The *LIE* in LIBOR

By:
Mary Beth Brown
Lindsay Kahlbaugh
Daniel McNamara
Jordan Youngblood

Situation

An international investigation into the LIBOR revealed a widespread plot by multiple banks like Barclays to manipulate interest rates for profit as far back as 2003

What is LIBOR?

- The London Interbank Offered Rate (LIBOR) is a benchmark interest rate
- Often considered a total assessment of the health of the financial system
- The basis of many capital market transactions worldwide

What Happened?

- Barclays and 15 other global financial institutions colluded to manipulate LIBOR rate beginning in 2003 and continuing onward
- Attempted to deceptively raise their liquidity in addition to defrauding U.S. derivatives markets

Why did this happen?

- LIBOR was manipulated upward or downward based on trader's position to make profits or prevent losses
- It also provided Barclays with "a degree of stability in an unstable time" during the Great Recession
- No government regulated LIBOR at the time; LIBOR was administered through the BBA and the FXMM
- LIBOR determination effectively operated on an honor system

Legal and Ethical Implications

Penalties for Parties

- In 2015, five banks pleaded guilty to criminal charges of manipulating exchange markets
  - Agreed to pay over $5 billion to the U.S. Justice Department and other regulators
- Barclays settled cases with British and American authorities
  - $435 million in 2012
  - $100 million to 44 U.S. states in 2016

Reactions to Scandal

- "The motives of the Fed, Bank of England, US and UK banks are aligned, their policies mutually reinforcing and beneficial…The LIBOR fixing is another indication of this collusion"
- The scandal sparked demands for:
  - Deeper reform of the LIBOR rate-setting system
  - Reform of the Federal Reserve system
  - Harsher penalties for harming individuals and institutions

Recommendations

- Controls to prevent against data tampering
- Management of LIBOR calculation and reporting by a more well-equipped, independent agency
- Publication of individual banks' LIBOR submissions
- "Cooling-off period" for traders
- Calculation of LIBOR on a lag
- Regulatory agency responsible for reviewing borrowing data and reconciling submissions

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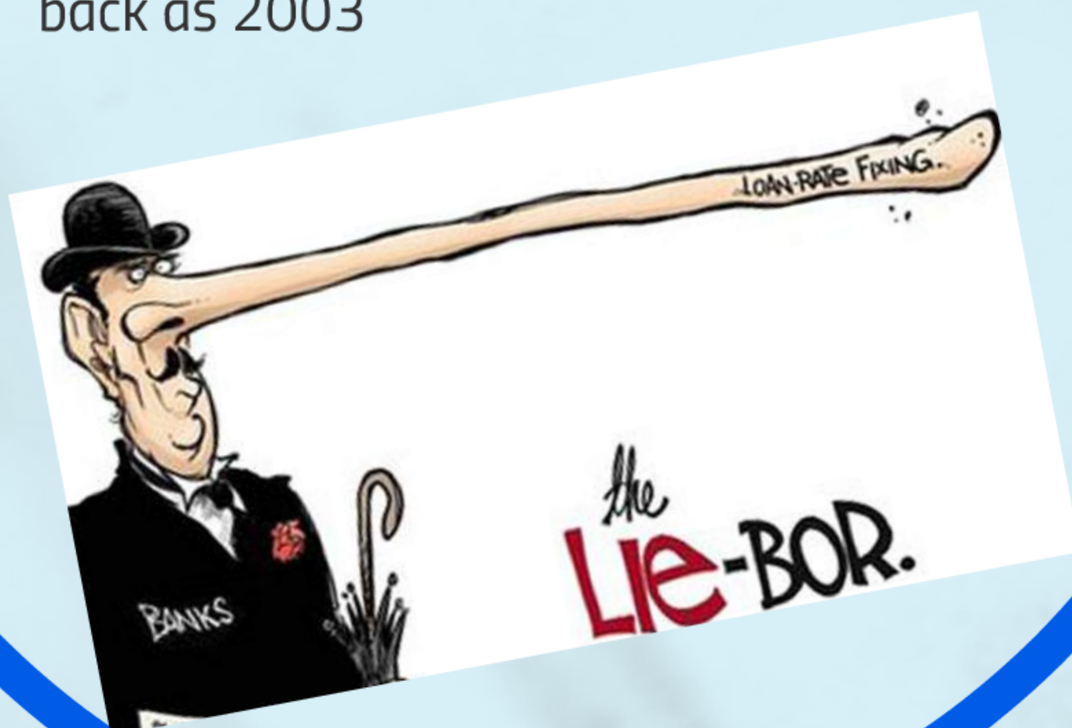

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How is LIBOR calculated?

- A representative panel of global banks submit an estimate of their costs of borrowing from other banks
- The middle 50% of estimates are averaged and reported as LIBOR

Importance of LIBOR

- The most relied-upon global benchmark for short-term interest rates and overall health of the economy
- One of the most crucial interest rates used in capital market calculations and finance
- Underpins ~$800 trillion worth of loans and financial contracts
  - approximately 12X global GDP
- Banks use LIBOR as a base rate for setting interest rates on consumer and corporate loans

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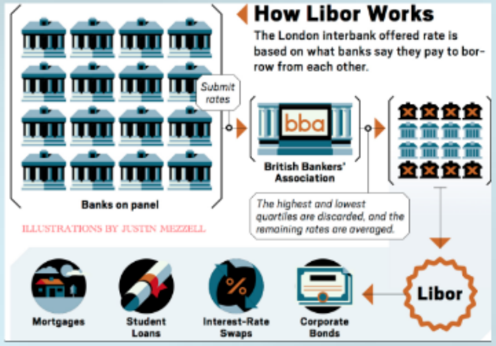

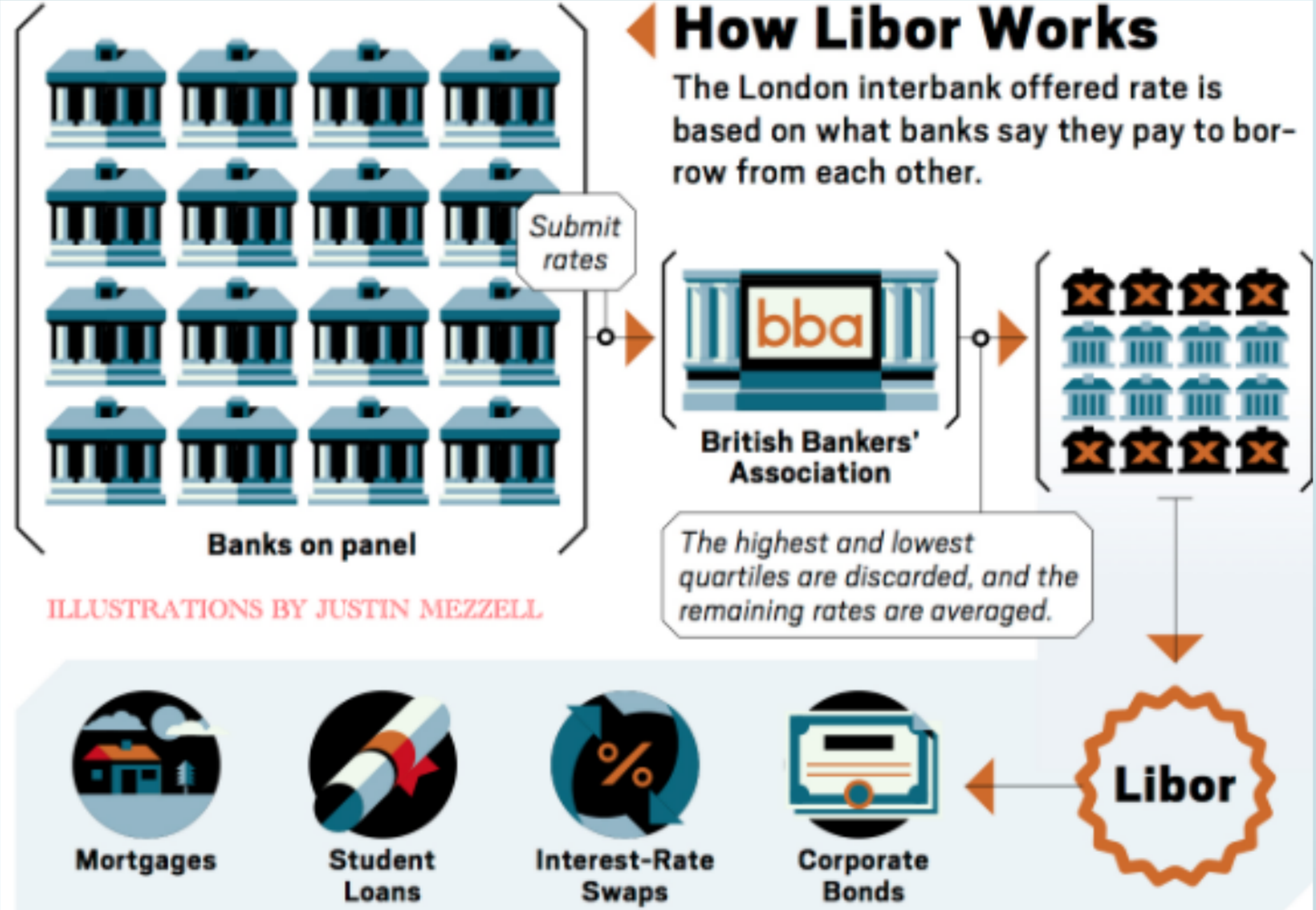
How Libor Works
The London interbank offered rate is based on what banks say they pay to borrow from each other.
Submit rates
bba
British Bankers' Association
Banks on panel
The highest and lowest quartiles are discarded, and the remaining rates are averaged.
ILLUSTRATIONS BY JUSTIN MEZZELL
Libor
Mortgages
Student Loans
Interest-Rate Swaps
Corporate Bonds

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The Emails

- The FSA investigation found "a large amount of email and instant message evidence" that showed Barclays' derivatives traders making requests for particular submissions