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# On arbitration, arbitrage and arbitrariness in financial markets and their governance: unpacking LIBOR and the LIBOR scandal

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# **Abstract**

Amongst a series of scandals to hit international financial markets in recent years, that surrounding the London Interbank Offered Rate (LIBOR) – a highly influential interest rate benchmark – has attracted particularly intense media scrutiny. This paper seeks to push beyond conventional understandings to unpack critically both LIBOR itself and the

scandal commoc arbitration

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## Disclosure statement

No potential conflict of interest was reported by the authors.

# Notes

- 1. It is not the only internationally relevant interest rate benchmark; there are several others, of which one, the Euro Interbank Offered Rate (EURIBOR), which serves a comparable role for euro-denominated as LIBOR does for (primarily) sterling- and dollar-denominated instruments, was also caught up in the manipulation scandal we examine in this paper.
- 2. Here, the notion of legal technology refers to the work that LIBOR performs in anchoring legal relationships, rather than indicating a fundamental relationship to broader systems of legal norms. We will return to the question of LIBOR's normative status in a later section of the paper.
- 3. Note that the quoted rate is always annualized, however. Note also that until February 2014, and thus throughout the period of the manipulation scandal examined

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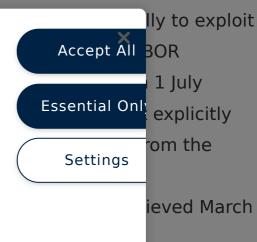
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- 6. <a href="http://www.bbalibor.com/explained/the-basics">http://www.bbalibor.com/explained/the-basics</a> (retrieved August 2013).
- 7. <a href="https://www.theice.com/iba\_calculation.jhtml">https://www.theice.com/iba\_calculation.jhtml</a> (emphasis added) (retrieved March 2014).
- 8. <a href="http://www.global-rates.com/interest-rates/libor/libor-information.aspx">http://www.global-rates.com/interest-rates/libor/libor-information.aspx</a> (retrieved August 2013).
- 9. IntercontinentalExchange acquired the right to administer LIBOR when it purchased NYSE Euronext in November 2013; the latter, through its own subsidiary Euronext Rate Administration Limited, had been appointed as the new administrator in July 2013 by the independent Hogg Tendering Advisory Committee.
- 10. <a href="http://trademarks.justia.com/861/83/ice-86183638.html">http://trademarks.justia.com/861/83/ice-86183638.html</a> (retrieved March 2014).
- 11. One way this is expressed is as a correlation between banks' liquidity risk premiums (measured as the spread between LIBOR and US Treasury rates) and sovereign default risk premiums (measured by sovereign bond yield or credit default swap spreads) (Huang et al., 2012). As a Bank of International Settlements report noted in the context of both 2008 and 2011, 'indicators of bank stress are closely correlated with the indicators of stress in government securities markets. This demonstrates the close relationship between the perceived solvency of governments and the solvency of their countries' banks' (Allen & Moessner, 2012, p. 3).
- 12. This proprietary value has long been appreciated by the BBA. When, in 2008, The Wall Street Journal reported growing distrust of LIBOR, the BBA responded forcefully. 'If it is deemed necessary', spokesman John Ewan said, 'we will take action to preserve the reputation and standing in the market of our rates' (Mollenkamp, 2008). IBA,



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- 13. The first actions against the bank were brought privately by an Austrian hedge fund (Aldrick, 2012).
- 14. Furthermore, comparable investigations have been launched into alleged manipulation of benchmark rates in the (even bigger) international foreign exchange (currency) markets, as opposed to the credit markets that LIBOR and kindred rates underpin. Here, the rates in question are the pivotal spot exchange rates such as those compiled and published by WM/Reuters, whose benchmarks for 160 currencies are determined by trades occurring in the 60-second period known, in a glorious irony, as 'the fix', and where the central allegation is of manipulation collectively to concentrate trades within this window to maximize the impact on the published benchmarks. See, e.g., Schäfer and Shotter (2014).
- 15. Of course, given LIBOR's widespread use as a pricing benchmark, the direct targets represent just one small group of actors potentially impacted by LIBOR arbitrage. We will return to this in the final section of the paper.
- 16. There is evidence that there was some informal co-ordination among traders and Barclays submitters to avoid the former outcome (FSA, 2012, pp. 20-21).
- 17. The FSA was merged into the new UK Financial Conduct Authority only nine months after the release of the Barclays Final Order.
- 18. For instance, Barclays was accused of violating Principle 5 of the FSA, which states that 'a firm must observe proper standards of market conduct' and Principle 3: 'a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems' (FSA, 2012, p. 39).
- 19. This allegation was echoed by US Federal Reserve Chairman Ben Bernanke, who testified to a Congressional Panel in mid-2013 that 'the disclosures are troubling and

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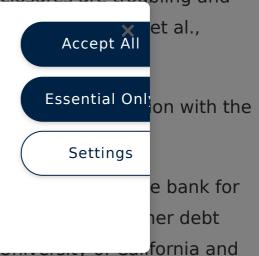
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the cities of Baltimore (MD), New Britain (CT), Richmond (CA), Riverside (CA) and San Mateo (CA) (Cotchett & McCarthy, 2013; The New York Times, 2013).

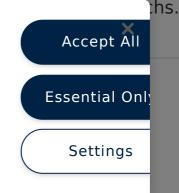
- 22. According to revised DOJ prosecution guidelines '... where the collateral consequences of a corporate conviction for innocent third parties would be significant, it may be appropriate to consider a non-prosecution or deferred prosecution agreement with conditions designed, among other things, to promote compliance with applicable law and to prevent recidivism' (DOJ, 2008).
- 23. The Wheatley Review of Barclays' LIBOR transgressions, commissioned by the Chancellor of the Exchequer, concluded 'LIBOR manipulation and attempted manipulation is unlikely to constitute a criminal offence which falls under the prosecutorial responsibility of the FSA' (HM Treasury, 2012, p. 18).
- 24. For instance, 'a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems ... The extent of Barclays' misconduct throughout the Relevant Period was exacerbated by these inadequate systems and controls ... Compliance's failures meant that other issues at Barclays relating to the LIBOR and EURIBOR submissions process were allowed to continue' (FSA, 2012, p. 39).
- 25. For other banks involved in the scandal, this has translated into outright jurisdictional competition. For instance, the Canadian Competition Bureau's investigation of the Royal Bank of Scotland resulted in the bank's characterization of demands for trading data and documents as an 'invasion of the sovereignty of the United Kingdom' (Robertson et al., 2012).
- 26. Other recent cases involving conflicts of interest between banks' intermediation and proprietary trading functions have invoked similar reforms. See, for instance, Dorn

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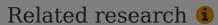


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Phil Ashton is Associate Professor of Urban Planning & Policy at the University of Illinois at Chicago. Phil's research focuses on banking, consumer credit and the governance of finance. He has applied these concerns within written work on sub-prime mortgage lending, risk and infrastructure privatization. He is now working on a book on the juridical dimensions of the sub-prime mortgage crisis, including recent legal settlements with large sub-prime lenders over lending and servicing abuses.

## **Brett Christophers**

Brett Christophers, Associate Professor at Uppsala University, and is an economic geographer who has written widely on the political and cultural economies of capitalism in both historical and contemporary perspectives, with a particular emphasis on finance and financial capital. He is the author of three monographs – most recently Banking across Boundaries (Wiley-Blackwell, 2013) – and numerous journal papers.



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