Manipulating LIBOR...

Should the SFO rush in to prosecute banks over LIBOR, asks **David Corker**

- The LIBOR rate controversy has caused a media furore in recent weeks.
- Will the SFO be able to utilise criminal law to punish those responsible?

The furore over alleged manipulation of the LIBOR continues to rage. In the wake of Barclays being hauled over the coals by a parliamentary committee, the Serious Fraud Office (SFO) has announced that it will open an investigation to probe untoward conduct by any of the 16 banks who were on the LIBOR panel during 2008. Eager to ride the waves of "bash the bankers" populism, the Government has immediately advanced the agency an extra stipend to cover its costs.

To outsiders, LIBOR is a strange mechanism; in the world of banking, it is the most important interest rate. Yet, even if the banks on its panel are honest when they submit their estimates of borrowing costs which determine its various daily rates, their numbers are almost entirely fanciful. The method of calculating LIBOR is not based on banks reporting actual transactions; no submission purports to reflect actual cost. What the banks are asked to do just before 11am each working day is submit an estimate of a rate they would pay to borrow, say, $50m for three months. Allegedly (although Barclays has admitted its complicity), what some of the banks did during 2008 and before was to align their submissions in order to drive the final LIBOR up or down depending on what suited their financing needs that day.

It is easy to see how such a quasi-bidding-ring should, when exposed, render the participant banks liable to censure, civil suit and regulatory sanction. It all looks like a conspiracy or a cartel with winners and losers. When the LIBOR was lower as a result of these machinations, the banks presumably would profit by borrowing at a lower rate than they might otherwise have been able to. Doubtless the scandal will engulf many banks with investigations galore and more storms of outrage. Lawyers can look forward to an orgy of litigation.

The SFO would be wise to dip its toe, rather than dive into, this maelstrom. While it clearly has the power to prosecute and so grab a great deal of attention for itself, the legal terrain upon which to bring a case is challenging. An ignominious failure to convict a banker after an inevitable high-profile trial would stain the reputation of its new director and spark fresh calls for its abolition. The last time the SFO brought a case which alleged price-fixing (*R v Goldshield*), it misunderstood the law so badly that the case collapsed at the first hurdle.

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Possible statutory offences

So what offences are in play? Beginning with the statutory ones, there is false accounting created by s 17 of the Theft Act 1968. LIBOR submissions are a mass of financial data all on one sheet which would be alleged to be false or misleading. The problem, however, is that this information is not created for an accounting purpose which the offence requires a prosecutor to prove. All parties know the submission is composed of estimates and not necessarily based on real activity. So the alleged illegal conduct is outside the scope of this offence.

As price-fixing or manipulation looks likely, how about the cartel offence created by s 188 of the Enterprise Act 2002 (EA 2002)? This offence proscribes four defined types of cartellist behaviour and only one of these could potentially apply: an arrangement which the parties intend if carried out would directly or indirectly fix a price for the supply of a product or service. "Price" is not defined and so the word must be given its natural meaning. So were the collusive LIBOR banks fixing a price?

LIBOR does not sell or supply anything. EA 2002 refers only to a price which LIBOR is not and so the offence to fit this situation will have to be related to how LIBOR acts as a pricing component for other financial products. The SFO would have to prove the impact of what the alleged colluders intended on those collateral contracts. Maybe this is possible, but a wise prosecutor would see the warning-lights: heavy reliance on expert evidence to show impact and a case relying for its vitality on bringing esoteric and complex derivative contracts to life before a jury. If the SFO builds its case on these foundations, by the time of the trial they may turn out to be sand not rock.

Another problem arises because of the way the LIBOR is calculated. With 16 banks providing their estimates with outlier submissions at the bottom and top of the range excluded, the colluders know that it will be impossible to fix it to a specific rate unless almost all of the banks are in their number. That has never been suggested and so if the colluders number only three or four they know that they cannot fix LIBOR but only influence it. Indeed, that is the point of a panel of 16, that unless the bidding ring comprises the majority of them, price-fixing is impossible.

As a result of s 188 criminalising only a narrow range of anti-competitive conduct, the nature and complexity of LIBOR takes alleged manipulation of it outside of its ambit. Moreover, alleged collusive banks could never face prosecution for alleged price-fixing as the offence only applies to individuals.

The Fraud Act 2006 (FrA 2006) overhauled the canon of law applying to white collar crime post January 2007 and ss 2-4 of it define three ways in which a person can act fraudulently. Of this trio only one is really apposite to alleged false LIBOR submissions—dishonest misrepresentation, or perhaps fraud by abuse of position. While these might seem to fit the facts of the alleged malpractice, the SFO would be obliged in the event of a contest not only to identify dishonest conduct which might prove more difficult than it seems but also, although strictly not required by FrA 2006,

show some proof of actual gain or loss. As the CPS legal guidance says: "In many instances it is the fact of the gain or loss that will prove the defendant's dishonesty beyond reasonable doubt."

Can a misrepresentation be inferred from the fact that a bank claimed at 11am in its LIBOR submission that it would expect to pay X rate, yet by noon it was agreeing to pay Y? Put another way, can this submission be judged a false or misleading bid in the light of subsequent conduct? An appreciation of the LIBOR system reveals that there is no inconsistency. A disconnect between the benchmark and the actual cost of borrowing shows only that there is no necessary link between the bank's estimate and market prices.

Presumably, evidence of foul play would be revealed by contemporaneous emails etc which suggest that the bank's submission was at odds with what its LIBOR submitters believed it could borrow for. So the misrepresentation is of an individual's true state of mind or opinion. While FrA 2006 makes it permissible to prosecute for this, the problem is that both the submitter and the intended recipient or victim, in this case the market, knows that the submitter is only making a guess about something hypothetical. Moreover, the question the submitter has to give an answer to leaves plenty of scope for subjectivity and doubt: what rate would you pay to borrow in "reasonable market size"? This term is not defined yet presumably the size of a deal will affect its price. What it is which has allegedly been misrepresented becomes a difficult issue. Can you have a misrepresentation amounting to an offence about something so nebulous?

If the answer is yes, the issue becomes whether the submitter was acting dishonestly or not. Of course that depends on the evidence but the fact that with LIBOR submissions and market prices there is no cause and effect, everyone knows they are a guess and that the question which the submitter answers is inherently vague, suggests that the SFO would have an uphill struggle in proving dishonesty.

Conspiracy to defraud

This leaves the common law offence, the so-called "prosecutor's darling" which FrA 2006 was originally intended to kill off but was instead granted a reprieve. Conspiracy to defraud. This offence is the broadest criminal offence in our criminal law; committed when two or more persons agree dishonestly to prejudice the economic interests of another. There is no need to prove that the conspiracy had any effect in terms of harming anyone and the intended prejudice can be ephemeral or potential. As to identifying who the intended victim was, a broad class of persons will suffice.

The usefulness of this offence to a prosecutor is that, unlike the statutory offences already considered, the emphasis is almost entirely on what was agreed. The intended means of implementation, whether or not they could have sufficed and the extent of any loss inflicted are all immaterial and so, while they are distinct legal concepts, in a trial the alleged agreement and the alleged dishonesty usually become conflated. Of all the offences considered in this article this is the one least vulnerable to technical objection.

The breadth of this offence, however, is also its weakness. To prove its case, the SFO would have to show that there was a single overarching conspiracy and all the alleged manipulations are referable to that. So anything inconsistent with this grand and simplistic conspiracy theory tends to undermine it: evidence of *ad hoc* requests, of different traders drifting in and out and the lack of a prime mover are all features which suggest the absence of a conspiracy. Moreover, the alleged conspirators must all be motivated by the same intention or object so if the evidence revealed that their manipulations were for different reasons, such as in some instances to reduce the risk of the bank having to seek a bail-out from the Government, the conspiracy count will founder. Based on the evidence provided by Barclays to date, there seems to be some evidence supporting the theory that Barclays perceived its manipulations were tacitly approved by the Bank of England. Such a version of events, if credible, would destroy the SFO's case in the courtroom.

Conclusion

The SFO has a difficult task ahead in deciding whether the criminal law can be used to sanction this latest outburst of financial misconduct. The greatest deterrent is the threat of imprisonment; corporate fines may fail to offset benefits and provide a far weaker impulse to directors not to choose the opportunity to mis-sell a product or form a cartel. But criminal litigation can take years to resolve and often turns out to have a disappointing and ineffectual outcome. The SFO therefore should tread very carefully; and make sure that, before it decides to bite on LIBOR, it has the necessary sharp teeth. The truth is that the criminal law is not equipped to prosecute the conduct revealed by the LIBOR investigation and what will inevitably follow is a call for a new offence to fill the gap; thus rather belatedly shutting the stable door. NLJ

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