

## Libor Manipulation Probe and Litigation Update

**The record-breaking £59.5 million fine imposed on Barclays by the Financial Services Authority (FSA) and \$360 million penalty imposed by the U.S. Commodity Futures Trading Commission and Department of Justice in connection with the improper submission of London InterBank Offered Rate (Libor) rates has led to intense public scrutiny of Barclays' practices, procedures and management and possible misconduct by other financial institutions. Sedgwick has been watching this issue closely for a few months. In May, Chicago partners Eric Scheiner and Jennifer Broda wrote an article published in the *PLUS Journal* about the price-fixing cases in the U.S., the development of the investigations, and the impact for insurers before the headlines and Barclays settlement was announced.<sup>1</sup>**

As U.S. and U.K. regulators' investigations into the conduct of other major banks are ongoing, it seems possible that, depending on their findings, they could also be the subject of significant penalties. This may fuel ongoing litigation in the U.S. against financial institutions and other parties in relation to Libor manipulation and it is possible similar claims may be made in other jurisdictions, such as the U.K.

Below, our financial services team in London and the U.S. consider:

- The background to the allegations of Libor manipulation.
- Civil proceedings in the U.S. and possible future claims.
- Investigations by regulators.
- The implications for insurers.

### Background

Libor is the benchmark that establishes the interest rate at which member banks will loan money to each other for a given time period (various periods ranging between one day and one year) and in a given currency.<sup>2</sup> It is established for 10 separate currencies, including the U.S. dollar, the Japanese yen and the British pound.<sup>3</sup> Similar interbank rates are used in other financial markets, including Tokyo (Tibor) and Europe (Euribor).

Besides being used to determine the rate at which member banks loan money to each other, Libor is important for additional reasons. As the primary benchmark for global short-term interest rates, Libor is also important for the pricing of fixed income futures, option swaps and other derivative products traded on exchanges and determining the value of products traded on the Over-the-Counter market as well as lending transactions, such as mortgages.

In order to calculate Libor, the banks calculate their own interest rates for the day and submit them confidentially to Thomson Reuters, the agency charged with calculating the Libor figure.<sup>4</sup> Once Thomson Reuters receives the submissions from each member bank, it ranks them in descending order and then excludes 25 percent of both the lowest and highest submissions.<sup>5</sup> The remaining submissions are then averaged to reach the daily Libor figure. While the number of member banks may differ, this process is repeated for each of the nine other currencies for which Libor is calculated.<sup>6</sup> Similar methods are used for setting the Tibor and Euribor rates by banks in each of those respective geographic areas.

The thrust of the allegations made against banks is that they made inappropriate submissions that took into account

requests made by their own interest rate derivative traders (and traders at other banks) in order to improperly influence the Libor (or Euribor and Tibor) rate in order to benefit their trading positions.

### Civil Proceedings in the U.S. and Possible Future Claims

In 2011, at least 21 class action lawsuits were filed in various U.S. federal courts against a number of Libor member banks.<sup>7</sup> The lawsuits were initiated by investors who purchased many millions of dollars of interest rate swaps tied to Libor (interest rate swaps can be used as a means to hedge against changes in interest rates), by groups of customers such as traders who made Libor-related bets, and by investors in large companies' debt that was linked to Libor.<sup>8</sup>

The member banks named in these lawsuits include Bank of America Corporation, Barclays Bank PLC, Citibank NA, HSBC Holdings plc, JPMorgan Chase & Co., Lloyds Banking Group plc, UBS AG, WestLB AG, Credit Suisse Group AG, Deutsche Bank AG, and Royal Bank of Scotland Group PLC, among others. The U.S. Judicial Panel on Multidistrict Litigation has now consolidated these actions for pretrial purposes in the U.S. District Court for the Southern District of New York under the caption *In Re LIBOR-Based Financial Instruments Antitrust Litigation* (MDL No. 2262) (the "MDL").<sup>9</sup>

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On April 30, 2012, three amended consolidated class action complaints were filed in the following actions pending in the MDL: (1) *Mayor and City Council of Baltimore v. Bank of America, et al.* (Case No. 11 Civ. 5450)(the “OTC Action”); (2) *Exchange-Based Plaintiff Action* (Case No. 11 Civ. 2613)(the “Exchange-Based Action”); and (3) *Gelboim v. Credit Suisse Group AG, et al.* (Case No. 12 CV 1025) (the “Gelboim Action”). The OTC, Exchange-Based, and Gelboim Actions are brought on behalf of different classes of plaintiffs,<sup>10</sup> but make similar allegations against the banks. The plaintiffs in each of these actions essentially allege that the defendants perpetrated a scheme to depress Libor for the U.S. dollar for two primary reasons. First, the plaintiffs assert that because the interest rate a bank pays (or expects to pay) on its debt is widely viewed as embodying the market’s assessment of the risk associated with the bank, the defendants understated their borrowing costs to the British Bankers’ Association (thereby suppressing Libor) to portray themselves as economically healthier than they actually were. Second, artificially suppressing Libor allowed defendants to pay lower interest rates on Libor-based financial instruments that defendants sold to investors.

Each of the consolidated complaints asserts causes of action for violation of the Sherman Antitrust Act. The Exchange-Based Action also asserts causes of action for violations of the Commodity Exchange Act. The OTC and Exchange-Based Actions further assert claims for restitution, disgorgement, or unjust enrichment. The plaintiffs seek unspecified compensatory damages, treble damages with respect to the antitrust violations, prejudgment interest, establishment of a constructive trust with respect to the unjust enrichment claims, and attorneys’ fees and costs.

In addition to the individual and institutional investors’ claims, the brokerage Charles Schwab has also filed lawsuits against several banks alleging violations of antitrust, racketeering and securities laws in California federal court (the “Charles Schwab Actions”). Those actions have also been transferred to the MDL.

On June 29, 2012, the bank defendants (with the exception of Barclays and UBS) moved to dismiss the claims asserted in the OTC, Exchange-Based, and Gelboim Actions, as well as claims asserted in the Charles Schwab Actions. The defendants argue that the amended complaints do not state a claim under the antitrust laws because they fail to demonstrate how the banks’ alleged conduct restricted competition or restrained trade among the defendants or anyone else. According to the banks, the plaintiffs merely accuse defendants of making false reports for their own purposes to a trade association regarding the rates at which they believed they could borrow money in London. The banks argue that the amended complaints do not adequately plead any joint action or agreement by competitors to restrain competition in some market, or allege any facts from which such an agreement can be inferred. In addition, defendants assert that the plaintiffs do not allege any conduct that would constitute a restraint of trade in violation of the Sherman Act. The banks assert that the plaintiffs’ allegations regarding false interest rate reporting are not alleged to be and are not a competitive act because there are no buyers or sellers, market, profit, or competition of any kind associated with the mere reporting of rates or setting of Libor.

With respect to the Exchange-Based Action, the banks assert that they are time-barred because the plaintiffs’ allegations demonstrate they were on inquiry notice

of potential violations over two years before the initial complaint was filed, as the *Wall Street Journal* published several articles in 2008 regarding the banks’ alleged flawed interest rate reporting. The banks further argue that the plaintiffs’ claims are impermissibly extraterritorial because they allege manipulation of a London-based commodity, and the Commodity Exchange Act does not have any extraterritorial reach. Finally, the banks assert that the plaintiffs fail to state claims for manipulation or unjust enrichment.

The plaintiffs have not yet filed their opposition to the banks’ motion, and no briefing schedule has been set. The banks indicated in their motion papers that Barclays and UBS will be filing separate motions to dismiss, although they will be joining in arguments made by the other bank defendants.

Recent news reports indicate that several large institutional investors may follow Charles Schwab’s lead and opt out of the class action lawsuits pending in the MDL. The news articles suggest that large investors want to maintain tighter control over their cases, and believe that they can potentially recover substantially larger settlements by proceeding individually.

In the U.K., at least two law firms have indicated they intend to pursue claims against Barclays on behalf of impacted parties following its settlement with regulators, although it will be difficult to advance “class actions” in the U.K. in the manner in which they proceed in the U.S.

It is also conceivable civil claims could be commenced against other parties, such as brokers, who may have been involved in the alleged misconduct – as set out below, a number of these entities are currently being investigated by regulators.

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Many banks have dismissed or suspended employees who are implicated in alleged Libor manipulation. There is a risk such dismissals (of well remunerated individuals) could give rise to an increase in employment claims and incentivize disgruntled employees to assist prosecutors and plaintiffs. For example, the Royal Bank of Scotland Plc has reportedly dismissed at least four employees in connection with its internal probe into the manipulation of these rates.<sup>11</sup> In response, one of those terminated traders, Tan Chi Min, has filed a wrongful dismissal action in the Singapore High Court.<sup>12</sup> In that wrongful dismissal action, Min alleges that it was “common practice” for Royal Bank of Scotland senior employees to make Libor-related requests to the Libor rate setters and that such conduct was known to senior management.<sup>13</sup>

According to other reports, employees have been dismissed, placed on leave or suspended at JPMorgan Chase, Deutsche Bank and Citigroup.<sup>14</sup> In addition, although no conclusions of wrongdoing have been made, at least two senior UBS traders were suspended in connection with the probe<sup>15</sup>.

### Investigations by Regulators

Various governmental agencies have announced criminal investigations into whether member banks committed Libor manipulation, and such investigations have spread over three continents. Investigations are currently being conducted by the U.S. Securities and Exchange Commission, U.S. Commodity Futures Trading Commission, U.S. Department of Justice, Japan’s Financial Supervisory Agency, the U.K. FSA, Canada’s Competition Bureau, the European Commission, and the Swiss Competition Commission, among others.<sup>16</sup>

Some of the banks that have disclosed that they have been approached by regulators investigating Libor include Barclays Plc, Royal Bank of Scotland Group Plc, HSBC Holdings Plc., Citigroup, Inc., UBS AG, Credit Suisse, Deutsche Bank, JPMorgan Chase & Co., Tokyo-Mitsubishi UFJ, Mizuho Financial Group Inc., Rabobank Groep N.V., Societe Generale, and Sumitomo Misui Banking Corporation.<sup>17</sup>

As noted above, Barclays were recently fined £59.5 million by the FSA for misconduct relating to Libor and Euribor submissions and has paid \$360 million in penalties to the U.S. Commodity Futures Trading Commission and Department of Justice.

Japan’s FSA has also imposed sanctions with regard to wrongdoing. In December 2011, Japan’s FSA sanctioned Citigroup by demanding the temporary suspension of trading derivative products tied to Tibor and Libor after two Citigroup traders were accused of trying to improperly influence Tibor by asking other banks for an advantageous rate in violation of Japan’s Financial Instruments and Exchange Act.<sup>18</sup> UBS reportedly received a smaller sanction as well for allegedly similar misconduct.<sup>19</sup> The reports indicate that there was no evidence that Tibor was actually manipulated, but Japan’s FSA took the position that both banks lacked appropriate internal controls to prevent such manipulation.<sup>20</sup> In addition to the sanctions, Citigroup announced a \$50 million write-off unwinding the two traders’ positions.<sup>21</sup>

We will have to wait and see whether other banks will be found to have been involved in similar misconduct and what action regulators in different jurisdictions may take against them.

The investigations do not stop with just the banks. There have been allegations

that brokers communicated with traders at various banks in an attempt to influence the various types of rates. Some of the brokerages reportedly being investigated include ICAP Plc, Tullett Prebon and RP Martin Holdings Ltd.<sup>22</sup>

### Implications for Insurers

Claims or investigations may potentially implicate directors and officers and E&O insurances.

To date, it does not appear that any individual directors and officers of banks have been implicated in the MDL litigation, but consolidated amended complaints are still being drafted and there is a potential for litigation involving directors and officers with regard to the alleged misconduct.

The costs associated with the defense of these types of actions, the civil litigation exposure and the potential for civil and criminal penalties could be very significant given the widespread impact these interbank rates have on various financial instruments. In this regard, if these costs and exposures are borne by the financial institutions themselves, derivative claims (either in the U.K. or U.S.) against directors and officers relating to improper oversight are a possibility. Moreover, if there are any alleged public misrepresentations or material omissions made by the financial institutions in their financial statements or otherwise, class action securities litigation is also a possibility.

Investigations by regulators may also give rise to claims for reimbursement of costs incurred by or on behalf of directors and officers for the legal costs that are incurred in advising them.

A number of banks may have blended insurance programs with several types of

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coverage. As such, the banks may attempt to tender actions related to this alleged misconduct to their errors and omissions coverage depending on the circumstances of the case. Additionally, should regulators determine that criminal activity was also involved, fiduciary bond policies could be impacted as well. Finally, in light of the various terminations of likely well-compensated traders, there could be additional significant employment practices liability claims that are made.

As a result of the potential involvement of brokers and hedge funds, claims could also eventually be made against those types of entities, potentially implicating their insurers. Depending on the scope of the various investigations and the level of involvement with other financial institutions, smaller banks could also eventually be implicated.

**Conclusion**

News about the various ongoing international investigations is coming out on almost a daily basis but based on the information that has come to light it appears at least some attempts to manipulate these various interbank rates may have occurred.

In light of the significant volume of financial products tied to these rates, the

exposure to financial institutions and other entities presented by these investigations and litigation has the potential to be as large as some of the biggest securities class actions settlements that have arisen out of the subprime scandal. Based on what has transpired to date, it is foreseeable that more criminal investigations will be announced and more charges brought.

**Endnotes**

<sup>1</sup> Eric Scheiner and Jennifer Broda, "Move Over Subprime? Financial Institutions and Brokers Face Increasing Concerns Over Allegation of Improper Libor Manipulation" Plus Journal, Professional Liability Underwriting Society, Volume XXV (May 2012)  
<sup>2</sup> <http://www.bbalibor.com/>.  
<sup>3</sup> Id.  
<sup>4</sup> Id.  
<sup>5</sup> Id.  
<sup>6</sup> Id.  
<sup>7</sup> In re: LIBOR-Based Financial Instruments Antitrust Litigation, No. 11-2262 (Multidistrict litigation lead docket)(S.D.N.Y., MDL transfer order issued Aug. 12, 2011), August 12, 2011 at <http://derivatives-litigation.blogspot.com/2011/08/in-re-libor-based-financial-instruments.html> (last visited March 31, 2012).  
<sup>8</sup> An Expensive Smoking Gun, Economist.com (listed as from the print edition), April 14, 2012 at <http://www.economist.com/node/21552586> (last visited April 15, 2012).  
<sup>9</sup> The current parties listed as defendants in the court docket include: Bank of America Securities LLC, Bank of America Corporation, Bank of Tokyo-Mitsubishi FJ, Bank of Tokyo Mitsubishi UFJ Ltd, Barclays Bank Plc, Barclays Capital Inc., Barclays U.S. Funding LLC, Citibank NA, Citigroup Global Markets Inc., Credit Suisse Group AG, Credit Suisse Group NA, Credit Suisse Securities (USA) LLC, Deutsche Bank AG, Deutsche Bank Financial LLC, Deutsche Bank Securities Inc., Does 1-10 Inclusive, HBOS PLC, HSBC Holdings plc., HSBC Securities (USA) Inc., J.P. Morgan Chase & Co., J.P. Morgan Clearing Corp., Lloyds Banking Group plc, RBS Citizens, NA, Rabobank Group, Royal Bank of Canada, Royal Bank of Scotland Group plc, Societe Generale, The Norinchukin Bank, UBS AG, UBS Securities LLC, and WestLB AG.  
<sup>10</sup> The OTC Action is brought on behalf of all persons or entities that purchased in the United States, directly from a defendant, a financial instrument that paid interest indexed to Libor ("Libor-Based Instrument") any time during the period August 2007 through May 2010. The Exchange-Based Action is brought on behalf of a purported class of plaintiffs who transacted in Eurodollar futures contracts and options on futures contracts on exchanges such as the Chicago Mercantile Exchange between August 2007 and May 2010. The Gelboim Action is brought on behalf of plaintiffs who owned (including beneficially in "street name") any U.S. dollar-denominated debt security (a) that was assigned a unique identification number by the CUSIP system; (b) on which interest was payable at any time between August 2007 and May 2010; and (c) where that interest was

payable at a rate expressly linked to the U.S. Dollar Libor rate.  
<sup>11</sup> Lindsay Fortado and Gavin Finch, RBS Said to Dismiss Bankers as Libor Probe Expands to Brokers, Businessweek.com, February 12, 2012 at <http://www.businessweek.com/news/2012-02-12/rbs-said-to-dismiss-bankers-as-libor-probe-expands-to-brokers.html> (last visited April 12, 2012).  
<sup>12</sup> Andrea Tan and Jesse Westbrook, Brevan Howard Asked RBS to Change Libor, Lawsuit Says, Bloomberg.com, March 29, 2012 at <http://www.bloomberg.com/news/2012-03-29/brevan-howard-asked-rbs-to-change-libor-lawsuit-says.html> (last visited April 12, 2012).  
<sup>13</sup> Id.  
<sup>14</sup> Caroline Binham, Brooke Masters and Megan Murphy, Brokers Suspended in Libor Inquiry, ft.com, February 8, 2012 at <http://www.ft.com/intl/cms/s/0/7021c8b4-527a-11e1-ae2c-00144feabd00.html#axzz1rqvXs0lv> (last visited April 12, 2012).  
<sup>15</sup> Megan Murphy and Cynthia O'Murchu, UBS Suspends Traders in Libor Probe, ft.com, February 15, 2012 at <http://www.ft.com/intl/cms/s/0/705a1102-571f-11e1-be5e-00144feabd00.html#axzz1rqvXs0lv> (last visited April 12, 2012).  
<sup>16</sup> Mike Mintz, Investigators Look Into Whether Bank Employees Manipulated Crucial Interest Rates, Martindale.com Blog, February 16, 2012 at <http://blog.martindale.com/investigators-look-into-whether-bank-employees-manipulated-crucial-interest-rates> (last visited March 31, 2012).  
<sup>17</sup> Carrick Mollenkamp, Exclusive: U.S. Conducting Criminal Libor Probe, Reuters.com, February 28, 2012 at <http://www.reuters.com/article/2012/02/28/us-libor-probe-idUSTRE81R1ZG20120228> (last visited April 12, 2012); Credit Suisse Says Cooperating with Libor Probes, Reuters.com, March 23, 2012 at <http://www.reuters.com/article/2012/03/23/us-creditsuisse-libor-idUSBRE82M08S20120323> (last visited April 12, 2012); Andrew Mayeda and Joshua Gallu, JPMorgan, HSBC Among Firms Facing Canada Libor-Fixing Probe, Bloomberg.com, February 14, 2012 at <http://www.bloomberg.com/news/2012-02-14/jpmorgan-hsbc-are-among-seven-firms-facing-libor-fixing-probe-by-canada.html> (last visited April 12, 2012); Martin de SaPinto and Caroline Copley, Swiss Question 12 Banks as LIBOR Probe Widens, Reuters.com, February 3, 2012 at <http://www.reuters.com/article/2012/02/03/us-swiss-banks-competition-idUSTRE81209620120203> (last visited April 12, 2012).  
<sup>18</sup> Lindsay Whipp, Tokyo Watchdog Imposes Two Sanctions on Citi, ft.com, December 16, 2011 at <http://www.ft.com/intl/cms/s/0/645da6a2-27d6-11e1-a4c4-00144feabd00.html#axzz1rqvXs0lv> (last visited April 12, 2012) (the reports indicate that the attempts to manipulate Libor were reported by a whistleblower employee at Citigroup).  
<sup>19</sup> Id.  
<sup>20</sup> Hiroko Tabuchi, Japan Calls for Action Against Citigroup and UBS, nytimes.com, December 9, 2011 at <http://dealbook.nytimes.com/2011/12/09/japan-calls-for-action-on-citigroup-and-ubs/> (last visited April 12, 2012).  
<sup>21</sup> Lindsay Whipp, Tokyo Watchdog Imposes Two Sanctions on Citi, ft.com, December 16, 2011 at <http://www.ft.com/intl/cms/s/0/645da6a2-27d6-11e1-a4c4-00144feabd00.html#axzz1rqvXs0lv> (last visited April 12, 2012).  
<sup>22</sup> Andrew Mayeda and Joshua Gallu, JPMorgan, HSBC Among Firms Facing Canada Libor-Fixing Probe, Bloomberg.com, February 14, 2012 at <http://www.bloomberg.com/news/2012-02-14/jpmorgan-hsbc-are-among-seven-firms-facing-libor-fixing-probe-by-canada.html> (last visited April 12, 2012); Caroline Binham, Brooke Masters and Megan Murphy, Brokers Suspended in Libor Inquiry, ft.com, February 8, 2012 at <http://www.ft.com/intl/cms/s/0/7021c8b4-527a-11e1-ae2c-00144feabd00.html#axzz1rqvXs0lv> (last visited April 12, 2012).

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