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FSA Mostly Clears Itself on Missed Libor-Rigging Signals

By Lindsay Fortado - Mar 5, 2013

The U.K. Financial Services Authority said a review of how it handled the investigation into Libor manipulation found no failures on the scale of previous scandals involving its oversight of Northern Rock Plc or Royal Bank of Scotland Group Plc.

The regulator, facing lawmaker criticism that it missed warning signs on the rigging of benchmark interest rates for years, said today that an internal report on how it handled "dislocation" in the London Interbank Offered Rate from 2007 until May 2009 found that there were areas where the regulator could have performed better.

At the time, "the FSA's bank supervisors were primarily focused on ensuring they understood the prudential implications of severe market dislocation," FSA Chairman Adair Turner said in a statement. The agency "had no formal regulatory responsibility for the Libor submission process. As a result, the FSA did not respond rapidly to clues that low-balling might be occurring."

When Barclays was fined 290 million pounds ($439 million) by the U.S. and U.K. in June last year, the bank admitted submissions used to set interest rates were rigged in an effort to profit from bets on derivatives and to help the bank appear financially healthier than it was. The London-based lender also said it had alerted regulators to problems with Libor before the investigation, communicating with the FSA, Bank of England, Federal Reserve Bank of New York and the British Bankers' Association 33 times in 2007 and 2008.

Libor 'Dislocations'

Out of 97,000 documents the FSA searched in its review, none referred to attempts by traders to manipulate rates, the regulator said. Many indicated "dislocations" in Libor, where there was a divergence between banks' submissions and actual rates, a wider range of submissions, or disparities because there wasn't sufficient data on which to base the rate. The FSA said it was "acutely aware" of that situation in 2007 to 2008.

"Clear evidence of this dislocation did not, in itself, however, carry any implication that 'low-balling' was occurring," the FSA said.

About $300 trillion of contracts worldwide, including home mortgages, interest-rate swaps and loans, are tied to Libor.

The FSA concluded it was too focused on dealing with the financial crisis that followed the bankruptcy of Lehman Brothers Holdings Inc. and should have considered the likelihood low-ball rate submissions were occurring. It also said it should have managed the information it received better.

CFTC Investigation

The FSA opened its investigation into rate manipulation in early 2010, a year-and-a-half after the U.S. Commodity Futures Trading Commission's probe. Barclays, RBS (RBS) and UBS AG (UBSN) have been fined about $2.5 billion by U.S. and U.K. regulators for rate- rigging, and more than a dozen other firms are under investigation.

In its discussion with the FSA, Barclays "consistently" raised concerns its competitors were submitting artificially low quotes used in setting the rate, the bank told lawmakers in July. When it was fined, Barclays admitted to colluding with other banks to manipulate Libor and similar benchmarks.

The Bank of England had no knowledge of criminal wrongdoing and passed along any market rumors about the Libor-setting process to the FSA, the central bank said in a statement today.

"As senior Bank officials made clear in public, it was widely known that the interbank market had effectively closed, and so there were questions about what the Libor rates were based on," Britain's central bank said.

FSA Disbanding

The BOE will take over prudential regulation when the FSA is abolished at the end of the month.

The British government last week formally started the search for a replacement body to oversee Libor after the British Bankers' Association, the industry group that created the benchmark in 1986, agreed to relinquish oversight.

During the time period the FSA reviewed, Libor was calculated by a poll carried out daily by Thomson Reuters Corp. on behalf of the BBA, which asked firms to estimate how much it would cost to borrow from each other for different periods and in different currencies.

Gary Gensler, the chairman of the CFTC, recently questioned the long-term viability of Libor, saying underlying markets on which it relies may be permanently disrupted. The rates must be anchored to real transactions in order for people to have confidence in them, he said in an interview last month.

Northern Rock was the first British casualty of the U.S. subprime market's collapse and was taken over by the British government in February 2008. RBS also received a bailout by the U.K. and remains the largest government-owned lender in Britain.

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