, to date are given below:

- On 27 June 2012, the FSA fined Barclays Bank £59.5m for misconduct relating to LIBOR and the European Interbank Offer Rate (**"EURIBOR"**), including making benchmark submissions in order to attempt to benefit its own trading submissions and failing to have adequate systems and controls in place.
- On 19 December 2012 UBS AG was fined £160m by the FSA for, amongst other offences, manipulating various LIBOR and EURIBOR currencies during 2008 and, prior to then, for improperly having regard to the profitability of its own trading positions when making submissions.
- On 6 February 2013 Royal Bank of Scotland plc was fined £87.5m by the FSA for manipulating LIBOR to improve the profitability of its trading books between 2006 and 2012. Other offences included making "wash trades" to create a distorted view of trading volumes. Wash trading is now specifically defined as a behaviour amounting to market abuse in UK legislation.
- On 25 September 2013 ICAP Europe Ltd was fined £14m by the FCA for manipulating Japanese Yen LIBOR submissions.
- On 29 October 2013 Rabobank was fined £105m by the FCA for manipulation of various currency LIBORs. Offences included internal and external requests to set LIBOR rates, as well as collusion with LIBOR Panel Banks and brokers.
- On 28 July 2014 Lloyds Bank plc and Bank of Scotland plc were fined £105m for manipulating LIBOR and Repo Rates. "Repo Rates" are the rates offered by major banks in London for dealing general collateralised lending transactions. The two banks also committed offences relating to the UK Special Liquidity Scheme, by which UK banks were able to, for a fee, swap mortgage backed securities for UK Treasury Bills. The banks manipulated Repo Rates in order to lower the fees they had to pay to the Bank of England for the UK Treasury Bills.
- On 22 January 2015 the FCA fined and banned two former senior executives of interdealer broker Martin Brokers (UK) Limited, David Caplin and Jeremy Kraft, for lack of competence and misconduct, part of which was in relation to the manipulation of LIBOR. The individuals were fined £210,000 and £105,000 respectively and were both banned for life from holding positions of significant influence at FCA authorised firms.

- On 17 March 2015, the FCA issued a final notice to Paul Robson, a former trader at Rabobank, which banned him from the UK financial services industry for life for his part in the manipulation of Yen LIBOR at Rabobank.

Criminal action against individuals

It is understood that the SFO has written to at least 22 people to notify them that they are under investigation. The SFO has brought criminal charges for conspiracy to defraud against a number of individuals in the UK. In October 2014 one senior banker became the first person to plead guilty and be convicted of criminal charges relating to the manipulation of LIBOR. A former UBS and Citigroup trader is due to stand trial in May 2015. Meanwhile a number of other criminal investigations by the SFO into fraud relating to the manipulation of LIBOR are ongoing.

Civil actions

In *Graiseley Properties Limited v Barclays Bank PLC*, Graiseley brought a claim for damages arising from allegedly having been mis-sold certain interest rate swap products (which used LIBOR as a benchmark). Following the publication of the FSA's final notice against Barclays in June 2012, the High Court gave permission for Graiseley to amend its claim to plead fraudulent misrepresentation relying on certain implied representations as to the integrity of LIBOR. In a separate interim hearing the Court confirmed that individuals within Barclays should not be granted anonymity in the legal proceedings.

In a subsequent case, *Deutsche Bank AG v Unitech Global Limited*, Unitech applied to amend its counterclaim to include a claim for misrepresentation based on alleged manipulation of LIBOR. However, the High Court took the view that the alleged implied representations regarding the integrity of LIBOR were very wide and linking a future payment to LIBOR in a contract should not (of itself) give rise to the representations being alleged by Unitech as to how LIBOR is or would be compiled in the future.

These conflicting interim High Court decisions were appealed and in November 2013 the Court of Appeal granted both Graiseley and Unitech permission to amend their claims to plead misrepresentation by reference to alleged LIBOR manipulation.

The Graiseley case was due to be heard during a six week trial starting at the end of April 2014. However, Graiseley and Barclays reached an out of court settlement a few weeks before the start of the trial. A public statement released by Barclays noted that they had agreed a restructuring of Graiseley's debt as part of the deal.

Deutsche Bank applied to the Supreme Court for permission to appeal the Court of Appeal’s decision to allow Unitech to amend its pleading. The Supreme Court decided that it should not interfere with the Court of Appeal's decision that the amended case was "arguable" (in circumstances where the Court of Appeal had not decided the substance of the amended claims). It therefore remains to be seen whether the UK will see its first LIBOR "test case".

In April 2014, Barclays also settled a much less publicised claim which included allegations relating to LIBOR manipulation. This was a Commercial Court action involving a Portuguese company claiming €12m in damages for having allegedly been mis-sold 16 unsuitable derivative contracts.

The above claims all involve alleged misrepresentation by reference to LIBOR manipulation with the principal aim of extracting parties from unfavourable derivative contracts. The UK still awaits its first damages claim to be brought by a claimant alleging they have suffered loss as a result of LIBOR manipulation.

7. How are the potential conflicts of interest affecting banks or other financial institutions addressed in your jurisdiction? Which requirements are adopted to ensure that benchmarks reflect economic reality and that they are used correctly?

Under MAR, benchmark submitters are required to "maintain and operate effective organisational and administrative arrangements to enable it to identify and manage any conflicts of interest" that may arise from their carrying out a benchmark related activity. Likewise, benchmark administrators are required to have effective administrative arrangements in place that allow it to identify and manage any conflicts of interest that may arise from its administration of a specified benchmark.

In order to ensure that benchmarks reflect economic reality, benchmark submitters are required to ensure that their benchmark submissions are determined using an effective methodology (including one based on qualitative as well as quantitative data). Rather than setting out prescribed methods for determining benchmarks, the FCA rules place general requirements on submitters to ensure that the data behind benchmark submissions are credible and robust. Meanwhile, benchmark administrators are required to have regard to the importance of maintaining the integrity of the market, including by carrying out statistical analysis of the benchmarks it manages, as well as being obliged to notify the FCA of attempted or suspected manipulation.

8. Are any measures foreseen in your jurisdiction for the protection of “whistleblowers”?

Under MAR, all administrators of regulated benchmarks are required to have an effective whistleblowing procedure in place which allows any person to notify them anonymously of actual or suspected manipulation.

The FCA has also published general whistleblowing guidelines for those who alert it to offences, which include maintaining the anonymity of whistleblowers where possible. It is intended in the future that UK banks and other financial institutions will also be required to have specific measures in place to protect whistleblowers. The FCA released a Consultation Paper in February 2015 on the proposed changes to the FCA rules relating to whistleblowers and it is expected that these requirements will be implemented at a later date.

More generally, the UK Public Interest Disclosure Act 1988 gives legal protection to employees from dismissal or penalisation for disclosing serious concerns relating to the commission or suspected commission of a criminal offence by their employer. As the manipulation of benchmarks is a criminal offence under FSMA, whistleblowers would be protected under this legislation.

9. Is there any measure in place in your jurisdiction to guarantee suitable and appropriate evaluation of benchmarks?

Under the UK benchmarks regime, benchmark administrators are required to have an oversight committee that scrutinises benchmark submissions and develops practice standards setting out the various responsibilities of the benchmark administrator and the benchmark submitter in respect of its regulated benchmark. In relation to LIBOR, these general rules are expanded upon in ICE Benchmark Administration Limited's ("**IBA**") Code of Conduct for Contributing Banks. IBA is the benchmark administrator for LIBOR and its Code of Conduct has been accepted by FCA as the industry standard for administrators of benchmarks.

Firms that administer benchmarks are also required to submit daily benchmark data to the FCA, as well as submitting quarterly aggregate statistics outlining the activity in the underlying market relevant to the specified benchmark. The FCA's approach, so far, seems to focus on implementing deterrents to stop administrators and submitters of benchmarks from manipulating their benchmarks.

10. Which requirements and/or transparency rules – if any – are undertaken in your jurisdiction in order to prevent distortions of competition resulting from divergences between other national laws and/or to provide more legal certainty for market participants? (i.e. to prevent or limit regulatory complexity and potential regulatory arbitrage)

The FCA is effectively the sole regulator of firms carrying on regulated activities in relation to benchmarks in the UK. As a result, one does not see much possibility for regulatory arbitrage at a UK level. Regulatory complexity has already been limited by having one set of consolidated rules for benchmarks, issued by the FCA.