



Financial Services Authority

Internal Audit report

A review of the extent of awareness
within the FSA of inappropriate
LIBOR submissions

March 2013

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1. Executive summary

1. This chapter contains the following sections:
 - 1.1 Background and methodology;
 - 1.2 Conclusions; and
 - 1.3 Lessons to be learned and recommendations.

1.1 Background and methodology

2. On 27 June 2012, the FSA published a Final Notice¹ in which it announced a £59.5mn fine for Barclays Bank Plc ('Barclays') for breaches of Principles 2, 3 and 5 of the FSA's Principles for Businesses in relation to the London Interbank Offered Rate (LIBOR) and the Euro Interbank Offered Rate (EURIBOR)².
3. That Final Notice makes reference (in section C) to 'inappropriate LIBOR submissions to avoid negative media comment' (also referred to as 'lowballing') and in section B to 'inappropriate submissions following requests by derivatives traders'. In order to maintain consistency, we use the terms 'lowballing' and 'trader manipulation' throughout this report to refer to and differentiate between the different types of misconduct.
4. We note that Final Notices related to LIBOR for UBS AG³ ('UBS') and the Royal Bank of Scotland plc⁴ ('RBS') have been published since the Terms of Reference for this review were agreed (we attach the Terms of Reference as Annex 2).

Focus on lowballing

5. Following the publication of the Final Notice, Barclays disclosed to the Treasury Committee 13 contacts that it had had with the FSA about lowballing between 6 December 2007 and 30 September 2008, three of which are referred to in the Final Notice. The FSA's Chairman therefore asked Internal Audit to review whether there were other relevant communications to, or within, the FSA that may have indicated that the FSA was, or should have been, aware of lowballing and, if it were possible from the available information, to form a judgement about the appropriateness of the FSA's responses at the time. We note that the FSA's Chairman wrote to the Treasury Committee setting out some communications identified before Internal Audit started its review⁵.

Trader manipulation

6. While our scope focused on identifying any communications related to lowballing, we also searched the 97,000 documents we reviewed (see paragraph 10) for any references to trader manipulation. We did not find any such references.

¹ FSA Final Notice, 27 June 2012

² The scope of our review included both LIBOR and EURIBOR. The only relevant references to EURIBOR we found in the communications were minor references in Communication 8 and 36. Therefore, we do not raise any specific conclusions in relation to EURIBOR.

³ FSA Final Notice, 19 December 2012

⁴ FSA Final Notice, 6 February 2013

⁵ Treasury Committee publication: 'Fixing LIBOR: some preliminary findings. Written Evidence'. The FSA's letter, dated 24 July 2012, was number 18 in the list of written evidence.

Period under review

7. Our review focused on the period January 2007 to May 2009 (hereafter in this report referred to as the ‘review period’). We decided at the outset that we would extend the period to cover an earlier or later period if the results of our document review indicated that this would be appropriate. The Final Notice explained that Barclays was lowballing during the period September 2007 to May 2009. Internal Audit reviewed the FSA’s records from January 2007 to identify any relevant communications received before September 2007. As we set out in Section 3.1, the first relevant communication that we found was dated 5 September 2007. We found no evidence to suggest it would be appropriate to review records before January 2007. As far as the end point of the review period is concerned, by May 2009 the FSA was working with the Commodity Futures Trading Commission (CFTC), which had issued information requests to certain firms in relation to their LIBOR submissions. We therefore concluded that a later end point of the review would not be necessary.
8. While we are aware that instances of trader manipulation occurred before January 2007 and after May 2009, we considered that the two and a half year period we selected was a reasonable sample period from which to form a judgement about whether the FSA received any indication of such manipulation.

Terminology related to LIBOR used in this report

9. In Chapter 2, we provide an explanation of the LIBOR fixing process and key terms we use in this report. In summary:
 - LIBOR ‘submissions’ are the rates that contributor (or panel) banks provide for a given currency and borrowing period (for example overnight, 1 week or 3 months).
 - These submissions are averaged to produce LIBOR ‘fixings’.
 - The LIBOR ‘fixing process’ refers to the mechanism by which contributor banks determine their individual submissions and how these are checked, processed and averaged to produce fixings.
 - As described in the Wheatley Review⁶, the activities of contributing to or administering LIBOR (meaning the fixings process, including submissions and oversight) were not ‘regulated activities’ as defined under the Financial Services and Markets Act 2000 (relevant in this report when we explain what was, and what was not, the FSA’s responsibility).

Methodology of the review

10. Internal Audit searched and reviewed electronic records (on the FSA’s records management system and within relevant email accounts⁷) from the period January 2007 to May 2009. In summary, we loaded 17 million documents and emails into search software. We sought to identify all communications recorded within the FSA which were relevant to LIBOR and EURIBOR using the search term ‘IBOR’. Our initial filter using that search term found approximately 97,000 documents and emails which the team then individually reviewed.
11. During the review period, the FSA was increasingly using electronic records rather than paper records; however it is possible that relevant paper records may have been received

⁶ The Wheatley Review of LIBOR: final report, September 2012

⁷ Where these were available – see Annex 1.

and archived. Internal Audit therefore sought to identify, as far as practically possible, relevant archived hard copy records from the same period.

12. Internal Audit also interviewed 20 key current and former colleagues.
13. From the 97,000 documents, we then identified those that we considered made a direct reference to lowballing and those that contained a reference that could, in our judgement, have been interpreted as such⁸. We included all of the contacts to the FSA from Barclays that were disclosed to the Treasury Committee (see paragraph 17). Based on this methodology, we identified 74 relevant sets of communications. In the interests of transparency, and to help illustrate how we have reached our conclusions, we include the relevant parts of all of those communications in Chapter 3. We provide background information in Chapter 2, Section 2.3 about the underlying material from which these communications and quotes were obtained.
14. The 74 sets of communications comprise:
 - 12 internal FSA communications;
 - 18 sets of Market conditions and Market Intelligence updates from the Bank of England;
 - 2 sets of minutes from meetings of the Bank of England's Sterling Money Markets Liaison Group;
 - 30 communications from firms;
 - 7 media articles; and
 - 5 sets of communications comprising exchanges with the BBA, CFTC and Office of Fair Trading (OFT) (as these sets of communications spanned a number of weeks or months we refer to them as 'events').
15. In many cases, the purpose of the communications we have identified was to give general market conditions updates to staff. These had wide circulation lists. Many of the extracts we include in this report are short extracts from much longer documents. Within these documents, comments on LIBOR varied in prominence.
16. In light of the FSA's confidentiality obligations under European Directives and the Financial Services and Markets Act 2000, we have anonymised and redacted certain information in this report, where that information is not in the public domain. We have anonymised firm names as follows: LIBOR Panel Bank; Non LIBOR Panel Bank; and Building Society. We have redacted data that could be used to identify a firm, for example, by using 'xx' instead of the actual figure or by referring to 'higher than' or 'lower than' to convey the meaning rather than providing exact figures. In finalising the report, we showed drafts to a number of individuals and organisations involved in the communications included in the report (particularly where there might be a perception of criticism), to allow them the opportunity to provide any comments for us to consider.
17. Barclays disclosed to the Treasury Committee 13 contacts it had with the FSA, where LIBOR fixings were mentioned⁹. Three of these are referred to in the Final Notice¹⁰. Barclays has given permission to the FSA to reproduce extracts from the other contacts it

⁸ For example, we included material that questioned the reasons for LIBOR dislocation, but excluded material where a reference was limited to describing movements in LIBOR.

⁹ 'Supplementary information regarding Barclays settlement with the Authorities in respect of their investigation into the submission of various interbank offered rates (AMENDED)'

¹⁰ FSA Final Notice, 27 June 2012, paragraphs 128, 131 and 173

disclosed to the Treasury Committee and a number of other communications we found as part of our review. Therefore we have not anonymised or redacted those communications in this report.

18. When referring to current and former members of FSA staff, we refer to directors and above by their title (for example, Chief Executive Officer (CEO), Director of Markets Division) and to staff below director level as 'member of staff'. We use 'a representative of ...' to refer to individuals from external organisations, unless that information is already in the public domain.
19. The scope of Internal Audit's work as set out above was subject to several limitations, which are set out in detail in Annex 1¹¹.
20. This report uses 'Internal Audit' and 'we' or 'our' to refer to the Internal Audit team. When referring to the FSA and its actions or judgements, we specify this.

Areas outside the scope of the review

21. Because this was an evidence-based review and the focus has been on communications that we found had been circulated to, or within, the FSA, we do not comment on:
 - any relevant material that may have been circulated within (or between) other organisations (unless we found that the communication had also been received by the FSA). For example, we found no evidence that an email from the then President of the New York Federal Reserve Bank to the Governor of the Bank of England (of 1 June 2008)¹² was received by the FSA;
 - publicly available material, unless we confirmed it was circulated to the FSA (for instance, we have not found records of some of the media articles referred to in the Treasury Committee's preliminary findings¹³);
 - any additional comments or discussions that may have occurred in relation to communications we have included in the report, unless we found that the FSA had been party to these;
 - any actions that other organisations may have taken (or not taken) in relation to communications we include, unless we found that the FSA had been informed of these actions;
 - any events that took place after the period covered by our review, such as how the FSA's enforcement action developed or any further consideration of the appropriateness of the LIBOR fixing process; and
 - actions taken in relation to subjects included in communications that did not specifically relate to LIBOR.
22. The scope of our review did not include seeking to quantify the scale of lowballing. We note that the scale of individual firms' misconduct is reflected in the relevant Final Notices.

¹¹ These limitations include: the extent to which relevant records existed (for example, the possibility that records had not been saved in the electronic records management system); difficulties in identifying members of email circulation lists; and difficulties in searching scanned, encrypted, paper and audio files.

¹² This email from the then President of the New York Federal Reserve Bank outlined recommendations for enhancing the credibility of LIBOR.

¹³ 'Fixing LIBOR: some preliminary findings' published on 18 August 2012 – Section 3.

23. Following the publication of the Barclays' Final Notice, the Government asked Martin Wheatley, Managing Director of the Conduct Business Unit and CEO designate of the Financial Conduct Authority, to carry out an independent review of a number of aspects of the setting and use of LIBOR. The scope of our review is distinct from the Wheatley Review which was focused on formulating policy recommendations with a view to:
- reforming the current framework for setting and governing LIBOR;
 - determining the adequacy and scope of sanctions to tackle LIBOR abuse appropriately; and
 - considering whether similar 'considerations' applied with respect to other price-setting mechanisms in financial markets, and providing provisional policy recommendations in this area.

Context

24. The review period coincides with a period of intense market instability. Market conditions deteriorated significantly in the second half of 2007 as the subprime mortgage crisis developed, and worsened considerably in September 2008 before improving towards the end of the year and into 2009 following interventions by central banks. Deteriorating market conditions were interacting with structural issues in the LIBOR fixing process causing dislocation between LIBOR and other indicators (hereafter in the report referred to as 'LIBOR dislocation') as follows:
- banks' difficulties in providing accurate LIBOR submissions because some markets became very illiquid with very few transactions occurring at some maturities;
 - the fact that, as LIBOR is fixed at a point of time, actual trades could be expected to differ from the 11am fixing, particularly during periods of volatility; and
 - the fact that the BBA definition of LIBOR included submissions being based on 'reasonable market size' borrowings. Trades of different amounts, particularly in stressed market conditions, could attract different funding rates.
25. LIBOR dislocation manifested itself in five main ways:
- the spread between LIBOR fixings and other rates (such as the Overnight Indexed Swap rate – see paragraph 44) widening;
 - the volatility in LIBOR fixings and spreads;
 - the divergence between LIBOR submissions and actual rates that could be obtained in the market;
 - a wider dispersion of LIBOR submissions; and
 - a greater divergence between funding rates for different banks depending on their perceived creditworthiness (also known as 'tiering', see paragraphs 68).
26. The combination of deteriorating market conditions and structural issues in the LIBOR fixing process therefore would have caused dislocation completely independent of any lowballing or trader manipulation.
27. The activities of contributing to or administering LIBOR were not 'regulated activities' as defined under the Financial Services and Markets Act 2000 - the BBA was responsible for overseeing the LIBOR fixing process. Manipulation and attempted manipulation of LIBOR was also unlikely to fall under the market abuse regime¹⁴. However, the FSA was

¹⁴ 'The Wheatley Review of LIBOR: initial discussion paper', August 2013, paragraph 2.34 and annex B

responsible for regulated firms' conduct in relation to its Principles for Businesses; this was relevant to regulated firms' LIBOR submissions¹⁵.

1.2 Conclusions

28. Overall, we found many communications that indicated LIBOR dislocation. Such communications increased between April and June 2008. During the review period, the FSA's focus was on the impact of the deteriorating market conditions for individual firms' capital and liquidity positions and in some cases their very viability. The FSA recognised that LIBOR dislocation was caused by structural issues in the LIBOR fixing process interacting with the deteriorating market conditions (see paragraphs 24 to 26) and it fed into the BBA's review of that process.
29. Of the 97,000 documents and emails we reviewed, we highlight 74 sets of communications in this report that we considered contained either a direct reference to lowballing or a reference that could, in our judgement, have been interpreted as such. We judged 26 of the 74 communications to include a direct reference, of which the significant majority were received between April and June 2008 (covered in Section 3.3 of Chapter 3). These 26 communications included the telephone calls from Barclays in March and April 2008 (Communications 28 and 37) already in the public domain through the Enforcement Final Notice. We consider those two communications were the clearest contacts we found that indicated that an individual bank was lowballing. In relation to the communications that did not have a direct reference to lowballing, we consider that they could have provided such an indicator, particularly when considered in aggregate.
30. By contrast, we also observed material that recognised LIBOR dislocation, but did not conclude that there was also lowballing (for example, the conclusions of an article within the March 2008 Bank for International Settlements Quarterly Review (see paragraph 95) and the October 2008 International Monetary Fund's Global Financial Stability report (see paragraph 136)).
31. **Based on the body of communications and the FSA's responses to them, we make the following conclusions and raise related lessons to be learned (see Section 1.3). The FSA should have:**
- **considered the possibility and likelihood of lowballing (particularly in the period from April 2008), rather than assuming the only problems with LIBOR were those caused by structural issues in the LIBOR fixing process interacting with deteriorating market conditions (lesson 3). In addition, we consider the FSA should have been more proactive before April 2008 in contacting the BBA to pursue the structural issues;**
 - **been more inquiring and challenging of the information in individual communications and more sensitive to the accumulation of the communications (lessons 3 and 4);**
 - **ensured that communications were analysed, circulated and escalated in an appropriately targeted manner (lessons 2, 4, and 5). This would have helped make it clearer what action might be required and by whom, and identify linkages between communications so that they could be considered in aggregate. This was particularly the case for information received by supervisors, especially in relation to Barclays (although we recognised the**

¹⁵ As outlined in the relevant Final Notices, Barclays breached Principles 2, 3 and 5 of the FSA's Principles for Businesses, whereas UBS and RBS breached Principles 3 and 5.

- **supervisory team’s competing priorities and resource constraints¹⁶;**
 - **given explicit consideration to the FSA’s responsibilities for regulated firms’ conduct in relation to the Principles for Businesses and the potential for (and impact of) lowballing, rather than being focused solely on the BBA’s oversight role for the LIBOR fixing process, particularly after the BBA announced its review (lesson 1); and**
 - **clarified roles and responsibilities within the FSA, including for dealing with external bodies (see paragraph 131); sought clarification of the roles and responsibilities of external bodies (see paragraph 110); and sought clarification of the roles and responsibilities between Tripartite authorities - particularly given the relevant communications being circulated by the Bank of England (lesson 2).**
32. **Overall, we conclude that the FSA’s focus on dealing with the implications of the financial crisis for the capital and liquidity positions of individual firms, together with the fact that contributing to or administering LIBOR were not ‘regulated activities’, led to the FSA being too narrowly focused in its handling of LIBOR-related information. This was both in terms of challenging and inquiring about that information, and considering its conduct responsibilities in relation to the Principles for Businesses and any potential for consumer or market detriment. Our view is strengthened by the fact that the FSA did go on to take enforcement action in relation to the FSA’s Principles for Businesses.**
33. In addition to these conclusions, in Chapter 4 we provide answers to five key questions that we consider may arise from the communications and commentary in Chapter 3.

1.3 Lessons to be learned and recommendations

34. We draw out six lessons for the FSA and future regulatory authorities. The FSA’s Internal Audit report ‘The supervision of Northern Rock: a lessons learned review’ (the Northern Rock Report) and its Board report on ‘The failure of the Royal Bank of Scotland Financial Services Authority Board Report’ (the RBS report) raised a number of related recommendations for the FSA. These reports covered periods that overlapped with the review period for this report, so there are some common lessons. In addition, the October 2012 publications describing the approaches of the FCA and PRA (‘FCA approach document: Journey to the FSA’ and ‘The Bank of England, Prudential Regulation Authority: The PRA’s Approach to Banking Supervision’) covered certain areas that are relevant here. In order to address the lessons, we raise nine recommendations (Section 4.2, summarised in the table on the next page and in Section 4.3).

¹⁶ The failure of the Royal Bank of Scotland Financial Services Authority Board Report, December 2011, p80, showed that the Barclays’ supervision team comprised four staff and 0.5 of a manager at October 2007. This team also provided sectoral support across the Major Retail Groups Division, for example, on liquidity monitoring.

Lesson	Recommendation(s)
The regulatory perimeter	
1: Activities outside the regulatory perimeter and their implications	<p>1.1 We question whether there might be other significant non-regulated activities, where wrongdoing by regulated firms in relation to those activities could breach the FCA and PRA Principles for Businesses, pose a threat to the safety and soundness of those firms, or potentially cause significant consumer or market detriment.</p> <p>We recommend that FCA and PRA senior management consider how such activities will be identified and assessed by the new regulatory authorities' risk and governance frameworks, so that risk-based prioritisation decisions can be made in relation to them.</p>
Roles and responsibilities	
2: Roles and responsibilities	<p>2.1 We recommend that FCA senior management satisfies itself that there is a clear division of responsibilities relating to LIBOR between the authorities in the new regulatory framework, including for receiving and sharing LIBOR-related information and for acting on that information where necessary. If FCA senior management finds that the division of responsibilities is not clear, it should act with PRA senior management and other regulatory authorities to seek clarification.</p> <p>2.2 We recommend that FCA senior management (in consultation with the PRA if necessary) establish clear internal roles and responsibilities relating to LIBOR.</p>
Culture of the regulatory authorities	
3: Inquiry and challenge	<p>3.1 We recommend that FCA and PRA senior management embed the lessons from this review appropriately in the cultures of the regulatory authorities. This should include ensuring that staff are sufficiently inquiring and challenging and that they maintain the necessary breadth of perspective.</p>
How the regulatory authorities use and record information and intelligence	
4: Use of information and intelligence	<p>4.1 As an important element in developing the desired culture of the FCA and PRA, alertness to the need to share intelligence appropriately should be reinforced as a principle for all staff behaviour. For the FCA we recommend that the new Policy, Risk and Research Division develops clear success measures for its target operating model that take account of this lesson from our review.</p> <p>4.2 FCA and PRA senior management should clarify responsibilities in relation to the use of information from external sources including analysts' reports, media articles and market data.</p>
5: Circulating and escalating information	<p>5.1 We recommend that FCA and PRA senior management establish effective working arrangements for the circulation and sharing of information, including to whom information should be circulated and the action required of the recipient.</p> <p>5.2 We recommend that the FCA and PRA senior management establish effective working arrangements for the escalation of information.</p>
6: Record keeping	<p>6.1 We recommend that, in developing their records management policies, FCA and PRA senior management include success measures and key performance indicators that take into account the lessons raised in this review and the review's inherent data gathering limitations.</p>

2. Information relating to the LIBOR fixing process, LIBOR fixings and spreads, and the organisation of this report

35. This chapter contains the following sections:

- 2.1 Explanation of the LIBOR fixing process during the review period;
- 2.2 Key LIBOR fixings and spreads in the period; and
- 2.3 How this report is organised.

2.1 Explanation of the LIBOR fixing process

Definition of LIBOR

36. LIBOR is a benchmark reference rate, produced for 10 currencies with 15 borrowing periods quoted for each - ranging from overnight to 12 months. LIBOR gives an indication of the average rate at which a LIBOR contributor bank can obtain unsecured funding in the London interbank market for a given period, in a given currency.

What is LIBOR used for?

37. LIBOR is an interest rate that banks use when lending to each other. It is used in over the counter (OTC) interest derivative contracts and exchange traded interest rate contracts. It is also used as a reference point for retail products such as mortgages and loans.

What is the fixing process?

38. The LIBOR fixing process refers to the mechanism by which contributor banks determine their individual submissions and how these are checked, processed and averaged to produce fixings.

39. The Wheatley Review recommended changes to the LIBOR fixing process. The explanation below relates to the process in operation during the review period: January 2007-May 2009.

How was LIBOR calculated during the review period?

40. Contributor banks submitted a rate at which they could borrow unsecured funds in the interbank market for a given currency and borrowing period (for example overnight, 1 week or 3 months). The rates submitted were collated, the top and bottom 25% of those submitted rates were excluded and the average was then taken of the remaining rates. This process would determine that day's LIBOR fixing. Contributor banks (also known as panel banks) were selected, by the BBA, based on three factors: scale of market activity, credit rating, and perceived expertise in the currency concerned.

41. LIBOR was defined by the BBA at the time¹⁷ as "*the rate at which a contributing bank believes it could borrow funds should it wish to do so, by asking for and then accepting inter bank offers in a reasonable market size just prior to the fix time, which is 11am London time.*" The submitted rates could therefore be a subjective measure rather than being necessarily based on actual transactions.

¹⁷ Source: 'Understanding the construction and operation of BBA LIBOR – strengthening for the future', BBA, 10 June 2008.

42. Although LIBOR submissions were meant to be based on the rate at which the contributor bank could borrow funds, we observed confusion in some of the documents we reviewed in which LIBOR submissions were interpreted to be the rate at which a contributor bank should lend in the interbank market.

LIBOR submissions and fixings

43. Contributor banks made LIBOR submissions for a given currency and range of borrowing periods, from which the LIBOR fixings were calculated as set out in paragraphs 40 and 41. However, in the communications we found as part of our review, we noted that the terms ‘fixings’ and ‘submissions’ were often used interchangeably.

LIBOR and the Overnight Indexed Swap spread

44. An Overnight Indexed Swap (OIS) is a type of interest rate swap where payments based on a fixed rate of interest are exchanged for payments based on a variable (‘floating’) rate. Because only the net difference in interest is paid, there is limited counterparty risk. An OIS rate is based on a daily overnight rate, typically a central bank rate. For example, for US dollars, the rate is the daily US Federal Funds Rate.

45. In contrast, LIBOR takes into account banks’ creditworthiness in addition to reflecting the price of funds for a particular period, since there is risk that any bank placing funds will not receive this money back.

46. The LIBOR-OIS spread is the difference between LIBOR in a particular currency and the corresponding OIS rate. Because of the counterparty risk element in LIBOR, this spread is therefore an indicator of banks’ perceived level of credit risk.

2.2 Key LIBOR fixings and spreads in the period

47. We show on the following two pages, charts of 3 month Sterling LIBOR and its US Dollar equivalent (on the basis that many financial instruments use these as reference rates) and also the spread between those LIBOR rates and the comparable OIS rate in the period. These spreads hit unprecedented levels in August 2007 and remained volatile throughout the remaining review period.

Chart 1: 3 month Sterling LIBOR

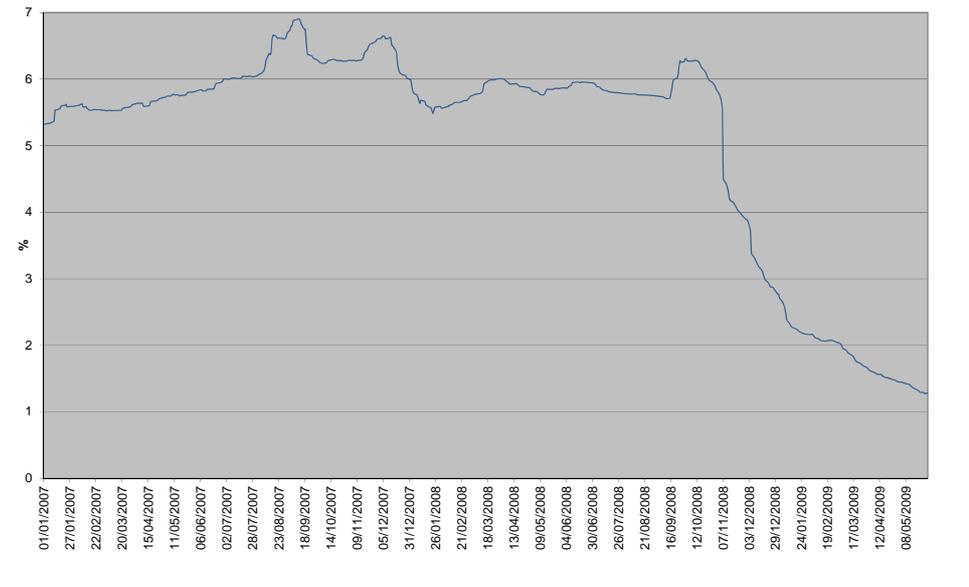


Chart 2: 3 month US Dollar LIBOR

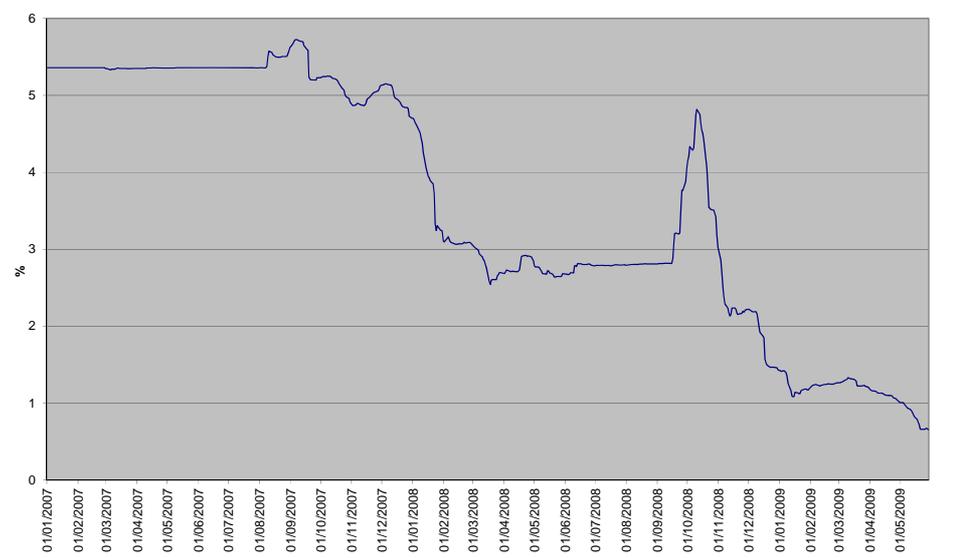
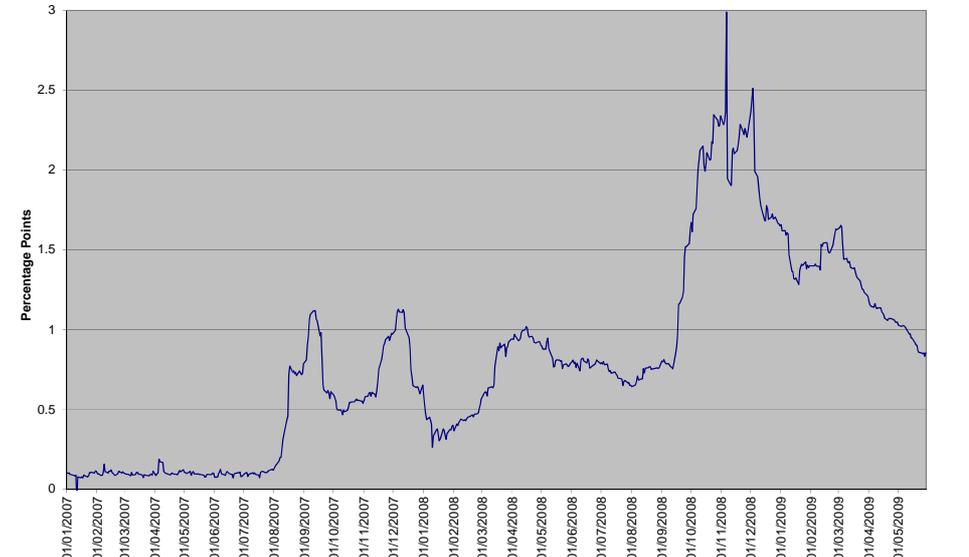
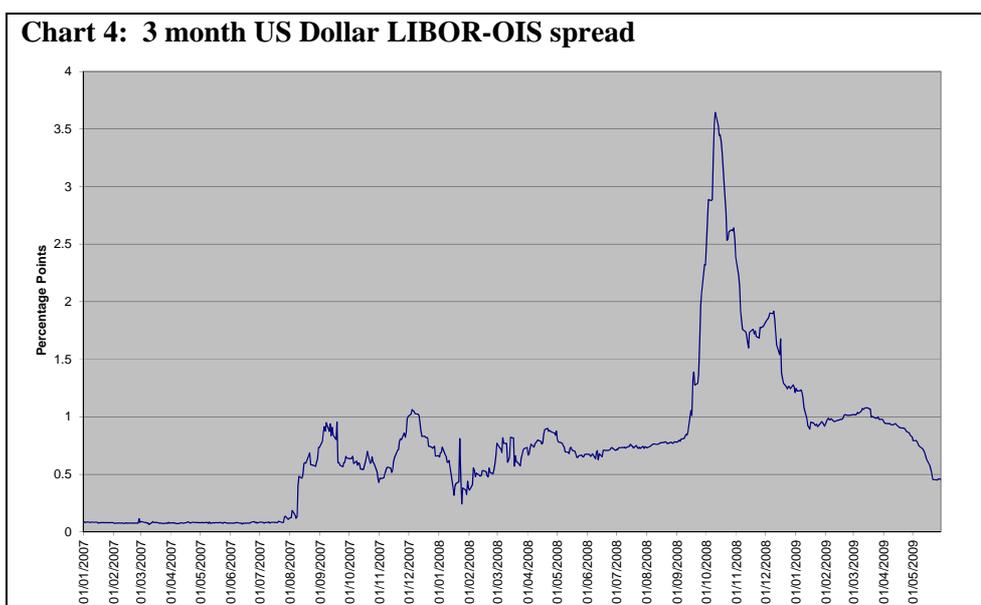


Chart 3: 3 month Sterling LIBOR-OIS spread





Charts 1 to 4 source data: Thompson Reuters and Bloomberg

2.3 How this report is organised

48. Chapter 3 sets out the communications we found and the action the FSA took in response to them. It contains four sections which each cover a particular time period. Sections 3.1 and 3.2 cover the period when market conditions began deteriorating – we have split this into two sections for ease of readability given the length of the period. Section 3.3 covers the period up to when the BBA published its consultation paper on the LIBOR fixings process, and Section 3.4 covers the remaining period within the scope of our review. These time periods are not of equal length.

49. Each section starts, as background, with a brief description of key relevant market events in the period; it then lists the individual communications we found and those to whom they were circulated. Each section concludes with a commentary. We set out below more detail on the subsections that deal with communications and commentary.

What is contained in each ‘Communications and their circulation’ subsection of Chapter 3

50. These subsections describe the relevant communications we identified in the period, together with to whom they were circulated.

51. We have divided information into ‘sets’. In some cases, a set may describe a note and its circulation. In other cases, it may comprise an exchange of emails on a particular subject. For each set of communications we:

- provide the date of the initial communication (sets of communications are ordered by this date);
- describe the type of communication (see explanation in paragraph 52);
- describe the information;
- describe to whom the communication was circulated (see explanation in paragraphs 53 to 56); and
- describe any relevant action that was taken (see explanation on context of communications in paragraph 57).

Types of communications

52. We found the following types of communication during the review period:

a) FSA internal communications

- These included internal analyses and market commentary. In addition, from August 2007 until October 2008, the FSA held Market Conditions Meetings (at least two-three times per week and sometimes daily), at which market developments and information were discussed by representatives from different areas of the FSA. The minutes of these meetings were circulated widely within the FSA including to the Executive Committee (ExCo) and the Chairman. These notes were intended to be commentary on market events and, since they included views provided by firms and market contacts, they did not necessarily represent the FSA's views.

b) Communications from the Bank of England

- The Bank of England prepared market conditions updates for its staff (including a daily 'Market Intelligence Summary', 'Markets Daily Report' and 'Markets Morning Updates' – all referred to as a 'Market conditions update' in this report – and a weekly 'Sterling Markets Division Market Intelligence' note). By way of example, the Markets Morning Updates would tend to be a few pages of markets snippets and were generally circulated by a member of Bank of England staff below director level. Certain FSA staff received the Market Intelligence Summaries, Markets Daily Reports and Markets Morning Updates from August 2007 until at least the end of the review period (end-May 2009) and the Sterling Markets Division Market Intelligence notes from at least January 2007 to October 2008.
- These Bank of England reports had more limited circulation within the FSA (compared to the notes of the FSA Market Conditions Meetings) and circulation varied according to the communication and over time (we specify the circulation for each communication, within each time period).
- These notes were intended to be commentary on market events and since they included views provided by firms and market contacts, they did not necessarily represent the Bank of England's views.

c) Communications from firms

- During the review period, the FSA had intensive contact with firms about their capital and liquidity positions (at certain points during the period some firms provided liquidity updates several times per day by telephone or email). The calls and emails were regularly summarised and widely communicated (including orally at the Market Conditions Meetings). FSA supervisors and risk specialists also circulated notes of meetings with firms about their capital and liquidity positions. From November 2007, several financial institutions completed weekly surveys of wholesale funding conditions. These, together with a summary, were circulated within the FSA until April 2008, including to certain directors and above.

d) Press and other communications

- Throughout the review period, relevant media articles and external analysis relating to the accuracy of LIBOR fixings and submissions were received by individuals within the FSA.

e) Events

- We have included communications with other organisations where the content could have related to lowballing. We refer to these sets of communications in the report as ‘events’. There were 5 events comprising discussions with the BBA, the CFTC and the OFT.

Circulation of communications

53. When describing the nature of each communication, we have sought wherever possible to state to whom it was circulated. We specify the recipient division¹⁸ and whether it was circulated to a director or above (managing director, ExCo, CEO or the Chairman). We do not specify individuals by name. Many of these notes were circulated very widely in a non-targeted manner. It should be noted that in many cases we could not assess whether emails were read by recipients.
54. At times during the review period, certain individuals held multiple roles within the FSA. We set out in Chapter 3 all the roles at director level and above that an individual held at the time of receiving a particular communication. In addition, where an individual was a member of an executive body of the FSA (for example ExCo) and a communication was circulated to the mailing list for this executive body we have not identified each member of the executive body individually.
55. Communications were on occasions sent to a named email distribution (mailing) list that included FSA staff. Although we were unable to determine exactly who was on a mailing list, we were able to confirm some recipients by reviewing whether individuals received the relevant email at the time. Using this approach and by comparing different emails sent to the same distribution list, we were able to apply our judgement as to who was likely to have received communications sent to a distribution list. The FSA also used shared mailboxes to send and receive emails. Access to these mailboxes varied over time and where possible we have identified the relevant FSA staff that were likely to have had access to these mailboxes.
56. Communications were also sent to the offices of senior staff (for example the Chairman’s Office). Where possible we have distinguished whether a communication was circulated to an office or the individual.

Context of communications

57. It should be noted that references to LIBOR rates or submissions were often made in the context of other subjects, for example general market updates or liquidity information received from firms. Actions taken in relation to those other subjects not specifically relating to LIBOR, were not within the scope of our review and so are not covered. For example, a funding update provided by a firm may have included a comment on LIBOR dislocation. Although we may not have observed any comment or action in relation to the comment on LIBOR, FSA staff may have taken other action in relation to the funding update, such as evaluating the firm’s financial position. This action would not be commented on within Chapter 3.

¹⁸ During the review period there were some reorganisations of the FSA leading to changes in the names of some divisions and some redistribution of responsibilities among directors.

What is contained in each 'Commentary' subsection of Chapter 3

58. Each subsection includes three parts:

- Part 1 comments on the extent to which communications indicated potential lowballing;
- Part 2 comments on the awareness within the FSA of the significance of the communications; and
- Part 3 comments on what actions the FSA took in relation to the communications.

3. Communications and commentary

59. As we have outlined in Chapter 2, we have divided our communications into four sections which each cover a particular time period. The sections are as follows:

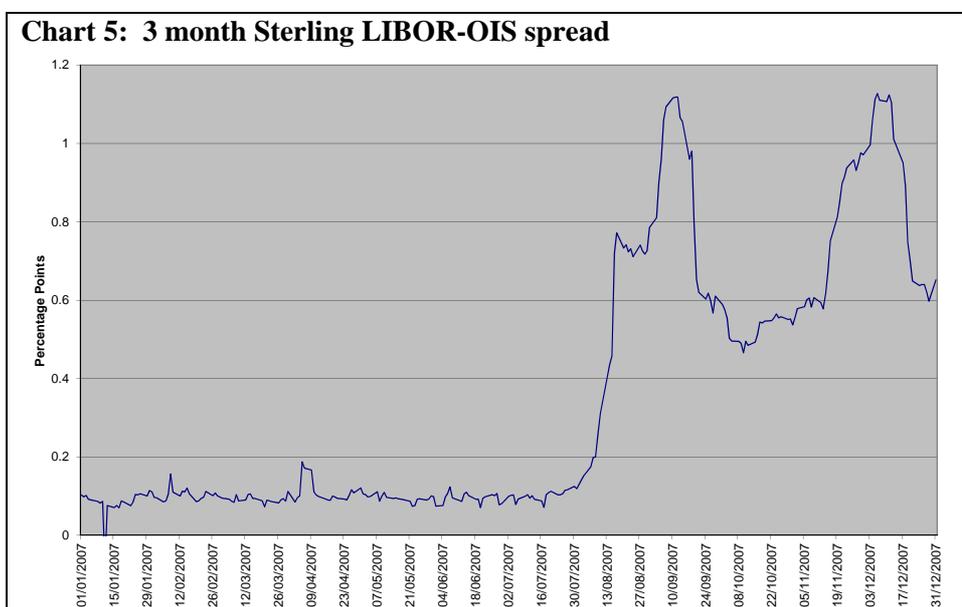
- 3.1 1 January 2007-31 December 2007;
- 3.2 1 January 2008-31 March 2008;
- 3.3 1 April 2008-25 June 2008; and
- 3.4 26 June 2008-31 May 2009.

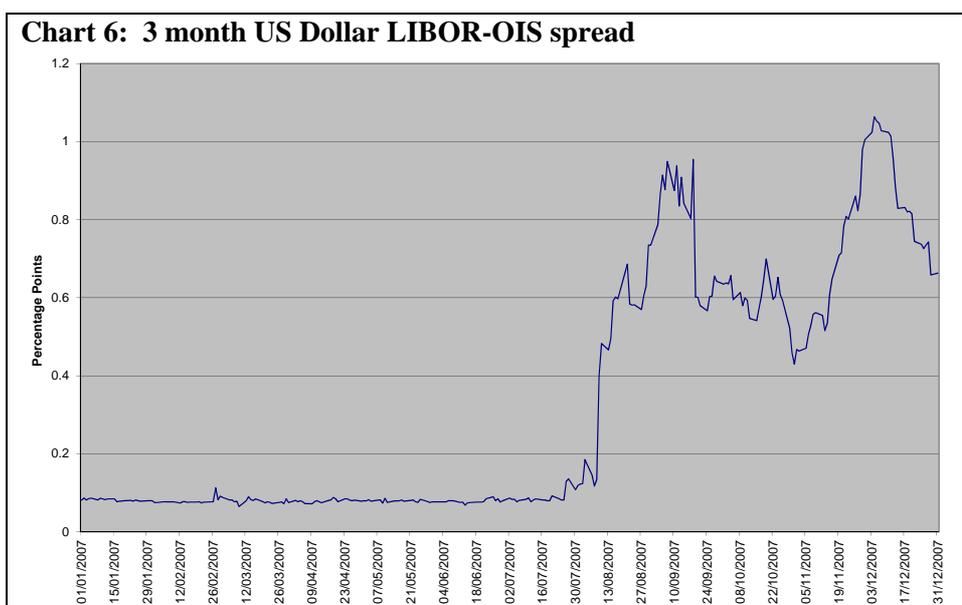
60. Sections 3.1 and 3.2 cover the period when market conditions began deteriorating – we have split this into two sections for ease of readability given the length of the period. Section 3.3 covers the period up to when the BBA published its consultation paper on the LIBOR fixings process, and Section 3.4 covers the remaining period within the scope of our review. These time periods are not of equal length.

3.1 1 January 2007 to 31 December 2007

61. Market conditions deteriorated in the second half of 2007 as the subprime mortgage crisis developed. This was reflected by a sharp increase in LIBOR-OIS spreads with the Sterling 3 month spread exceeding 100bps by the beginning of September. A number of financial institutions experienced liquidity issues, and the Bank of England announced on 14 September that it was providing a liquidity support facility to Northern Rock.

62. Although narrowing towards the end of September, LIBOR-OIS spreads widened to over 110bps at the beginning of December as various financial institutions announced large write-offs and losses and were subject to ratings warnings and downgrades.





Charts 5 and 6 source data: Thompson Reuters and Bloomberg

3.1.1 Communications and their circulation

63. We have identified 14 sets of communications in 2007. These comprise:

- two internal FSA communications on market conditions/LIBOR;
- nine Market conditions and Market Intelligence updates from the Bank of England;
- a note for record of a meeting of the Bank of England’s Sterling Money Markets Liaison Group; and
- two communications from firms on fixings/submissions.

64. We provide further information on these communications below, including to whom they were circulated.

Communication 1

Note of Market Conditions meeting	5 September 2007	Internal FSA
<p>The note included the following comments:</p> <ul style="list-style-type: none"> • “Sterling 3 month LIBOR is 6.7975%. LIBOR should track base rates (5.75%) but is substantially different. The swap forward rate is 6.23% and this provides an indication of the level that LIBOR should be at. Therefore LIBOR is currently out of sync with what it tracks.” • “[A Non LIBOR Panel Bank mentioned that] although LIBOR is fixed at 11.00am, LIBOR is moving intraday and no one knows the true value. [The Chair of the meeting] asked the question as to whether it will be possible and useful for LIBOR to be fixed more frequently.” 	<p>The meeting was chaired by the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector.</p> <p>It was also attended by staff below director level within:</p> <ul style="list-style-type: none"> • Major Retail Groups Division (MRGD); Wholesale Firms Division; • Retail Firms Division (RFD); • Strategy and Risk Division; and • the Wholesale Management Services Unit. <p>In addition to the above a note of the meeting was circulated to the Chairman, ExCo and:</p> <ul style="list-style-type: none"> • the Director of Markets Division/the Auditing and Accounting Sector; • the Director of MRGD/the Financial Stability Sector; • the Acting Directors of RFD; 	

	<ul style="list-style-type: none"> • the Director of Treating Customers Fairly Division (TCFD)/the Insurance Sector; • the Director of Retail Themes Division (RTD)/the Consumers Sector; • the Director of Retail Policy Division (RPD)/the Asset Management Sector; and • the Director of Communications Division. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • the Financial Stability Sector team; • MRGD; • RFD; • Wholesale and Prudential Policy Division; • RTD; • RPD; • TCFD; • General Counsel’s Division; and • Communications Division.
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Communication 2

Note of an industry conference: ‘Euromoney Total Derivatives Fixed Income Forum’	18 September 2007	Internal FSA
<p>The note included the following comments:</p> <ul style="list-style-type: none"> • <i>“It is felt that LIBOR has issues at the moment, but will return to normal.”</i> • <i>“LIBOR has structural problems; banks may enter rates but not offer at the rates quoted.”</i> • <i>“Are the fixings real, apart from for those who have to refinance?”</i> 	<p>A member of staff below director level within Markets Division attended the conference. A summary which included the three bullet points was circulated to the CEO and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • Major Retail Groups Division; • Wholesale Firms Division; • Strategy and Risk Division; • Enforcement Division; • General Counsel’s Division; • Communications Division; and • the Wholesale Management Services Unit. <p>In addition, a note (Interest Rate Derivatives Surveillance Summary 2007) was circulated on 12 November 2007 to staff below director level within Markets Division which included the comments in the second and third bullet points.</p>	

Communication 3

Market conditions update	1 October 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“Little activity reported in the term US market today, but several contacts mentioned that Libor rates are being set too low given that many names (Spanish, Italian, Irish and German names) are paying above Libor to get funds.”</i> 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> • the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and • the Director of Major Retail Groups Division/the Financial Stability Sector. 	

Communication 4

Market conditions update	2 October 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> “<i>There is still a lack of offers in the dollar market, despite a few more from Hong Kong today, and therefore liquidity is reported as very thin. Several contacts noted that they think Libors should be higher, but banks are keeping them low.</i>” 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and the Director of Major Retail Groups Division/the Financial Stability Sector. <p>The note was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> Markets Division; the Financial Stability Sector team; and Strategy and Risk Division. 	

Communication 5

Meeting of the Bank of England’s Sterling Money Markets Liaison Group	15 November 2007	Bank of England
<p>One of the discussion items was the ‘Interbank market and Libor fixings’. The note of the meeting included the following comments:</p> <ul style="list-style-type: none"> “<i>Several group members thought that Libor fixings had been lower than actual traded interbank rates through the period of stress. Libor indices needed to be of the highest quality given their important role as a benchmark for corporate lending and hedging, and as a reference rate for derivatives contracts.</i>” “<i>John Ewan (BBA) outlined the quality control and safeguard measures used by the BBA to ensure the quality of Libor. Dispersion between panel banks’ submissions had increased during August but had since fallen back, in part reflecting clarification from the BBA on Libor definitions.</i>” 	<p>The FSA was represented by a member of staff below director level within Markets Division. On 1 April 2008, as part of a collection of papers for the following Sterling Money Markets Liaison Group and in the context of non-LIBOR related agenda items, the minutes were circulated to staff below director level within Markets Division.</p> <p>The minutes were also published on the Bank of England’s external website.</p>	

Communication 6

Market conditions update	23 November 2007	Bank of England
<p>The note included the following comments:</p> <ul style="list-style-type: none"> “<i>In line with general market conditions, contacts reported subdued activity in money market today.</i>” “<i>Several contacts have noted that Libors are being set at least 10bps lower than where banks are willing to pay for cash.</i>” 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and the Director of Major Retail Groups Division/the Financial Stability Sector. 	

Communication 7

Market conditions update	27 November 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> “<i>Same old story in the term market, very few offers to lend. Libors again being quoted too low compared to where the actual cash market is trying to trade, e.g. 3-month Libor is expected around 5.07, but banks are willing to pay the following, highlighting the tiring [sic], [the note listed bids for 2 LIBOR Panel Banks and 3 non-LIBOR banks. There was a spread of 20 basis points between the highest and lowest, and 3 of the 5 banks’ bids were higher than the expected LIBOR fixing of 5.07.] There were some offers out of NY yesterday at 5.09%, but could not trade (credit) with names willing to pay.</i>” 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and the Director of Major Retail Groups Division/the Financial Stability Sector. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> the Banking Sector team; the Financial Stability Sector team; Markets Division; and Strategy and Risk Division. 	

Communication 8

Market conditions update	27 November 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> “<i>More contacts mentioned that Libor and Euribor fixes may be understating true borrowing costs in the cash markets.</i>” 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector. <p>It was also forwarded on to staff below director level within MRGD.</p>	

Communication 9

Market conditions update	28 November 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> “<i>The correlation between Libors and cash continues to break down with Libors around 10bp below where cash is trading, for example 3s Libor is expected around 5.07%, but cash is trading as high as 5.20% to Germans and 5.15% to other Europeans. Several banks have noted that the dislocation between cash, OIS, and forwards is making it very difficult to trade/price.</i>” 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> the Banking Sector team; the Financial Stability Sector team; and Strategy and Risk Division. <p>It was also forwarded on to staff below director level within MRGD.</p>	

Communication 10

Sterling Markets Division Market Intelligence Summary	29 November 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • [a broker reported in the context of Sterling LIBOR-OIS spreads] <i>“increased talk that Libors were actually being slightly understated given that banks did not want to post a rate above the pack; others thought it had been a finger in the air exercise for some months.”</i> 	<p>The note was attached in an email and circulated to an FSA mailing list entitled ‘BoE Markets’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division (WFD)/Director of the Banking Sector; • the Director of Markets Division; • the Director of Strategy and Risk Division (SRD); and • the Director of Small Firms Division. <p>It also included staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • Major Retail Groups Division; • WFD; and • SRD. <p>We were able to confirm that it was circulated to the Director of SRD.</p>	

Communication 11

Market conditions update	29 November 2007	Bank of England
<p>The note included the following comments:</p> <ul style="list-style-type: none"> • <i>“In USD 1-month Libor is expected around 5.20% an increase of 38bps from yesterdays fix. However, this is still probably too as it bares no resemblance to where cash is trading [sic].”</i> • <i>“The correlation between Libors and cash continues to break down especially in the 1-3 months. The 1 month is now trading over the turn and is reported as a nightmare today. Although contacts expect [USD] Libor between 5.20-25%, cash has traded as high as 5.45% and 5.40% to several names, with a Spanish name paying as high as 5.74% via the euro swap and [a Non LIBOR Panel Bank] paying [higher than 5.74%]. There is a similar story in 2's and 3's, with European names paying, via the euro swap, at least 10-15bps above the expected Libor, which is making a mockery of the fixings.”</i> 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> • the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and • the Director of Major Retail Groups Division/the Financial Stability Sector. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • the Banking Sector team; • the Financial Stability Sector team; and • Strategy and Risk Division. 	

Communication 12

Market conditions update	4 December 2007	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> “<i>Contacts continue to speculate about how realistic the LIBOR fixings are. US dollar fixings were said to be on the low side, with the tiering of rates across the banks not as marked for fixings as for funding rates. This is because banks are concerned about being revealed as an outlier and the adverse comment this could attract.</i>” 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> the Acting Managing Director of Wholesale and Institutional Markets/Director of Wholesale Firms Division/Director of the Banking Sector; and the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector. <p>It was also forwarded on to staff below director level within MRGD and Retail Firms Division.</p>	

Communication 13

Note for record of a liquidity visit to a LIBOR Panel Bank	6 December 2007	External Firm
<p>The note included the following comment:</p> <ul style="list-style-type: none"> “<i>[the LIBOR Panel Bank] have questions over the quality of certain LIBOR fixes across currencies – with the feeling that many are too low.</i>” 	<p>The FSA was represented at the meeting by staff below director level within:</p> <ul style="list-style-type: none"> Wholesale Firms Division (WFD); Wholesale and Prudential Policy Division; and the Wholesale Management Services Unit (WMSU). <p>In addition to the above a copy of the note was circulated to staff below director level within:</p> <ul style="list-style-type: none"> WFD; and the WMSU. <p>A copy of the note was also located in the FSA’s record management system.</p>	

Communication 14

Barclays contact with the FSA	6 December 2007	External Firm
<p>The Barclays’ Final Notice (paragraph 173) states that Barclays’ Compliance contacted the FSA on 6 December 2007 by telephone to relay a concern about the levels at which other banks were setting US dollar LIBOR. An FSA note for record was not made of the telephone call.</p> <p>The Supervision team member replied by email the same day to the individual within Barclays’ Compliance. The email referred to an FSA newsletter dated October 2002, which was published on the FSA’s website. It included the following text on LIBOR:</p> <p><i>The interest rate market community has asked for some examples of conduct which is likely to breach the Code of Market Conduct. Consider the scenario where a market participant has notice of an important economic statistic prior to its general release to the market. This information would be relevant, would not be generally available, and would constitute ‘announceable information’ as per MAR 1.4.15 (1). Announceable information is defined as being ‘information which is routinely the subject of a public announcement although not subject to any formal disclosure requirement (MAR 1.4.12 (2)). If the participant were to deal in a qualifying investment traded on a prescribed market based on this information then it would be a breach of the Code. For example, Liffe has futures which trade on the basis of £, Swiss Franc, € and Yen interest rates; therefore trading based on economic statistics which are relevant to these futures before they have been announced is likely to amount to market abuse. Another example might be if one or more banks colluded to manipulate the fixing of Libor or Euribor to benefit a position they have in the interest rate future. This could fall within the false</i></p>		

or misleading impressions or distortion legs of the Code, though the extent to which this is possible varies according to the method of fixing which is used.

Although we did not find a record of the discussion, the Supervision team member recalled raising the telephone call orally at a meeting of staff below director level in the relevant department within Major Retail Groups Division.

3.1.2 Commentary for the period 1 January 2007 to 31 December 2007

65. This section provides commentary on the communications listed in Subsection 3.1.1. It is organised as follows:

- Part 1 comments on the extent to which communications indicated potential lowballing;
- Part 2 comments on the awareness within the FSA of the significance of the communications; and
- Part 3 comments on what actions the FSA took in relation to the communications.

Part 1 - The extent to which communications indicated potential lowballing

66. The communications described in Subsection 3.1.1 showed that reports on LIBOR dislocation appeared from September 2007 as LIBOR-OIS spreads began to peak.

67. We noted that deteriorating market conditions were causing dislocation between LIBOR and other indicators, and interacted with structural issues in the LIBOR fixing process.

This dislocation manifested itself in five main ways:

- the spread between LIBOR fixings and other rates (such as the Overnight Indexed Swap rate – see paragraph 44) widening;
- the volatility in LIBOR fixings and spreads;
- the divergence between LIBOR submissions and actual rates that could be obtained in the market;
- a wider dispersion of LIBOR submissions (Chart 7 on the next page illustrates this for Sterling LIBOR submissions); and
- a greater divergence between funding rates for different banks depending on their perceived creditworthiness (also known as ‘tiering’).

68. One of the implications of tiering is that LIBOR fixings became a poorer predictor of the rate at which a particular bank might be able to borrow. For example, a less creditworthy bank might only be able to borrow at substantially above the LIBOR fixing, whilst a more creditworthy bank might be able to borrow at substantially below. It may have appeared from the viewpoint of the less creditworthy bank that LIBOR and fixings were artificially low. So tiering may have been the explanation for communications:

- in which contacts mentioned that fixes might be understating true borrowing costs (Communication 8); and
- that highlighted where specific institutions were paying above LIBOR fixings (Communications 3, 7, 9 and 11).

Chart 7: 3 month Sterling LIBOR - difference between highest and lowest submissions

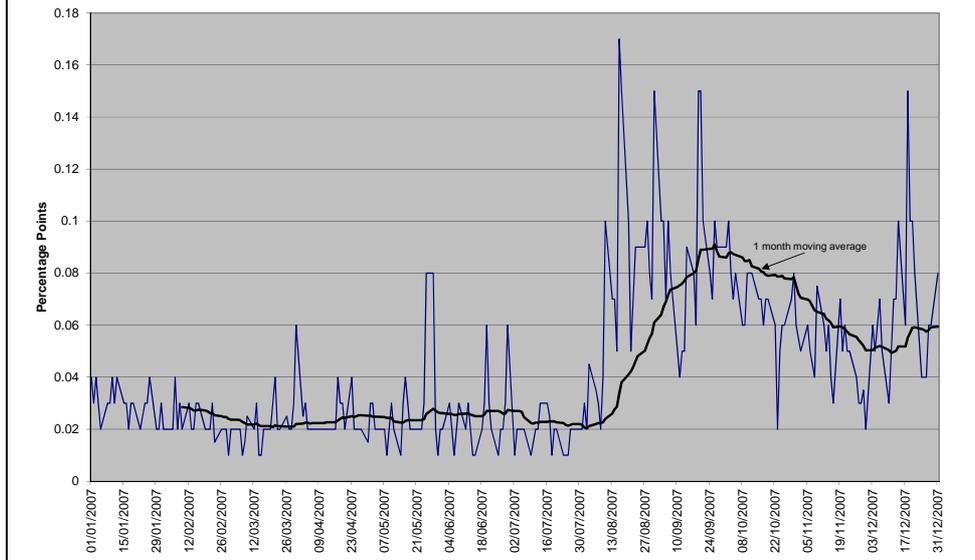


Chart 7 source data: Thompson Reuters

69. The structural issues in the LIBOR fixing process were as follows:

- The impact of tightening of liquidity and lack of activity in the market. In addition to the communications detailed in Subsection 3.1.1, we observed a number of others commenting that it was difficult, on occasion, for panel banks to provide accurate LIBOR submissions. For instance:
 - A note for record of an FSA meeting with a broker on 5 September 2007 recorded: *“there are virtually no transactions happening in the 3 month market, so the official LIBOR rate is not really a representative number”*.
 - A note of the FSA Market Conditions meeting on 27 November 2007 reported a LIBOR Panel Bank claiming that *“conditions are deteriorating in all currencies. GBP cash is regularly devoid of offers, and Libor rates quoted are ‘increasingly meaningless’. While EUR is liquid at the very short end, term liquidity is almost non existent other than the ECB 3 month repo.”*
- As LIBOR is fixed at a point in time actual trades could be expected to differ from the 11am fixing, particularly during periods of volatility. This is supported by the comment in Communication 1: *“LIBOR is moving intraday and no one knows the true value.”* The dollar fixing at 11am London time may have been particularly problematic as this was at a point in time when the New York markets were not yet open.
- The BBA definition of LIBOR included submissions being based on ‘reasonable market size’ borrowings. Trades of different amounts, particularly in stressed market conditions, could attract different funding rates (in addition to the lack of liquidity).

Structural issues in LIBOR were also referred to in Communication 2.

70. Several of the communications made a more direct reference to potential lowballing. Two of the communications from the Bank of England (Communications 10 and 12) reported comments that suggested there was an incentive for LIBOR submitters to provide a submission that was no higher than peer firms, i.e. that banks were conscious of the impact that higher submissions might have on their funding. A further Bank of England market update (Communication 4) referred to banks *“keeping [LIBORs] low.”* In addition, the minutes of the Bank of England’s Sterling Money Markets Liaison group

(Communication 5) cited the quality and control safeguards over LIBOR and noted that dispersion between submissions had fallen back, in part due to BBA clarification on definitions. We considered that one interpretation of these minutes could be a concern about the accuracy of LIBOR submissions and potential lowballing.

Part 2 - Comments on the awareness within the FSA of the significance of the communications

71. We considered that the communications described in Subsection 3.1.1 clearly show that there was awareness within the FSA of dislocation.
72. None of the communications was clear in recommending whether any action should be taken nor who should take it, with many designed to be general updates for information (10 of the 14 originated from the Bank of England).
73. We did not find that any communications relating to potential lowballing were escalated to the FSA Board during this review period.
74. Of the three communications from the Bank of England in paragraph 70 which have a more direct link to potential lowballing, all were widely circulated, including to an acting managing director. The minutes of the Bank of England's Sterling Money Markets Liaison Group (Communication 5), however, were only circulated below director level. Of all the communications in this period, two other communications were also only circulated below director level (including Communication 14 - the contact from Barclays).

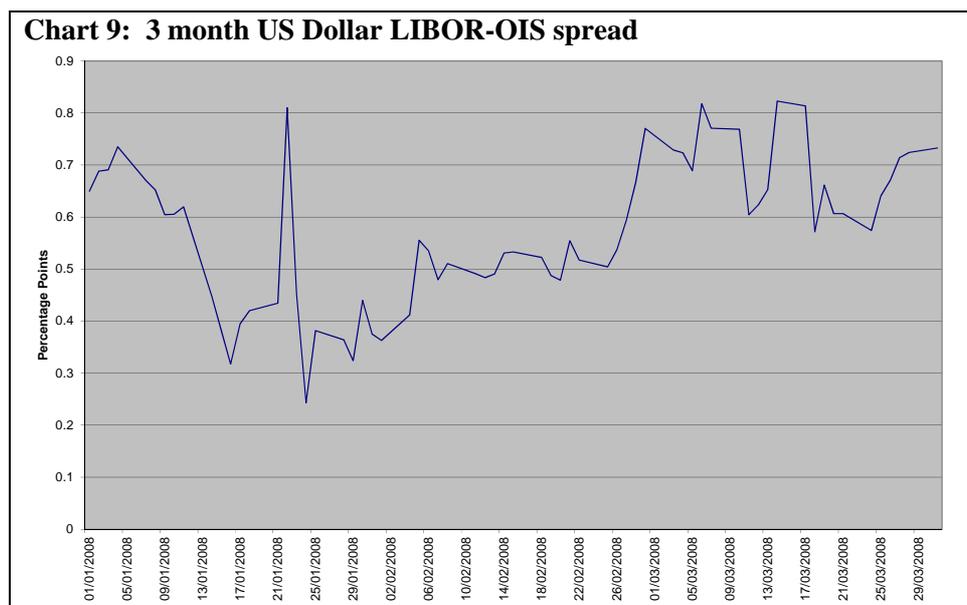
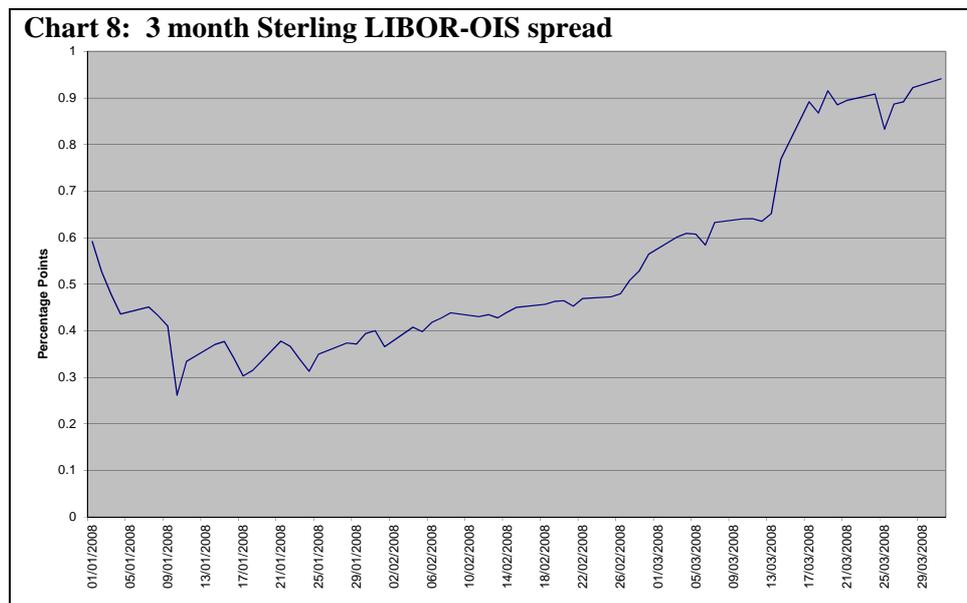
Part 3 – Comments on what actions the FSA took in relation to the communications

75. For the communications set out in Subsection 3.1.1, the FSA did not take any specific action to consider or investigate potential lowballing.
76. We considered what the relevant responsibilities were within the FSA with respect to LIBOR. The activities of contributing to or administering LIBOR were not 'regulated activities' as defined under the Financial Services and Markets Act 2000 - the BBA was responsible for overseeing the LIBOR fixing process. We comment further on responsibilities in Subsection 3.3.2.
77. On structural issues in the LIBOR fixing process, the minutes of the Bank of England's Sterling Money Markets Liaison group (Communication 5) show that the BBA was present at the discussion on LIBOR dislocation. We found no evidence that the FSA raised any concerns about LIBOR (structural or other) with the BBA within this period, although there were subsequent discussions during the BBA's review of LIBOR (see Sections 3.3 and 3.4).
78. We observed that structural issues in the LIBOR fixing process were discussed within the FSA at a Market Conditions meeting at 16 October 2007. A suggestion was made to "*investigate a more realistic measure of interbank rates than LIBOR*" – our review did not find any evidence that this was taken forward.
79. In relation to the contact from Barclays on 6 December 2007 (Communication 14), we were informed that this was not taken further because the query was not interpreted by the

Barclays' supervisor as specific: Barclays Compliance did not refer to its own submissions or reputation or name any other firms.

3.2 1 January 2008 to 31 March 2008

80. Market conditions continued to deteriorate in the first quarter of 2008, with stock markets falling (the FTSE 100 fell 11%). Significant events included Her Majesty's Treasury (the Treasury) announcing on 17 February that it was bringing Northern Rock into public ownership and on 16 March, Bear Stearns being acquired by JP Morgan Chase (following support from the New York Federal Reserve Bank). Although LIBOR-OIS spreads fell in the first two weeks of January, they increased thereafter to levels just below the peaks of late August 2007 and early December 2007 (see Charts 8 and 9).



Charts 8 and 9 source data: Thompson Reuters and Bloomberg

3.2.1 Communications and their circulation

81. We have identified 15 sets of communications in the first quarter of 2008. These comprise:

- five internal communications on LIBOR/money markets;
- four Market condition updates from the Bank of England; and
- six sets of communications from firms providing liquidity updates/views of wholesale funding conditions.

82. We provide further information on these communications below, including to whom they were circulated.

Communication 15

Email entitled 'Update Tightening in Eurodollar markets'	5 February 2008	Internal FSA
<p>The email from a member of staff within the Wholesale and Prudential Policy Division, included the following comment:</p> <ul style="list-style-type: none"> • “[The] 3M USD LIBOR/OIS March IMM spread today has caught up. The cash/ois spread is now around 51 level. Cash has been trading 5bp or so above LIBOR but this can only be temporary and the BBA panel banks will start shifting their LIBORs up in line with the ‘reality’.” 	<p>The email was circulated to:</p> <ul style="list-style-type: none"> • the Managing Director of Wholesale and Institutional Markets/Director of the Auditing and Accounting Sector; • the Director of the Banking Sector; and • the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • the Banking Sector team; • the Financial Stability Sector team; • MRGD; • Wholesale Firms Division; • Retail Firms Division; • Wholesale and Prudential Policy Division; • Strategy and Risk Division; and • General Counsel’s Division. <p>The note was also forwarded on to a member of staff within MRGD.</p>	

Communication 16

Market conditions update	7 February 2008	Bank of England
<p>The note included the following comments:</p> <ul style="list-style-type: none"> • “Libors are expected to be slightly lower today with very little cash trading beyond 1-month. The 1-month spread is around 35bp today from around 50bp at its widest yesterday, having been only 19bp at the start of the month. 3-month is steady around 53bp. • A similar story in the euro market, contacts expect spreads to widen, as Libors are forced higher on the back of no cash offers in the market. Similar scenario to when they started widening in November, with several banks complaining that Libors are being set far too low.” 	<p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of Major Retail Groups Division/Financial Stability Sector; • the Director of the Banking Sector; and • a member of staff below director level within Markets Division. 	

	We were able to confirm that this email was circulated to the Director of the Banking Sector and a member of staff below director level within Markets Division.
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Communication 17

Email entitled 'More Money Market Musings'	8 February 2008	Internal FSA
<p>The email from a member of staff below director level within the Strategy and Risk Division included the following comment:</p> <ul style="list-style-type: none"> “it is likely that the reported 1-month spreads for high quality names and ABCP spreads versus. [sic] LIBOR are not adequately reflecting the increased stresses we are hearing about in the market.” <p>The above quote was also included in an email entitled 'Re: Extension of the Bank liquidity arrangements' from the same member of staff on 22 February 2008.</p>	<p>The email was circulated to:</p> <ul style="list-style-type: none"> the Chairman; the Director of the Banking Sector; the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector; the Director of Wholesale Firms Division (WFD)/the Retail Intermediaries Sector; and the Director of Strategy and Risk Division. <p>The email was also forwarded on to an email distribution list entitled 'the Banking Sector Coordination group' (which included staff below director level within the Banking Sector team, MRGD, WFD, Retail Firms Division, Small Firms Division, Wholesale and Prudential Policy Division, Strategy and Risk Division, Retail Policy and Themes Division, Regulatory Transactions and Reporting Division and the Retail Management Services Unit).</p> <p>The email of 22 February 2008 was circulated to:</p> <ul style="list-style-type: none"> the Chairman; the CEO; the Managing Director of Retail Markets; the Director of the Banking Sector; and the Director of MRGD/the Financial Stability Sector. 	

Communication 18

Email summarising certain financial institutions' views of wholesale funding conditions	19 February 2008	External Firm
<p>The email, attaching submissions from certain financial institutions, noted the following comment from a LIBOR Panel Bank:</p> <ul style="list-style-type: none"> “LIBORS generally continue to be non-representative of true prices going through the market.” 	<p>The email was circulated to:</p> <ul style="list-style-type: none"> the Managing Director of Wholesale and Institutional Markets; the Director of the Banking Sector; and the Director of Major Retail Groups Division/ the Financial Stability Sector. <p>It was also circulated to a Senior Adviser and staff below director level within:</p> <ul style="list-style-type: none"> the Financial Stability Sector team; Major Retail Groups Division; and Strategy and Risk Division. 	

Communication 19

Note of Market Conditions meeting	19 February 2008	Internal FSA
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“1 year LIBORs are being set at unrealistic levels echoing the view that perhaps some of the tension is due to banks not willing to pay the price. MM funds in the US have been buying 1 year floating rate USD CDs at 3M LIBOR +20bp. The 1 year vs 3M swap yesterday was 2.67 suggesting that 1 year LIBOR fixing should be around 2.87 but banks set the 1 year LIBOR at 2.77, at the same time broker screens were quoting cash levels around 2.87. LIBOR is the ‘offered’ rate and so should be higher than the level top quality banks can refinance themselves and not lower.”</i> 	<p>The meeting was attended by staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Financial Stability Sector team; • Major Retail Groups Division (MRGD); • Wholesale Firms Division (WFD); • Retail Firms Division (RFD); • Wholesale and Prudential Policy Division (WAPPD); • Strategy and Risk Division (SRD); • the Asset Management Sector; and • Communications Division. <p>The note of the meeting was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • ExCo; • the Director of the Banking Sector; • the Director of MRGD/the Financial Stability Sector; • the Director of WFD/the Retail Intermediaries Sector; • the Director of Retail Policy and Themes Division/the Asset Management Sector; • the Director of Treating Customers Fairly Division/the Insurance Sector; and • the Director of Communications Division. <p>It was circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • the Financial Stability Sector team; • MRGD; • WFD; • RFD; • WAPPD; • SRD; • the Asset Management Sector team; • General Counsel’s Division; • Communications Division; and • the Wholesale Management Services Unit. <p>It was also circulated to the Bank of England and the Treasury.</p>	

Communication 20

Note entitled 'Liquidity conditions, wholesale funding profiles and liquidity risk'	21 February 2008	Internal FSA
<p>The note, written by a member of staff below director level within Wholesale and Prudential Policy Division on request of the Director of the Banking Sector, included the following comment:</p> <ul style="list-style-type: none"> • <i>“The unwillingness of banks to recognise the term premium or to pay up for money longer than 3 months can easily be seen in the way UK banks are setting LIBORs. US money market funds have recently purchased a small amount of 1 year floating rate USD CDs fixing at 3M LIBOR +20bs. (A large US money fund informed me on 19th February that [LIBOR Panel Bank 1] was posting +25bp but was not getting bought). The 1 year interest rate swap against 3 month LIBOR (1 year 3’s IRS) was 2.62 around 11am on 19th February, suggesting that the 1 year LIBOR should fix at least around 2.82 but was in fact set at 2.78. At the same time broker screens were quoting 1 year cash around 2.86 level, consistent with floating rate CD pricing and the IRS. This suggests that banks need to pay above LIBOR for 1 year money which is inconsistent; 1 year LIBOR should be the London Inter-Bank Offered rate where LIBOR fixing bank would be willing to lend 1 year cash to another similar bank if approached. [LIBOR Panel Bank 1’s] 3 month LIBOR +25bp for 1 year CD corresponds to a 1 year bid at 2.[xx], [LIBOR Panel Bank 1’s] own LIBOR fixing for 19th was [5 bps lower] suggesting that [LIBOR Panel Bank 1] is willing to lend 1 year cash at a level lower than it can currently fund itself. We have just been made aware that [LIBOR Panel Bank 1] has raised [...] 1 year money at LIBOR 1M +[xx]bp. The 1 year 3M vs 1M basis is currently 11bp mid so 1M LIBOR +[xx]bp equates to 3M LIBOR +[xx]bp.”</i> 	<p>The note was circulated to:</p> <ul style="list-style-type: none"> • the Director of the Banking Sector; and the Director of Major Retail Groups Division (MRGD)/ Financial Stability Sector. <p>The note was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • Retail Firms Division; and • Wholesale and Prudential Policy Division. <p>This was forwarded on to supervisors within MRGD, including to the LIBOR Panel Bank 1 supervisory team.</p> <p>The Director of the Banking Sector asked for a meeting to be set up to discuss this note, but we have found no evidence that such a meeting took place.</p>	

Communication 21

Email summarising certain financial institutions’ views of wholesale funding conditions	27 February 2008	External Firm
<p>The email, attaching submissions from certain financial institutions, noted the following comment from a LIBOR panel bank:</p> <ul style="list-style-type: none"> • <i>“There is very little interbank lending past O/N, liquidity conditions past 1 month are still poor. Where cash is available it is expensive this is not really spilling over into Libors, or at least only marginally.”</i> 	<p>The email was circulated to:</p> <ul style="list-style-type: none"> • the CEO; • the Managing Director of Wholesale and Institutional Markets/the Auditing and Accounting Sector; • the Managing Director of Retail Markets; • the Director of the Banking Sector; • the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector; and • the Director of Strategy and Risk Division (SRD). 	

<p>A member of the Supervision Team responded to this email with the following comment:</p> <ul style="list-style-type: none"> • <i>“A snippet from a call with the Bank of England I was on is that [the LIBOR Panel Bank] were seen in the market bidding for 3 month money this morning and were seen as ‘bidding up’, though not viewed as desperate.”</i> 	<p>It was also circulated to a senior advisor and staff below director level within:</p> <ul style="list-style-type: none"> • the Financial Stability Sector team; • MRGD; • Wholesale and Prudential Policy Division; and • SRD. <p>The email reply was copied to staff below director level within MRGD.</p>
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Communication 22

Note of Market Conditions meeting	27 February 2008	Internal FSA
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“Barclays advise further that in general, cash is expensive; however this is not being reflected in LIBOR rates. A member of staff commented that the diversion between interbank lending rates and LIBOR is a known effect, which has fluctuated. LIBOR is not based on transactions and therefore may not be reflective of the true interbank market. LIBOR is used for the pricing of derivatives, and loans.”</i> 	<p>The meeting was chaired by the Director of the Banking Sector and attended by staff below director level within:</p> <ul style="list-style-type: none"> • the Banking Sector team; • the Financial Stability Sector team; • Major Retail Groups Division (MRGD); • Wholesale Firms Division (WFD); • the Asset Management Sector team; and • Wholesale and Prudential Policy Division. <p>A note of the meeting was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • ExCo; • the Director of the Banking Sector; • the Director of MRGD/the Financial Stability Sector; • the Director of WFD/the Retail Intermediaries Sector; • the Director of Retail Policy and Themes Division/the Asset Management Sector; • the Director of Treating Customers Fairly Division (TCFD)/the Insurance Sector; • the Director of Communications Division; • the Bank of England; and • the Treasury. <p>In addition, it was circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • Retail Firms Division; • Strategy and Risk Division; • General Counsel’s Division; • TCFD; • Communications Division; and • the Wholesale Management Services Unit. 	

Communication 23

Market conditions update	3 March 2008	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> <i>[in the context of US Dollar LIBORs] “Contacts are suggesting that Libors have moved too low considering were [sic] cash is actually trading, i.e. the spread to OIS should actually be wider. There are very few offers around today, with a similar story to the last few weeks of medium European banks (mainly German and Austrian) paying above UK and US banks for cash out to 3 months. Beyond 3’s there is very little activity reported, although [LIBOR Panel Bank 1] continue to pay above Libor levels in a hope to attain funds and switch back to 1-month via an IRS. [LIBOR Panel Bank 2] are noted today as paying 1bp below Libor for 6-month money – not often seen in the market.”</i> 	<p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> the Chairman; the Director of Major Retail Groups Division/the Financial Stability Sector; the Director of the Banking Sector; and a member of staff below director level within Markets Division. <p>We were able to confirm that this email was circulated to the Director of the Banking Sector and a member of staff below director level within Markets Division.</p>	

Communication 24

Email summarising financial institutions’ views of wholesale funding conditions	11 March 2008	External Firm
<p>The email, attaching submissions from each financial institution, noted the following comment from a LIBOR Panel Bank:</p> <ul style="list-style-type: none"> <i>“LIBOR fixings are becoming increasingly irrelevant to the reality of the pricing in the market”.</i> 	<p>The email was circulated to:</p> <ul style="list-style-type: none"> the CEO; the Managing Director of Wholesale and Institutional Markets; the Director of the Banking Sector; and the Director of Major Retail Groups Division (MRGD)/the Financial Stability Sector. <p>It was also circulated to a senior advisor and staff below director level within:</p> <ul style="list-style-type: none"> the Financial Stability Sector team; MRGD; and Strategy and Risk Division. <p>In addition to the above, the email was also sent separately to the Managing Director of Retail Markets.</p>	

Communication 25

Email from Barclays entitled ‘Liquidity update – Monday 17th March’	17 March 2008	External Firm
<p>A liquidity update email from Barclays dated 17 March 2008 included the following comment:</p> <ul style="list-style-type: none"> <i>“There is little to no cash available where LIBORs are setting, the few lenders around in the market are increasingly name sensitive.”</i> <p>Another liquidity update email dated 26 March 2008 included a similar comment:</p> <ul style="list-style-type: none"> <i>“Liquidity conditions remain poor, there is little</i> 	<p>These emails were circulated to staff below director level within the Barclays’ supervision team within Major Retail Groups Division.</p> <p>The email dated 17 March 2008 was forwarded on to another member of the supervision team.</p>	

<p><i>to no lending activity to support where Libors are being set.”</i></p> <p>Barclays’ liquidity update email dated 19 March 2008 included the following comment:</p> <ul style="list-style-type: none"> • <i>“We feel that some banks are posting artificially low reference rates so as not to draw attention on themselves.”</i> <p>These emails were within the contacts disclosed by Barclays to the Treasury Committee. We did not find a copy of the emails dated 19 and 26 March 2008 in the FSA’s files.</p>	
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Communication 26

<p>Market conditions update</p> <p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“Several contacts have made comments on the particular low levels of USD LIBORs compared to where cash levels are being quoted. They suggest that Libors should be at least 10bp higher, although actual rate setters are saying that they are getting cheap funding direct from several sources.”</i> 	<p>26 March 2008</p>	<p>Bank of England</p>
	<p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Major Retail Groups Division/the Financial Stability Sector; • a member of staff below director level within Markets Division; and • a member of staff below director level within Wholesale Firms Division (WFD). <p>We were able to confirm that this email was circulated to two members of staff below director level (one in Markets Division and one in WFD).</p> <p>The email was subsequently forwarded on to members of staff below director level within:</p> <ul style="list-style-type: none"> • WFD; and • Wholesale and Prudential Policy Division. 	

Communication 27

<p>Market conditions update</p> <p>The note included the following comments:</p> <ul style="list-style-type: none"> • <i>“Cash markets are reported as worse than at any other time during the credit crisis, with no lending taking place in term, although several contacts suggest that once the quarter end turn is out of the way some liquidity should return. In the mean time banks not able to obtain funding via the Fed or ECB are willing to pay higher and higher levels of cash.”</i> • <i>“With no cash offers in term front end Libors are again higher today, around 3bp in the 1-3 months</i> 	<p>27 March 2008</p>	<p>Bank of England</p>
	<p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Major Retail Groups Division/the Financial Stability Sector; 	

<p><i>leading to widening spreads to OIS, by 5bp in the 3's. Contacts are still suggesting that Libors should be even higher and spreads wider at the moment."</i></p>	<ul style="list-style-type: none"> • a member of staff below director level within Markets Division; and • a member of staff below director level within Wholesale Firms Division. <p>We were able to confirm that this email was circulated to the Chairman.</p>
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Communication 28

Barclays contact with the FSA	27 March 2008	External Firm
<p>The Barclays' Final Notice paragraph 128 states that a manager in Barclays ('Manager D') contacted the FSA on 27 March in a routine liquidity call. The following is the relevant extract from the notice:</p> <ul style="list-style-type: none"> • <i>"Manager D referred to the lack of term money in the market and the affect [sic] of this on LIBOR: 'some people consider LIBORs to be being set too low, but then others reply, well they're not being set too low because there aren't really any offers there. However we're not getting much feedback generally that people are, can-, objecting to that LIBORs are too high, too low, or wrong. I think people just generally recognize that in the absence of actual flows in those periods, where LIBORs are being posted, is perhaps as good [an] indication as anything [...]. So if, if transactions aren't really going on, or there are only odd transactions with certain names, then i- what is the right LIBOR?'. Manager D made further comments about the accuracy of LIBOR generally, the difficulty in determining LIBOR submissions given market conditions and explained the calculation methodology of the final rates. He also stated that Barclays had been 'picked upon for posting LIBORs above everybody else' in 2007. Manager D went on to say 'what is everybody, open brackets to be honest, including ourselves close brackets, going to do? Keep their heads below the parapet and not stick out'. When questioned about the LIBOR calculation, Manager D replied 'the methodology works but if the inputs are lacking [...] whatever the methodology, is still going to quote, have a problem'."</i> <p>We did not find a detailed record of that telephone call. However, at the time of the financial crisis, a number of daily contacts were made with significant financial institutions and it was explained to us that the practice was to summarise telephone calls rather than produce detailed notes for record.</p> <p>An email entitled 'Major UK banks and building societies: morning up-date' summarised the above telephone calls, providing a general update of major banks' funding positions. This was sent by a member</p>		<p>The email referring to the discussion with Barclays was circulated to Chairman, the CEO, the Managing Director of Wholesale and Institutional Markets, the Managing Director of</p>

<p>of staff below director level within Major Retail Groups Division and included the following comment attributed to Barclays:</p> <ul style="list-style-type: none"> • <i>“There has been comment that Libors are ‘too low’ and the calculation of the Libor benchmarks might be causing apparent distortions. This issue is well known. While not too important for cash rates, Libor is central to the derivatives market, and USD Libor is even used in some US mortgage contracts. Barclays advise that they have seen divergence between cash and Libor of over 5 bps on occasion, but caveat that the methodology of using 16 contributors and dropping the top 4 and bottom 4 quotes, might be a factor depending on where the top and bottom quotes are.”</i> 	<p>Regulatory Services and the Directors of:</p> <ul style="list-style-type: none"> • the Banking Sector; • Major Retail Groups Division (MRGD)/the Financial Stability Sector; • Wholesale Firms Division (WFD); • Strategy and Risk Division (SRD); and • Retail Policy and Themes Division. <p>The email was also circulated to the Bank of England, the Treasury and staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • WFD; • Retail Firms Division; • Prudential Risk Division; and • Wholesale and Prudential Policy Division. <p>This email was also forwarded to staff below director level within SRD.</p>
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Communication 29

Email from Barclays entitled ‘liquidity update’	28 March 2008	External Firm
<p>The email, from an individual within Barclays Treasury, included the following comment:</p> <ul style="list-style-type: none"> • <i>“There are few cash offers to support where LIBORs are being set and the few lenders in the market are increasingly more name sensitive.”</i> <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee.</p>	<p>The email was circulated to staff within the supervision team within Major Retail Groups Division.</p>	

3.2.2 Commentary for the period 1 January 2008 to 31 March 2008

83. This section provides commentary on the communications listed in Subsection 3.2.1.

Part 1 - The extent to which communications indicated potential lowballing

84. We considered that the communications described in Subsection 3.2.1 clearly showed that reports on dislocation were continuing into 2008, similar to those we have described for 2007 (see Section 3.1). In addition to communications on LIBOR spreads (Communications 16 and 27) and LIBOR not reflecting trades or conditions in the market (Communications 15, 17 to 26, 28 and 29), we identified the communications below where we considered there was a more direct reference to potential lowballing.

85. Referred to in the Barclays’ Final Notice, Communication 28 was a routine liquidity call to the FSA from ‘Manager D’ at Barclays. The relevant comment was Manager D saying: *“what is everybody, open brackets to be honest, including ourselves close brackets, going to do? Keep their heads below the parapet and not stick out”*. We observed that a summary of the call was included in an email summarising major banks’ funding positions, which had a wide general circulation across the FSA. However, although the summary contained comments about LIBOR being *“too low”* and that *“the calculation of the LIBOR benchmark might be causing apparent distortions”*, there was no reference to the particular wording highlighted above. We noted that the comment was similar to

communications received in 2007 regarding banks being concerned about being “*above the pack*” or “*revealed as an outlier*” (see Communications 10 and 12 in Subsection 3.1.1). In addition to Communication 28, we identified a number of others in this period related to Barclays (Communications 22, 25 and 29) – of these, we considered one of these included a more direct reference to potential lowballing (the comment within Communication 25 regarding “*banks [...] posting artificially low reference rates so as not to draw attention on themselves*”).

86. There were also further Communications (19 and 20) in the period, originating within the FSA, with analysis to suggest LIBOR fixings should have been higher given other market indicators (in Communication 20 there was also a reference to a specific LIBOR Panel Bank willing to lend at rates lower than those at which it could fund itself).
87. The basis of the analysis in these notes was that swap rates and actual trades suggested that LIBOR fixings/submissions were too low. The notes suggested that banks were not willing to borrow at higher rates (i.e. were not willing to ‘pay the price’ for funds) and the implication of this was that they might not be able to fund themselves. We noted that the response by the appropriate FSA supervision team (Communication 21) focused on the implications of the higher actual rates that the LIBOR Panel Bank was having to pay, rather than whether LIBOR fixings could be too low for other reasons (such as lowballing).
88. We noted that the analysis in Communication 20 relied on a number of technical assumptions and variables that could be challenged, particularly since the variations between actual LIBOR fixings/submissions and the implied calculations were small. Moreover, the comparisons did not take into account the fact that LIBOR fixings are made at a particular point of time, whilst swap rates can change very quickly. In addition, Communication 20 describes LIBOR as the rate where the submitter would be willing to lend cash whereas the BBA defines LIBOR as the rate at which the submitter would be able to borrow.

Part 2 - Comments on the awareness within the FSA of the significance of the communications

89. The communications described in Subsection 3.2.1 continued to outline the awareness within the FSA of a dislocation between LIBOR fixings and market activity. Of the fifteen communications highlighted in this period, parts of all but three of the communications were circulated above director level.
90. The communications which we considered contained a more direct reference to potential lowballing (referred to in paragraphs 85 and 86) were recorded or circulated as follows:
 - Communications from Barclays: We noted that an email summarising the telephone call of 27 March 2008 (Communication 28) did not refer to the comments made by ‘Manager D’ from Barclays “*what is everybody, open brackets to be honest, including ourselves close brackets, going to do? Keep their heads below the parapet and not stick out*”. Some of the other contacts from Barclays were not circulated beyond the supervision team (emails within Communications 25 and 28).
 - Communications 19 and 20 (FSA analysis comparing LIBOR and market indicators): These communications were circulated at director level, with the circulation of Communication 19 also including the Chairman and ExCo.

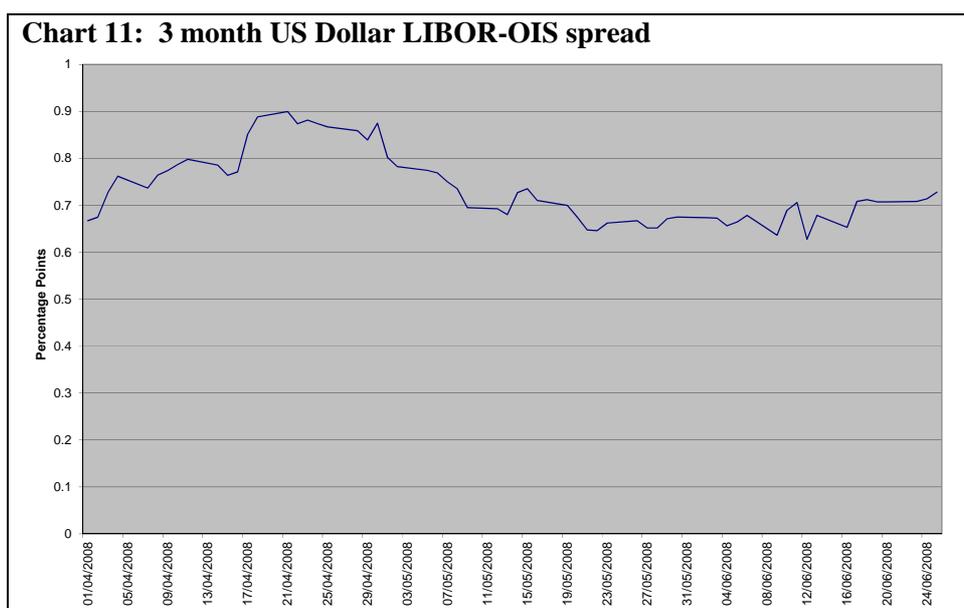
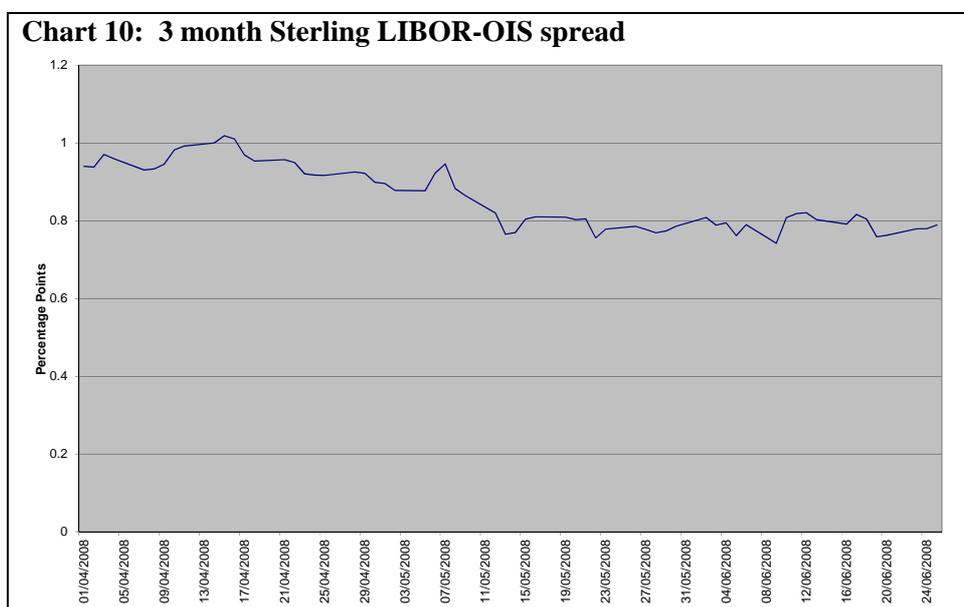
91. None of the communications was clear in recommending whether any action should be taken nor who should take it, with many designed to be general updates for information (for example the updates provided by the Bank of England). See paragraph 76 in Subsection 3.1.2 for our consideration of relevant responsibilities, on which we also comment further in Subsection 3.3.2.
92. We did not find that any communications relating to potential lowballing were escalated to the FSA Board during this period. LIBOR rates were mentioned as part of ‘general market conditions’ updates provided to the January and February 2008 Board meetings. However, these references were used to illustrate funding conditions at the time and made no reference to lowballing.

Part 3 - Comments on what actions the FSA took in relation to the communications

93. For the communications set out in this section, the FSA did not take any specific action to consider or investigate the potential lowballing.
94. As with the communications of 2007, we recognised that dislocation was being caused by the interaction of deteriorating market conditions (leading to ‘tiering’ - see paragraph 68) with structural issues in the fixing process (see paragraph 69). We observed many references to these issues in the communications during this period, as described below.
- Tiering - “*Tiering is becoming more apparent*” (included within a separate part of Communication 26) and “*the few lenders [...] in the market are increasingly [...] name sensitive*” (Communications 25 and 29).
 - Tightening of liquidity – “*There is very little interbank lending past O/N*” (Communication 21), “*There are very few offers around today*” (Communication 23), “*There is little to no cash available where LIBORs are setting*” (Communication 25) and “*There are few cash offers to support where LIBORs are being set*” (Communication 29).
 - Other structural issues - Communication 26 includes a comment that “*rate setters are saying that they are getting cheap funding direct from several sources*” – this suggests that some submitters may have been using references other than interbank on which to base their submissions.
95. We also observed external views in the period that recognised LIBOR dislocation, but did not conclude that there was also lowballing. The most significant example was an article within the Bank for International Settlements Quarterly Review published on 3 March 2008. A copy was sent to the FSA’s Chairman, CEO and managing directors. The article entitled ‘Interbank rate fixings during the recent turmoil’ analysed the robustness of fixings using statistical data and anecdotal evidence for the second half of 2007. This highlighted that a submitter had an incentive to quote a lower interest rate publicly “*for fear of increasing its borrowing costs*” and to manipulate submissions to benefit from positions that referenced the fixing. However, it concluded that “*alternative methods of estimating LIBOR [...] gave no indication that fixings were manipulated*” and that movements in fixings “*reflected the dislocation in the underlying interbank markets [...] changes in the credit quality of [submitters...] and a deterioration in liquidity.*” A separate article in the same report was entitled ‘What drives interbank rates? Evidence from the Libor panel’. In comparing LIBOR and credit default swaps, the article concluded that banks with a higher credit risk did not appear to be providing significantly higher submissions than banks with lower credit risk. However, the article did not link this observation to potential lowballing.

3.3 1 April 2008 to 25 June 2008

96. Stressed market conditions continued into this period, as reflected by LIBOR-OIS spreads which remained at a high level throughout the period (see Charts 10 and 11). To help improve liquidity in the banking system, the Bank of England launched its Special Liquidity Scheme on 21 April 2008. This allowed banks to swap high quality mortgage-backed and other securities for UK Treasury Bills.
97. On 16 April 2008, the BBA announced that it had brought forward its annual review of the LIBOR fixing process on account of dislocation. This culminated in the publication, on 10 June 2008, of a consultation paper seeking comments on proposals to modify the LIBOR fixing process. It also generated speculation on the accuracy of LIBOR fixings. A number of media articles commenting on the accuracy of LIBOR fixings were published during this period.



Charts 10 and 11 source data: Thompson Reuters and Bloomberg

<p>held at the London Investment Banking Association (LIBA) that the Managing Director of Wholesale and Institutional Markets had attended - LIBA had said that it would liaise with banks and the BBA and revert. We have found no record of any response from LIBA nor any further discussion between the FSA and LIBA.</p> <ul style="list-style-type: none"> • <u>Comment c)</u> - Advice from a member of staff below director level within General Counsel’s Division (GCD) was received, which was to the effect that the FSA did not regulate the BBA and that any concerns about LIBOR fixings should be raised directly with the BBA. <p>On 2 May 2008, the Director of Markets and Director of the Banking Sector approved a proposed response to the non LIBOR Panel Bank, subject to advice from GCD (received as <u>Comment c)</u>).</p> <p>The supervisor informed the non LIBOR Panel Bank by email on 2 May 2008 that the bank needed to raise the issue with the BBA.</p>	<p>2 May 2008 – <u>Comment c)</u> - the advice sought and received from General Counsel’s Division (GCD) was circulated to:</p> <ul style="list-style-type: none"> • the Director of Markets Division; and • the Director of the Banking Sector. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • the supervision team within WFD; • PRD; and • GCD. <p>The circulation of <u>Comment c)</u> included all earlier email correspondence within Communication 30.</p> <p>2 May 2008 - This email exchange regarding contact from the CFTC included the same circulation list as outlined for <u>Comment c)</u>.</p> <p>2 May 2008 – the supervisor sent the response directly to the firm.</p>
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Communication 31

<p>Meeting of the Bank of England’s Sterling Money Markets Liaison Group</p>	<p>3 April 2008</p>	<p>Bank of England</p>
<p>One of the discussion items at the meeting was ‘Current and expected future money market conditions’. The minutes included the following comment:</p> <ul style="list-style-type: none"> • <i>“As had been mentioned at the previous meeting, some group members thought that fixing Libor rates was complicated by a lack of term liquidity. In particular, US dollar Libor rates had at times appeared lower than actual traded interbank rates. The BBA described their quality control measures to the group and said that they speak to contributing banks regularly.”</i> <p>Note that we refer to the previous meeting of this Liaison Group in Communication 5.</p>	<p>The FSA was represented by a member of staff below director level from Markets Division.</p> <p>The minutes of the meeting were circulated to attendees on 22 May 2008 and forwarded on to a colleague below director level within Markets Division.</p> <p>The minutes were also published on the Bank of England’s external website.</p>	

Communication 32

Note for record of a conference call with a non LIBOR Panel Bank on its funding position	7 April 2008	External Firm
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“US LIBOR appears to be low compared to US Cash. European investors can make use of FX arbitrage to swap US LIBOR [...] back to £ sub-LIBOR.”</i> <p>On 9 April 2008, one of the supervisors present at the call replied to the email with the following comment:</p> <ul style="list-style-type: none"> • <i>“Just to advise that the subject of the disconnect in the USD Libor and cash rates has been discussed at the Market Conditions Meeting today. [The Director of the Banking Sector] advised that the BBA will be coming in this afternoon and we will pass our concerns on that USD Libor might be subject to ‘manipulation’. When we next speak to [the Non LIBOR Panel Bank] I think we can advise that their concerns have been recognised in the FSA, and appropriately escalated.”</i> 		<p>The note for record was circulated to staff below director level within Major Retail Groups Division.</p> <p>Although we found a record of the meeting with BBA being arranged, we have not found any record of the meeting itself.</p>

Communication 33

Email entitled ‘More Market Musings’	9 April 2008	Internal FSA
<p>An email from a member of staff below director level within the Strategy and Risk Division (SRD) included the following comment:</p> <ul style="list-style-type: none"> • <i>“Yesterday’s US TAF auction [Term Auction Facility] looks very odd. It stopped-out at 10bp above LIBOR. This implies, on the face of it, that banks will pay more to borrow secured from the Fed rather than borrow unsecured from each other, which seems absurd. A possible (better) interpretation is that the TAF result is evidence of a significant imbalance between the supply and demand for cash in the money markets.”</i> <p>Another member of staff below director level within SRD sent an email on the same day attaching a note on market conditions which included the following comment:</p> <ul style="list-style-type: none"> • <i>“The Fed allotted \$50bn in 28-day funds at its latest TAF yesterday. 79 bidders submitted bids totalling \$91.6bn; a cover ratio of 1.83, compared to the 1.78 cover ratio at the last TAF on March 24. The funds were allotted at a stop-out rate of 2.82% (compared to 2.62% on March 24). This is interesting given that one-month dollar LIBOR was only 2.72% yesterday, suggesting that banks are prepared to pay more to avoid funding themselves in the interbank market (or that LIBOR does not reflect the true price at which banks are able to source funds from one another).”</i> 		<p>The email was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division (FSD); and • the Director of Strategy and Risk Division (SRD). <p>It was forwarded on 11 April 2008 to the Bank of England.</p> <p>The second email was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • ExCo; • the Director of the Banking Sector; • the Director of FSD; • the Director of Wholesale Firms Division (WFD); • the Director of Retail Policy and Themes Division/the Asset Management Sector; and • the Director of Treating Customers Fairly Division/the Insurance Sector. <p>The second email was also circulated to the Bank of England, the Treasury and staff below director level within:</p> <ul style="list-style-type: none"> • the CEO’s Office;

	<ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • FSD; • Major Retail Groups Division; • WFD; • Retail Firms Division; • Wholesale and Prudential Policy Division; • Prudential Risk Division; • SRD; • the Asset Management Sector team; • General Counsel’s Division; and • Communications Division.
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Communication 34

Note of Market Conditions meeting	9 April 2008	Internal FSA
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“The 3M USD [Dollar] LIBOR is fixing around 75bp above the 3M OIS but European and UK firms are routinely paying 25-30bp over 3M USD LIBOR to swap into GBP and EUR making the cash/OIS spread for 3M USD LIBOR closer to 100bp rather than the 75bp seen on the LIBOR/OIS measure. The large LIBOR panel banks were telling us that there was no USD term liquidity but I think this means there is no USD liquidity at the rate they are setting 3M LIBOR because other firms were happy to pay USD LIBOR +25-30bp for arbitrage purposes. This raised the question of the relevance of the LIBOR fixings.</i> • <i>LIBORs (per the actual definition ‘the offered rate’) for tenors over 3M in all currencies appear to have been dislocated from the actual cash market since August. The LIBOR setting banks appear to be providing fixings for tenors greater than 3M at levels lower than they can and are refinancing themselves. For example [...] we observed [a LIBOR Panel Bank] issuing [...] 1 year CDs [...] bps over the level of the 1Y/1M swap. This translated into a 1 year fixed rate that was [xx-xx] higher than their own 1 year USD LIBOR fixing.</i> • <i>What we are now observing is the 3M USD LIBOR fixing also become dislocated from the actual levels firms can refinance themselves. The arbitrage is routinely seeing USD trade and print at LIBOR+25-30bp”.</i> <p>The note was forwarded from a member of staff within General Counsel’s Division to a member of a staff within Strategy and Risk Division (both below director level) with the following comment:</p> <ul style="list-style-type: none"> • <i>“I am not sure I entirely follow the issue around LIBOR, but wonder if there is a knock on to the syndicated loan market in that floating rate loans</i> 	<p>The meeting was attended by the Director of the Banking Sector and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • Major Retail Groups Division; • Wholesale Firms Division (WFD); • Retail Firms Division; • Prudential Risk Division; • the Asset Management Sector team; • Strategy and Risk Division; and • Communications Division. <p>In addition to the above a note of the meeting was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • ExCo; • the Director of Markets Division; • the Director of Financial Stability Division (FSD); • the Director of WFD; • the Director of Retail Policy and Themes Division (RPTD)/the Asset Management Sector; • the Director of Treating Customers Fairly Division/the Insurance Sector; and • the Director of Communications Division. <p>The note was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • the CEO’s Office; • the Banking Sector team; • FSD; • Wholesale and Prudential Policy Division; • RPTD; and • General Counsel’s Division. <p>The note was also circulated to the Bank of England and the Treasury.</p>	

they're willing to admit. The concern: Some banks don't want to report the high rates they're paying for short-term loans because they don't want to tip off the market that they're desperate for cash. The Libor system depends on banks to tell the truth about their borrowing rates. Fibbing by banks could mean that millions of borrowers are paying artificially low rates on their loans. That's good for borrowers, but could be very bad for the banks and other financial institutions that lend to them. No specific evidence has emerged that banks have provided false information about borrowing rates, and it's possible that declines in lending volumes are making some Libor averages less reliable. But bankers and other market participants have quietly expressed concerns to the British Bankers' Association, which oversees Libor, about whether banks are reporting rates that reflect their true borrowing costs, according to a person familiar with the matter and to government documents. The BBA is now investigating to identify potential problems”.

- *“A spokesman for the BBA, John Ewan, said [...] ‘If it is deemed necessary we will take action to preserve the reputation and standing in the market of our rates.’”*

The article also discussed the spread between the three-month Libor rate and US Treasury bills (see Communication 33).

Communication 36 (event)

On 16 April 2008, the BBA announced that it was bringing forward its annual review of LIBOR fixings. A BBA spokesman was reported as commenting as follows (source: a Wall Street Journal ‘MarketWatch’ article of 17 April 2008 entitled ‘BBA to start Libor review earlier as rate spikes’):

- *“The BBA could ask banks to leave the panel of lenders [...] if any cases of mis-reporting are found [...] That’s an extreme resort and we don’t think it will happen [...] We don’t think there’s been anybody trying to deliberately manipulate the figures.”*

A Bank of England Market conditions update of 16 April 2008 reported the announcement of the review as follows:

- *“the BBA asserted it could ban any member deliberately misquoting [...] This was mainly thought to be aimed at European banks understating their US\$ fixings, given they did not want to publicly acknowledge their higher bidding rates”.*

The first reference to the FSA being aware of the BBA’s review was on 9 April 2008 (see Communication 34).

The BBA published a consultation paper on 10 June 2008. Following responses, the BBA published a feedback statement on 5 August 2008 and a paper on governance and scrutiny of the LIBOR fixing process on 18 December 2008. We cover this further in Section 3.4.

We set out below communications related to the BBA’s review up to 25 June 2008 under the following headings:

- 1) Meetings between the FSA and the BBA;
- 2) Comments on the BBA’s emerging findings; and
- 3) Communications on the impact of the BBA’s review.

1) Meetings between the FSA and the BBA

Meeting of 28 April 2008

FSA minutes recorded the following:

- *“the banks have indicated to them [the BBA] that the BBA should not rock the markets by substantially changing the way which LIBOR is fixed.*
- *The BBA have written to LIBOR panel contributor banks to ask them to ensure that the figures that they are inputting are correct and really are the rates that they could borrow at in the cash market.”*
- *“it was evident that [the BBA representative] doubted whether the LIBOR fixing process would change significantly after the review [...] since in [the BBA representative’s] view the advantages of alternative options were not clear.”*

Meeting of 22 May 2008

An FSA memo summarising the meeting recorded the following:

- the FSA highlighted that its *“central concern is that some banks have on occasion been posting Libor fixings which do not accurately reflect their cost of funding”* and that *“transparency is very good, but accuracy is poor.”*
- The FSA commented to the BBA that a *“credible oversight process that promotes accuracy should, in our view, incorporate several monitoring devices to guard against and detect ‘gamesmanship’ of the quotes [...] The BBA needs to utilise mechanisms which will detect several banks collectively (i.e. as a pack)*

Meeting of 28 April 2008 – The meeting was attended by staff below director level within the Banking Sector team.

A note for record of the meeting was circulated to:

- the Acting Managing Director of Retail Markets;
- the Director of Markets Division;
- the Director of the Banking Sector;
- the Director of Wholesale Firms Division (WFD);
- the Director of Retail Policy and Themes Division (RPTD)/the Asset Management Sector;
- the Director of Strategy and Risk Division (SRD); and
- the Director of Financial Capability Division/the Consumer Sector.

The note was also circulated to staff below director level within:

- Markets Division;
- the Banking Sector team;
- Major Retail Groups Division (MRGD);
- WFD;
- Retail Firms Division (RFD);
- Wholesale and Prudential Policy Division (WAPPD);
- Prudential Risk Division (PRD); and
- RPTD.

Meeting of 22 May 2008 – The meeting was attended by the Director of Markets Division and staff below director level within:

- Markets Division;
- the Banking Sector team; and
- PRD.

In addition to the attendees above, a note of the meeting was circulated to the Managing Director of Wholesale and Institutional Markets who forwarded it to:

- the CEO;
- the Director of the Banking Sector;
- the Director of Financial Stability Division (FSD);

submitting off-market quotes.”

- The author of the note commented there was *“intense media scrutiny of Libor, some of which is ill-founded.”* and *“for the threat to drop a bank to be credible, it may have to be enforced. If none are ejected the press will likely cast dispersions [sic] on the seriousness of the BBA review.”*

The memo of the meeting was provided to the Treasury Committee as part of evidence submitted by the FSA.

Meeting of 30 May 2008

A briefing provided on 29 May 2008 by a member of staff below director level within Markets Division included suggestions on how to enhance the BBA’s monitoring process. An email summarising the discussion at the meeting noted:

- *“Likely course of action is to strengthen review panel, give review panel greater reference to actual transactions so as to control outliers”.*

Meeting of 25 June 2008

FSA minutes recorded that the FSA asked to be kept in touch.

- the Director of MRGD;
- the Director of WFD; and
- the Director of RFD.

The Chairman was sent a copy on 30 May 2008 at their office’s request.

Meeting of 30 May 2008 – The briefing note was provided to the Director of the Banking Sector. This was copied to the Director of Markets Division and forwarded on to the Chairman at their office’s request.

The meeting was attended by the Director of the Banking Sector who provided the summary of the meeting.

The summary of the meeting was sent to a member of staff below director level within Markets Division. This was copied to the Managing Director of Wholesale and Institutional Markets, the Director of Markets Division and staff below director level within:

- the Chairman’s Office;
- the CEO’s Office; and
- Markets Division.

Meeting of 25 June 2008

The note for record of the meeting was provided by a member of staff below director level within the Banking Sector team and circulated to the Acting Managing Director of Retail Markets and the Director of the Banking Sector.

The note was also circulated to staff below director level within:

- Markets Division;
- the Banking Sector team;
- MRGD;
- WFD;
- RFD;
- WAPPD;
- SRD;
- RPTD; and
- Treating Customers Fairly Division (TCFD).

2) Comments on the BBA's emerging findings

On 3 June 2008, the BBA sent a draft paper on its findings to the FSA. The following comments were made in email correspondence between FSA staff:

- Comment a) - A member of staff below director level within Prudential Risk Division (PRD) noted that *"this goes quite a long way down the path envisaged."* and *"I would add only we would like more detail on how the scrutiny mechanism would work"*.
- Comment b) A different member of staff below director level within PRD noted *"Poor in terms of recognising the real issue/criticism that contributors do not set a fixing that is representative of their real USD funding cost. Good in terms of desire to police. Poor in terms of the actual practicality of policing"*. The staff member added *"If the majority of the panel are fixing rates lower than where they can fund themselves the fixing is not representative of the panels funding costs. The paper does not even mention this the [sic] problem [...] I think the media and observers will see this negatively in so far as the BBA is ignoring or avoiding the issue."*

The FSA responded to the BBA on 3 June 2008 by email and included the following comment:

- *"The changes [...] appear to be a significant step in addressing a number of the issues and options"*.

Between 3-5 June 2008, there was an exchange of emails between the FSA and the BBA discussing comments on the draft report. Areas of discussion included:

- governance over the LIBOR fixing process;
- transparency and clarity over how submissions would be scrutinised – the FSA noting *"this will be a clear area of focus for the media and wider market"*;
- the importance of improving understanding of LIBOR; and
- what instruments should be eligible for consideration in LIBOR fixings.

On 9 June 2008, a near final draft of the BBA's consultation paper was provided to the FSA. An exchange of emails within the FSA noted:

- *"We have fed back a number of comments [...] which have been taken onboard to a varying degree by the BBA."*
- *In general our major concern remains that the scrutiny process for Libor remains light (i.e. governance/membership of the review Committee*

The BBA's initial request for comment on the draft paper was made to the Director of the Banking Sector. The Director of the Banking Sector forwarded on this request, and asked the Director of Markets to respond, copying in the Managing Director of Wholesale and Institutional Markets and a member of staff below director level from Markets Division (who took the lead on responding). The draft paper was also forwarded on to a member of staff within PRD, who circulated it to other staff below director level within PRD.

3 June 2008 - Comments a) and b) made on the BBA draft paper were circulated to staff below director level within Markets Division and PRD.

3-5 June 2008 – comments were circulated to staff within:

- Markets Division (including the Director);
- the Banking Sector team (including the Director);
- PRD (below Director level);
- the Bank of England; and
- the Treasury.

9 June 2008 – comments on the discussion of the near final draft were circulated to the Director of Markets Division, the Director of the Banking Sector and staff below director level within:

- Markets Division; and
- PRD.

<p><i>remains unclear, details of what task will be performed are also not fully disclosed)</i>” but added <i>“However, this is a DP [discussion paper] and we will stay abreast of the feedback.”</i></p> <ul style="list-style-type: none"> • <i>“Much improved [...] but not optimal”.</i> 	<p>The near draft final report was forwarded on to the Managing Director of Wholesale and Institutional Markets and to the Chairman’s Office (including the Chairman).</p>
<p>3) Communications on the impact of the BBA’s review</p>	
<p>The following communications commented on the impact of the BBA’s review on LIBOR fixings.</p> <p><u>a) Bank of England Market conditions update – 17 April 2008</u></p> <ul style="list-style-type: none"> • <i>“LIBOR – Obviously all the talk in the cash markets is were [sic] are Libors going to fix, following the BBAs warning to Libor setters, although some talk this morning that the BBA have said that they have been mis-quoted. In dollars expected Libors are currently being quoted between 7 - 15bp higher across the curve – 3’s up 8bp to 86bp [...] Euribors are only up around 1-2bp”.</i> <p><u>b) Wall Street Journal (WSJ) article - 29 May 2008 - entitled ‘WSJ analysis Suggests Banks May Have Reported Flawed Interest Data for Libor’</u></p> <p>This article noted that following the 16 April announcement of the BBA review: <i>“Over the next two days, banks raised their reported rates, causing dollar-denominated Libor to log its biggest jump since August.”</i></p> <p><u>c) FSA note giving update on funding positions of major UK banks and buildings societies – 5 June 2008</u></p> <p>This note included the following comment:</p> <ul style="list-style-type: none"> • <i>“A Non LIBOR Panel Bank described themselves as underwhelmed by the BBA’s lack of action on LIBOR fixings. They will raise this at the LMMA meeting next Wednesday.”</i> 	<p><u>a) Bank of England Market conditions update – 17 April 2008</u></p> <p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of FSD; and • a member of staff below director level within Markets Division; and • a member of staff below director level within WFD. <p>We were able to confirm that this email was circulated to the Chairman.</p> <p>The note was forwarded on to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • WFD; and • PRD. <p><u>b) Wall Street Journal article – 29 May 2008 – entitled ‘WSJ analysis Suggests Banks May Have Reported Flawed Interest Data for Libor’</u></p> <p>See Communication 48 for circulation list.</p> <p><u>c) FSA note giving update on funding positions of major UK banks and buildings societies – 5 June 2008</u></p> <p>This note was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • the CEO; • the Managing Director of Wholesale and Institutional Markets; • the Acting Managing Director of Retail

d) Bank of England Market conditions update – 5 June 2008

This note included the following comment:

- *“Libor/FRA/OIS spreads are stable on the week despite the BBA non event and negative press for US investment banks.”*

Markets;

- the Director of the Banking Sector;
- the Director of FSD;
- the Director of MRGD;
- the Director of WFD;
- the Director of RFD;
- the Director of WAPPD;
- the Director of PRD; and
- the Director of SRD.

The note was also circulated to the Treasury, Bank of England and staff below director level within:

- FSD;
- MRGD;
- WFD;
- RFD; and
- SRD.

d) Bank of England Market conditions update – 5 June 2008

The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’ referred to in a) above. We were able to confirm that this email was circulated to the Chairman.

The note was forwarded on to:

- the Managing Director of Wholesale and Institutional Markets;
- the Acting Managing Director of Retail Markets;
- the CEO’s Office (not including the CEO);
- the Director of RPTD/the Asset Management Sector; and
- the Director of TCFD/the Insurance Sector.

The note was also circulated to staff below director level within:

- Markets Division;
- the Banking Sector team;
- FSD;
- MRGD;
- WFD;
- RFD;
- WAPPD;
- PRD;
- SRD;
- the Asset Management Sector; and
- General Counsel’s Division.

<p>e) <u>Bank of England Sterling Markets Division Market Intelligence summary – 5 June 2008</u></p> <p>The cover email, sent by a member of staff below Director level within Strategy and Risk Division, included the following comment:</p> <ul style="list-style-type: none"> • <i>“Not much in this week’s note that we didn’t already know. It mainly focuses on [...] the review on Libor (widely seen as a ‘damp squib’).”</i> <p>The Market Intelligence summary note included the following comment:</p> <ul style="list-style-type: none"> • <i>“The result of the much publicised (early) annual review of the BBA Libor setting process on Friday evening was widely seen as a ‘damp squib’, with the Libor panels for all currencies staying exactly the same, and the BBA just committing to strengthening ‘the oversight of BBA Libor’ (with further details expected to emerge shortly). Radical reform had not been expected, but this was seen as the bare minimum that would be done.”</i> <p>f) <u>Bank of England Market conditions update – 19 June 2008</u></p> <p>This note included the following comment:</p> <ul style="list-style-type: none"> • <i>“Interesting to see 3 banks [named three LIBOR Panel Banks] have moved their [certain borrowing periods] Libors up recently, reflecting the actual levels they have been seen paying in the market. [One LIBOR Panel Bank] were [xx]bp over the BBA fix in the 1–year yesterday mirroring the premium they have been paying over their peers in the cash market. Contacts suggest maybe they have been spoken to by the BBA!”</i> 	<p>e) <u>Bank of England Sterling Markets Division Market Intelligence summary – 5 June 2008</u></p> <p>The note was attached in an email and circulated to an FSA mailing list entitled ‘BoE Markets’ referred to in a) above. We confirmed that this email was circulated to:</p> <ul style="list-style-type: none"> • the Managing Director of Wholesale and Institutional Markets; • the Director of the Banking Sector; • the Director of WFD; • the Director of SRD; and • staff below director level within MRGD, WFD, PRD and SRD. <p>f) <u>Bank of England Market conditions update – 19 June 2008</u></p> <p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’ referred to in a) above. We were able to confirm that this email was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • one member of staff below director level within Markets Division; and • one member of staff below director level within WFD. <p>The note was forwarded on to the same circulation list as outlined in d).</p>
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Communication 37

<p>Barclays contact with the FSA</p> <p>The Barclays’ Final Notice (paragraph 131) states that ‘Manager D’ from Barclays made the following comment in a routine liquidity telephone call with the FSA:</p> <ul style="list-style-type: none"> • <i>“we did stick our head above the parapet last year, got it shot off, and put it back down again. So, to the extent that, um, the LIBORs have been understated, are we guilty of being part of the pack? You could say we are. We’ve always been at the top end and therefore one of the four banks that’s been eliminated. Um, so I would, I would sort of express us maybe as not clean clean, but clean in principle”.</i> 	<table border="1"> <tr> <td data-bbox="845 1518 1101 1556">17 April 2008</td> <td data-bbox="1101 1518 1445 1556">External Firm</td> </tr> <tr> <td colspan="2" data-bbox="845 1556 1445 2027"> <p>The liquidity telephone call was between ‘Manager D’ at Barclays and two members of staff below director level within the supervision team in Major Retail Groups Division.</p> </td> </tr> </table>	17 April 2008	External Firm	<p>The liquidity telephone call was between ‘Manager D’ at Barclays and two members of staff below director level within the supervision team in Major Retail Groups Division.</p>	
17 April 2008	External Firm				
<p>The liquidity telephone call was between ‘Manager D’ at Barclays and two members of staff below director level within the supervision team in Major Retail Groups Division.</p>					

The email summarising that day’s liquidity telephone calls with Barclays entitled ‘April 17 morning update’ included a comment about overall funding conditions and a reference to how LIBOR fixings might be calculated in the future, but did not refer to the comments above about LIBOR.	
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Communication 38

Email from Barclays entitled ‘Liquidity update – Thursday 17 th April’	17 April 2008	External Firm
<p>The email, forwarded on to the FSA by Barclays Compliance, included the following comment:</p> <ul style="list-style-type: none"> • “<i>USD Libor fixings came under renewed scrutiny following an article earlier in the WSJ [Wall Street Journal]. The story suggested something that we have long known which is that USD Libors are fixing too low.</i>” <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee. We did not find a copy of this email in the FSA’s files.</p>	<p>The email was circulated to staff below director level within the supervision team within Major Retail Groups Division.</p>	

Communication 39

Market conditions update	18 April 2008	Bank of England
<p>The note included the following comments:</p> <ul style="list-style-type: none"> • “<i>USD Libors are expected to see similar increases to yesterday’s marked step-up following the BBA’s warning to banks about submitting accurate fixings.</i>” • “<i>Libor/OIS spreads have widened further with 3’s up 6bp to 92bp and 6’s up 6bp to 104bp, the widest level since the crisis started.</i>” • “<i>At the longer end of the curve there still looks as though Libor levels are too low compared to cash with [LIBOR Panel Bank 1] willing to pay [xx] bp and [LIBOR Panel Bank 2] [xx] bp above Libor!</i>” 	<p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division; • a member of staff below director level within Markets Division; and • a member of staff below director level within Wholesale Firms Division. <p>We were able to confirm that this email was circulated to the Chairman.</p>	

Communication 40 (event)

Contact by the Commodity Futures Trading Commission (CFTC)	22 April 2008	Event
<p>Between 22-25 April 2008, the CFTC contacted several FSA staff as a result of seeing reports of “<i>possible false reporting of information to the BBA</i>”. Two of these contacts sent media articles by email:</p> <ul style="list-style-type: none"> • Wall Street Journal ‘MarketWatch’ article entitled ‘BBA to start Libor review earlier as rate spikes’ of 17 April 2008: “<i>Concerns emerged this week that some banks may have been under-reporting</i>”. • Wall Street Journal article entitled ‘Libor’s Rise May Sock Borrowers’ of 19 April 2008: “<i>The</i> 	<p>Initial contacts from the CFTC included:</p> <ul style="list-style-type: none"> • 22 April 2008 – the second media article was circulated to two members of staff below director level within Enforcement Division. This was forwarded on to members of staff below director level within the Banking Sector team and Prudential Risk Division (PRD). • 23 April 2008 – a telephone call to the Director of the Retail Policy and Themes 	

BBA started its review amid growing concerns among bankers that their rivals weren't reporting their true high borrowing costs, for fear of signalling to the market they were desperate for cash."

- FT.com article entitled 'Doubts over Libor widen' of 21 April 2008: *"there is a widespread belief that some banks have an incentive to keep their bids low."... "the fee which banks must pay to access the [Bank of England's liquidity facility] is calculated on [LIBOR] as well [...] if the banks shove up Libor, it's going to cost them more"*.
- Bloomberg article entitled 'Libor to Rise as Banks Stay Wary, Derivatives Signal (Update1)' of 24 April 2008: *"[following the announcement of the BBA review] The correction in Libor has not completely happened"*.

A member of staff below director level within Enforcement Division responded to the CFTC by email on the day they were contacted stating they would look into this but considered *"the FSA does not have supervisory responsibility for the BBA rate setting mechanism although [...] we do have prudential supervisory responsibility over the FSA authorised banks providing the information to the BBA."*

Between 24-30 April 2008, several comments were expressed in email exchanges between FSA staff:

- Comment a) - A member of staff below director level within Markets Division noted that the FSA had been *"monitoring the Libor fix for many years."* The member of staff made a suggestion that the BBA would need to demonstrate it was bringing *"all its powers to play in investigating and censuring banks who submit unjustifiable outlying fixings."* The comments also suggested that as a solution the BBA should concentrate *"on doing a proper job of enforcing a rationale [sic] fixings."*
- Comment b) - A different member of staff below director level within the Markets Division suggested that Markets Division discuss the issue with the BBA after which *"we can visit any banks which have made significant increases in their returns to the BBA"*.
- Comment c) - As highlighted in communication 30 regarding the contact from a non LIBOR Panel Bank, a member of staff below director level from Prudential Risk Division commented *"I'd rather discuss this off email"*. We interviewed the individual as part of our review. The individual

Division/Asset Management Sector who referred the CFTC to the Director of Markets Division.

- 25 April 2008 – the Director of Markets Division forwarded an email (attaching all of the media articles) to the Managing Director of Wholesale and Institutional Markets, the Director of the Banking Sector, the Director of Financial Stability Division and staff below director level within Markets Division.
- 25 April 2008 – a telephone message was left for the Director of the Banking Sector; this was copied to the Director of Markets Division.
- 25 April 2008 – a member of staff below director level within PRD escalated to the Director of the Banking Sector, copying in the Managing Director of Wholesale and Institutional Markets and the Director of Markets Division.

The media articles were publicly available.

Comments a) to d) were circulated within Markets Division (including to the Director).

Comments c) and d) were also circulated to staff within:

- the Banking Sector team (including the Director); and
- PRD (below director level).

<p>explained that the comment reflected recognition that this issue was significant (for example, it could lead to potential litigation).</p> <ul style="list-style-type: none"> • <u>Comment d)</u> - The Director of the Banking Sector noted: <i>“It is not clear to me what jurisdiction if any they [the CFTC] would have in the matter”</i>. <p>Following further email correspondence, an approach was agreed on 1 May 2008 to:</p> <ul style="list-style-type: none"> • contact the BBA to <i>“understand what they are doing and seek to shadow their process”</i> and to <i>“install [sic] a greater sense of urgency into their process”</i>; • inform the CFTC on 6 May 2008 to explain <i>“that we are in discussions with the BBA – we are not inviting them to participate”</i>; and • to contact General Counsel’s Division (GCD) on the scope of jurisdiction of the BBA and CFTC. <p>In relation to this agreed approach, we have found no evidence of contact with the CFTC on the date suggested. We have found no evidence to suggest that GCD was contacted and its advice sought on the scope of jurisdiction.</p>	<p>1 May 2008 – the email outlining the agreed approach was circulated by the Director of Markets Division to the Director of the Banking Sector and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; and • PRD.
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Communication 41

Email from Barclays entitled ‘Liquidity update – Wednesday 23rd April (Confidential)’	23 April 2008	External Firm
<p>The email, forwarded on to the FSA by an individual within Barclays Compliance, included the following comment:</p> <ul style="list-style-type: none"> • <i>“USD Libors are still fixing below where cash would be available, currently the only offers of 3 months are at 3.20 and 1 year at 3.50 compared with Libors of 2.92 and 3.11 respectively, although when the US starts trading we expect to see money markets funds looking to buy CDs around 3.00 in 3’s and 3.35 in 1y.”</i> <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee. We did not find a copy of this email in the FSA’s files.</p>	The email was circulated to staff below director level within the supervision team within Major Retail Groups Division.	

Communication 42

Background note on LIBOR	30 April 2008	Internal FSA note
<p>A member of staff below director level within Prudential Risk Division produced a background note on LIBOR. This included the following comments:</p> <ul style="list-style-type: none"> • <i>“publicly available minutes from the BOE website of a November meeting [...recorded] that ‘several group members thought that LIBOR fixings had been lower than actual interbank rates’”</i>. • <i>“[an] article in the BIS [Bank for International Settlements] quarterly review said the fact that</i> 	This note was circulated to staff within Prudential Risk Division (including the Director) and to a member of staff below director level within Wholesale and Prudential Policy Division.	

<p><i>LIBOR is based on ‘non-binding quotes... may open up the possibility of strategic misrepresentation.’”</i></p> <p>The note also referred to a comment on LIBOR potentially understating actual lending costs by 20-30 basis points, which was attributed to an article by Citigroup analysts entitled ‘Is Libor broken?’ of 10 April 2008.</p> <p>No actions were proposed and it was unclear as to the purpose of the note.</p>	
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Communication 43

Bloomberg article	13 May 2008	Media article
<p>The article entitled ‘Libor Set for Overhaul as Credibility Is Doubted’ included the following comments:</p> <ul style="list-style-type: none"> • <i>“The LIBOR numbers that banks reported to the BBA were a lie’, said Tim Bond, head of global asset allocation at Barclays Capital in London. ‘They had been all along. The BBA has been trying to investigate them and that’s why banks have started to report the right numbers.’”</i> • <i>“The Bank for International Settlements said in a March report some lenders were manipulating the rates to prevent their borrowing costs from escalating.”</i> 	<p>This media article was publicly available and a copy of the article was located within the FSA’s record management system.</p> <p>A link to the article was sent to a member of staff below director level within Markets Division.</p> <p>The article was also included in a (Committee of European Insurance and Occupational Pensions Supervisors) Financial Requirements Expert Group meeting agenda sent on 30 May 2008 to the Director of Wholesale and Prudential Policy Division.</p>	

Communication 44

Wall Street Journal article	16 May 2008	Media article
<p>The Wall Street Journal (WSJ) article, entitled ‘Fed Officials Discuss Libor with Traders in London’, included the following comments:</p> <ul style="list-style-type: none"> • <i>“In recent days, U.S. Federal Reserve officials have been in contact with London traders who play a role in setting the rate, known as the London interbank offered rate, or Libor, people familiar with the matter say.”</i> • <i>“In one particularly unusual move, banks’ quotes for three-month and six-month U.S.-dollar loans rose sharply in the days after April 16, when an article in the Wall Street Journal highlighted the concerns about Libor and the BBA announced it would speed up its review. William C. Dudley, the executive vice president at the New York Federal Reserve, noted the increase in a speech in Chicago on Thursday.”</i> <p>A Bank of England Market conditions update for 16 May 2008 included a link to the WSJ article with the following comment:</p> <ul style="list-style-type: none"> • <i>“WSJ reports that Fed officials are discussing LIBOR with traders in London”.</i> 	<p>This media article was publicly available.</p> <p>The Bank of England Market conditions update was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that</p>	

	<p>used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division; • a member of staff below director level within Markets Division; and • a member of staff below director level within Wholesale Firms Division. <p>We were able to confirm that this email was circulated to a member of staff below director level within Markets Division.</p>
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Communication 45

Wall Street Journal article	22 May 2008	Media article
<p>The Wall Street Journal (WSJ) article, entitled ‘Small Change: The Libor Fix’ included the following comments:</p> <ul style="list-style-type: none"> • <i>“As the group that oversees one of the world’s most important interest rates weighs changes aimed at dispelling concerns about the rate’s accuracy, early signs are suggesting those changes will be modest. At most. For more than a month, the British Bankers’ Association has been reviewing the London interbank offered rate, or Libor, amid widespread concerns that it doesn’t accurately reflect what it is supposed to: the average rate at which banks lend money to one another.”</i> • <i>“One concern is that some banks could be providing quotes below what they actually pay to avoid looking desperate for cash.”</i> <p>A Bank of England Market conditions update for 22 May 2008 attached a copy of the WSJ article with the following comment:</p> <ul style="list-style-type: none"> • <i>“There is a WSJ piece on Libor changes (attached)”.</i> 	<p>This media article was publicly available.</p> <p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division; • a member of staff below director level within Markets Division; and • a member of staff below director level within Wholesale Firms Division (WFD). <p>We were able to confirm that this email was circulated to the Chairman.</p> <p>The note was forwarded on to staff below director level within:</p> <ul style="list-style-type: none"> • WFD; and 	

- Prudential Risk Division.

Communication 46

Bloomberg article	27 May 2008	Media article
<p>The article entitled ‘Libor Cracks Widen as Bankers Struggle With Reforms’ included the following comments:</p> <ul style="list-style-type: none"> • <i>“Even when the market knew UBS was massively exposed and Lloyds wasn’t, that was not reflected in Libor”.</i> • <i>“ ‘You’ve got to fix Libor’ said Tom Bond, head of asset allocation strategy in London at Barclays Capital, a unit of Barclays plc [...] ‘You don’t ever want to be in a situation like this again, where people can get away with quoting whether rate they like. Real people get hurt like this.’”</i> • <i>“Strategists such as Bond at Barclays went as far as calling the reporting rates a ‘lie’”</i> • <i>“UBS, the world’s biggest wealth manager, and Lloyds TSB [...] underscore the wide range in rates quoted to the BBA since July.</i> • <i>UBS’s three month offered rate in dollars averaged 1.3 basis points less than Libor from July through April 15. By contrast, Lloyds TSB quoted rates that were 0.04 basis point above Libor on average.”</i> • <i>“HSBC Holdings PLC... gave rates that averages 1.4 basis points less than LIBOR.”</i> • <i>“Royal Bank of Scotland Group PLC [...] submitted rates that averaged 0.9 basis point below Libor.”</i> <p>This article was referred to in a Bank of England Market conditions update of 27 May 2008, but with no mention of specific firms.</p>	<p>This media article was publicly available.</p> <p>The Bank of England Market conditions update was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division (FSD); • a member of staff below director level within Markets Division; and • a member of staff below director level within Wholesale Firms Division (WFD). <p>We were able to confirm that this email was circulated to a member of staff below director level within Markets Division.</p>	

<p>Internal emails entitled ‘Major UK banks and building societies’ and ‘[LIBOR Panel Bank 1] update’ of 27 May 2008 also referred to this article as follows (but did not attach the article):</p> <ul style="list-style-type: none"> • <i>“The Libor story was continuing on Bloomberg, where UBS had been reported as posting consistently low Libor settings in spite of losses.”</i> <p>A separate email entitled ‘UBS Daily Liquidity Call’ noted that the Bloomberg article had been raised during a telephone call between the FSA and UBS.</p>	<p>The ‘Major UK banks and building societies’ email was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • the CEO; • the Managing Director of Wholesale and Institutional Markets; • the Acting Managing Director of Retail Markets; • the Director of the Banking Sector; • the Director of FSD; • the Acting Director of Major Retail Groups Division (MRGD); • the Director of Prudential Risk Division (PRD); • the Director of Wholesale and Prudential Policy Division (WAPPD); and • the Director of Strategy and Risk Division. <p>The email was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • FSD; • MRGD; • WFD; and • Retail Firms Division. <p>The ‘LIBOR Panel Bank 1 update’ email was circulated to staff below director level within MRGD.</p> <p>The UBS daily liquidity call was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • the CEO; • the Managing Director of the Wholesale and Institutional Markets; • the Director of the Banking Sector; • the Director of FSD; • the Director of WFD; • the Director of WAPPD; • the Director of PRD; and • a member of staff below director level within MRGD.
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Communication 47

Bloomberg article	29 May 2008	Media article
<p>An article entitled ‘Libor Banks Misstated Rates Amid Rout’ included the following comments:</p> <ul style="list-style-type: none"> • <i>“Banks routinely misstated borrowing costs to the British Bankers’ Association to avoid the perception they faced difficulty raising funds as credit markets seized up, said Tim Bond, a strategist at Barclays capital [...] We had one week in September where our treasurer, who takes his responsibilities pretty seriously, said: ‘right, I’ve had enough of this, I’m going to quote</i> 	This media article was publicly available.	

<p><i>the right rates.’ All we got for our pains was a series of media articles saying that we were having difficulty financing.”</i></p> <ul style="list-style-type: none"> • <i>“Other banks tried to push their head above the parapet on occasions as well, but with every attempt you were met with a lot of rumor and innuendo”.</i> <p>This article was circulated by the Director of Markets Division and we observed discussions on it between a member of staff within the Major Retail Groups Division (below Director, but with the Director copied in) and the Director of Markets. This included the following comments:</p> <ul style="list-style-type: none"> • <i>“I am not quite sure what sort of interpretation people are putting on this”.</i> • <i>“We know that [... a LIBOR panel bank] complained to the BBA that they had seen other firms borrowing at rates which were above where they were posting rates (i.e. other banks putting in artificially low rates [...])”.</i> 	<p>The article was circulated to the Director of the Banking Sector and the Acting Director of Major Retail Groups Division. The article was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • Major Retail Groups Division; and • Prudential Risk Division.
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Communication 48

Wall Street Journal article	29 May 2008	Media article
<p>The Wall Street Journal (WSJ) article (‘Article A’), entitled ‘Study casts doubt on key rate’, included the following comments:</p> <ul style="list-style-type: none"> • <i>“The Journal analysis indicates that Citigroup Inc., WestLB, HBOS PLC, J.P. Morgan Chase & Co. and UBS AG are among banks that have been reporting significantly lower borrowing costs for the London interbank offered rate, or Libor, than what another market measure suggests they should be.”</i> • <i>“Faced with suspicions by some bankers that their rivals have been lowballing their borrowing rates to avoid looking desperate for cash, the British Bankers’ Association, which oversees Libor, is expected to report Friday on possible adjustments to the system.”</i> • <i>“The gap between the two measures [LIBOR and the default-insurance market] was wider for Citigroup, Germany’s WestLB, the United Kingdom’s HBOS, J.P. Morgan Chase & Co. and Switzerland’s UBS than for the other 11 banks. One possible explanation for the gap is that banks understated their borrowing rates.”</i> • <i>“At times of market turmoil, banks face a dilemma. If any bank submits a much higher rate than its peers, it risks looking like it’s in financial trouble. So banks have an incentive to play it safe by reporting something similar – which would cause the reported rates to cluster together.”</i> • <i>“In mid-April, UBS [...] was offering to pay an annual rate of 2.85% to borrow dollars for three</i> 	This media article was publicly available.	

months in the commercial-paper market [...] But when it reported for Libor purposes on April 16, UBS said it could borrow for three months from other banks at 2.73% - in line with all the other panel banks.”

- “Between late January and April 16, when the Journal first reported concerns about Libor’s accuracy, Citigroup’s reported rates differed the most from what the default-insurance market suggested. On average, the rates at which Citigroup said it could borrow dollars for three months were about 0.87 percentage point lower than the rate calculated using default-insurance data, the Journal’s analysis shows.”
- “The difference was 0.7 percentage points for WestLB, 0.57 point for HBOS, 0.43 for J.P. Morgan, and 0.42 for UBS.”
- “Questions about the rate arose at meetings held in November and April by a Bank of England money-market committee that includes banks and the BBA. The minutes of the committee’s April 3 discussions say that ‘U.S. dollar Libor rates had at times appeared lower than actual traded interbank rates.’”

A related article (‘Article B’) entitled ‘Behind the Journal’s Analysis’ published the same day, gave further information on how the WSJ had performed its analysis.

Article A was referred to in a Bank of England Market conditions update of 29 May 2008 with the following comment:

- “The Wall Street Journal, based on its own research, said that major banks are contributing to the ‘erratic behaviour’ in US dollar Libor rates. Its analysis suggested that Citi, WestLB, HBOS, JP Morgan and UBS are among banks that have been reporting significantly lower borrowing costs for Libor than suggested by CDS spreads.”

It was also referred to in a further Bank of England Market conditions update of 29 May 2008 with the following comment:

- “A Wall St Journal article this morning noted that CDS spreads and Libor fixings normally moved roughly in tandem for panel banks, but that the link had broken down earlier this year for a number of banks (HBOS, Citi, UBS, West LB and JPM being named) and the WSJ thought these banks understating their borrowing costs was a possible cause.”

Both Bank of England notes were attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.

From other communications in the period that used the same mailing list we inferred that the list included:

- the Chairman;
- the Director of the Banking Sector;
- the Director of Financial Stability Division (FSD);
- a member of staff below director level within Markets Division; and
- a member of staff below director level within Wholesale Firms Division (WFD).

We were able to confirm that this email was circulated to the Director of FSD.

The email attaching Article A was forwarded by the Director of FSD to staff below director level within Major Retail Groups Division (MRGD) with the comment “Presumably you have seen the WSJ comments about HBOS & LIBOR?” We did not locate any response.

Article A was also included in full in another Bank of England Market conditions update of 29 May 2008 with the following comment:

- *“WSJ has a piece on LIBOR in the build up to outcome of review due at the end of the week [sic]. Noting that certain banks Libor fixings reacting less to changes in their CDS [credit default swaps] than other banks, particularly in March. Names and shames HBOS, UBS, West LB, Citigroup and JPM.”*

The Director of the Banking Sector forwarded the Markets Morning Update note to a member of the Banking Sector team asking for the methodology of the WSJ article to be reviewed. The response noted:

- the WSJ confused Citigroup with Citibank NA;
- the data compared different rates with different maturities (3 month LIBOR with data appearing to be 6 month CDS spread); and
- the methodology may not have taken into account fully the Credit Default Swap counterparty risk.

An FSA email entitled ‘Major UK banks and building societies’ of 29 May 2008 summarising funding positions also included a comment on the analysis:

- *“[A representative from a LIBOR Panel Bank]*

The email containing the Bank of England Market conditions update attaching Article A in full was circulated to the Bank of England mailing list entitled ‘FSA & HMT Markets updates’ highlighted above. We were able to confirm that this email was circulated to the Director of Banking Sector and members of staff below director level within Markets Division and Strategy and Risk Division (SRD).

The Market conditions update was forwarded on to:

- the Managing Director of Wholesale and Institutional Markets;
- the Acting Managing Director of Retail Markets;
- the Director of Retail Policy and Themes Division/the Asset Management Sector;
- the Director of Treating Customers Fairly Division/the Insurance Sector; and
- the Director of Communications Division.

It was also forwarded on to staff below director level within:

- Markets Division;
- the Banking Sector team;
- FSD;
- MRGD;
- WFD;
- Retail Firms Division (RFD);
- Wholesale and Prudential Policy Division (WAPPD);
- Prudential Risk Division (PRD);
- SRD;
- the Asset Management Sector team;
- General Counsel’s Division;
- Communications Division; and
- Information Systems Division.

The review of the methodology of the WSJ article performed by the Banking Sector team was sent to the Director of the Banking Sector and copied to the Directors of Markets Division and PRD and staff below director level within:

- Markets Division; and
- PRD.

The email entitled Major UK banks and building societies was circulated to:

- the Chairman;
- the CEO;

<p><i>was pretty incensed by the press coverage of the LIBOR fixing issue today, in particular [the representative] berated the poor quality of the analysis conducted by the 3 academics on behalf of the Wall Street Journal (copy included in today's market up-date from BoE). Said that a number of reasons why CDS market (currently in a state of dislocation) would not correlate with LIBOR fixing."</i></p>	<ul style="list-style-type: none"> • the Managing Director of Wholesale and Institutional Markets; • the Acting Managing Director of Retail Markets; • the Director of the Banking Sector; • the Director of FSD; • the Director of WFD; • the Director of PRD; • the Director of WAPPD; and • the Director of SRD. <p>It was also circulated to the Bank of England, the Treasury and staff below director level within:</p> <ul style="list-style-type: none"> • FSD; • MRGD; • WFD; and • RFD.
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Communication 49

Bloomberg article	10 June 2008	Media article
<p>The article, entitled 'LIBOR to Be Set by More Banks as BBA Boosts Scrutiny' included the following comments:</p> <ul style="list-style-type: none"> • <i>"Banks routinely misstated borrowing costs to the BBA to avoid the perception they faced difficulty raising funds".</i> • <i>"Rates offered by UBS and Lloyds TSB [...] underscore the range in quotes to the BBA since July [...UBS's] average was 1.3 basis points less than its peers. Lloyds TSB quoted rates that were 0.04 basis point above Libor on average."</i> 		<p>This media article was publicly available.</p> <p>A link to this article was circulated to a member of staff below director level within Markets Division.</p>

3.3.2 Commentary for the period 1 April 2008 to 25 June 2008

100. This section provides commentary on the communications listed in Subsection 3.3.1.

Part 1 - The extent to which communications indicated potential lowballing

101. The communications described in Subsection 3.3.1 showed that reports on LIBOR dislocation increased materially in the period 1 April 2008 to 25 June 2008, relative to the two previous periods (in Sections 3.1 and 3.2).

102. The communications in this period also made a more direct reference to potential lowballing, particularly following the BBA's announcement of its review on 16 April 2008. We considered that these included:

- media articles claiming firms were submitting lower rates to avoid speculation about their funding position (Communications 35 and 42 to 49);
- concerns raised by firms including by two non LIBOR Panel Banks (Communications 30 and 32) and by Barclays (Communications 37, 38, 41);
- a comment within a Bank of England Market conditions update the day the BBA review was announced regarding the reference to the ban being *"thought to be aimed at European banks understating their US\$ fixing, given they did not want to publicly*

acknowledge their higher bidding rates” (see the introduction to Communication 36);
and

- comments that secured funding rates were higher than unsecured rates (Communications 33 and 35).

Part 2 – Comments on the awareness within the FSA of the significance of the communications

103. There was a wide circulation of most of the communications in this period. 10 of the 20 communications in this period also went to managing director level or above (including the communications on the claim from a Non LIBOR Panel Bank – Communication 30 – and from the CFTC - Communication 40) and there were examples of the Chairman’s office asking for copies of documentation (see Communication 36).

104. However, on some occasions where information was received by supervision teams, the communications were not circulated nor escalated beyond the supervisory team. This was the case for Communications 32, 35, 37, 38 and 41. Communication 37 was particularly significant since it referred to Barclays sticking its “*head above the parapet*”. This would have been a particularly useful communication as context to the reference to Barclays in various Bloomberg articles at the time, although it did not add materially to the Bloomberg points. Similarly, the Bloomberg article of 27 May 2008, that named several banks as potentially submitting inaccurate rates (Communication 46), was circulated within the FSA as only referring to UBS.

105. We observed that there was some awareness within the FSA of the significance of potential lowballing. Relevant comments by FSA staff included:

- The comment from a member of staff below director level within Prudential Risk Division about the claim from the non LIBOR Panel Bank (Communication 30): “*[the] implications if someone wanted to challenge the ‘fairness’ of the fixes are massive*”.
- The comment from a member of staff below director level within General Counsel’s Division in relation to a note on a Market Conditions meeting (Communication 34) – “*there could be a more significant issue if it is not being calculated properly as that would potentially mean that people are paying rates on a false premise.*”
- The comment from a member of staff below director level within Markets Division in relation to the same Market Conditions note: “*Its very difficult to tell if this is a real issue (if it were there may be market manipulation issues).*”
- The minutes of a meeting with the BBA of 22 May 2008 highlighting that the FSA’s “*central concern is that some banks have on occasion been posting Libor fixings which do not accurately reflect their cost of funding*” (Communication 36).
- With reference to the contact from the CFTC, the comment from a member of staff below director level within Prudential Risk Division that “*[they would] rather discuss this off email*” (Communication 40).

106. Of these five comments, four were circulated at director level or above. Two were circulated at managing director level or above (the first and the fourth bullets).

107. We did not find that any communications relating to potential lowballing were escalated to the FSA Board during this period. Similarly to the previous period (Subsection 3.2.2), LIBOR rates were mentioned as part of ‘general market conditions’ updates provided to the April and May 2008 Board meetings. However, these references were used to illustrate funding conditions at the time and made no reference to lowballing.

108. We have commented in Subsection 3.1.2 part 3 (paragraph 76) on what the FSA's responsibilities were in respect of LIBOR. In terms of roles within the FSA during this period, from our review of the communications and interviews held as part of our review, we have established that the Markets Division took the lead on liaising with the BBA on whether any improvements were needed in the fixing process. We noted that it appeared clear what the division of responsibilities was between the FSA and the BBA (see part 3, paragraphs 112 and 113).

109. The Banking Sector team was responsible for cross-firm banking issues (and managing the relationship with the BBA). However, we recognised that the Banking Sector team was focused on other aspects of the crisis during this period. Banking supervision teams were primarily concerned about the liquidity and capital positions of individual banks. More generally, we also saw the different areas of the FSA working together (particularly on dealing with the claim from a Non LIBOR Panel Bank (Communication 30), the BBA (Communication 36) and the CFTC (Communication 40)).

110. We noted that a question was raised within the FSA whether the CFTC had any jurisdiction in investigating LIBOR fixings (see the last two paragraphs within Communication 40). Although an action was agreed to check with General Counsel's Division, we found no evidence to suggest it was. However, we do not consider this had any material impact since at this stage the BBA's review was underway, and the CFTC did not take further action until subsequent media articles appeared, at which point the FSA fully engaged with the CFTC (see Subsection 3.4.2 - paragraphs 138 and 139).

Part 3 - Comments on what actions the FSA took in relation to the communications

111. The communications indicated that the focus of the FSA's action in relation to potential lowballing was feeding into the BBA's review (see Communication 36).

Objectives and engagement with the BBA

112. We noted the FSA had clear objectives in relation to its engagement with the BBA. The approach agreed within the FSA noted contacting the BBA to "*understand what they are doing and seek to shadow their process*" and to "*install [sic] a greater sense of urgency into their process*" (see Communication 40).

113. We saw evidence that the FSA engaged actively with the BBA. This took the form of the FSA discussing proposals at meetings and commenting on draft versions of the BBA's paper. We saw evidence of comments made on the governance of the fixing process and on the process for checking submissions.

Did the FSA consider it had achieved its outcomes in its interaction with the BBA review?

114. The BBA's review proposed measures to improve the fixing process. In relation to these, we observed that the FSA considered its comments had been "*taken onboard to a varying degree*" but that the process for ensuring the accuracy of submissions "*remains light*" (Communication 36). Nevertheless, there was recognition within the FSA that this was a first stage in a longer process - we comment in Subsection 3.4.2 on how the FSA liaised with the BBA on feedback to the consultation paper, and on the BBA's subsequent work on governance.

115. Although the BBA proposed measures to improve the fixing process, its paper did not refer to whether it had found lowballing and it led to no banks being removed from a panel. The focus of the consultation paper was to explain what the BBA saw as “*misunderstandings and misperceptions*” on the way the fixing mechanism worked, how LIBOR was being compared to other market indicators and how LIBOR fixings were interpreted. However, the BBA did recognise in the paper the potential for stigma in providing submissions and committed to exploring options to address this whilst maintaining transparency.

116. We observed that the FSA recognised the importance of the BBA removing firms from a panel if they were found to be submitting inaccurate rates – the FSA minutes of the 22 May 2008 meeting with the BBA (Communication 36) noted “*for the threat to drop a bank to be credible, it may have to be enforced. If none are ejected the press will likely cast dispersions [sic] on the seriousness of the BBA review*” and with the circulation of a draft of the consultation paper, an exchange of emails between FSA staff noted: “*If the majority of the panel are fixing rates lower than where they can fund themselves the fixing is not representative of the panels funding costs. The paper does not even mention this the [sic] problem [...] I think the media and observers will see this negatively in so far as the BBA is ignoring or avoiding the issue.*”

117. However, notwithstanding any confidentiality issues, we found no evidence of the FSA discussing with the BBA concerns raised by firms, market intelligence or other communications in this period. This was despite some of the communications making direct reference to potential lowballing – particularly the claims from Barclays (made to one of the firm’s supervisors - Communication 37). Similarly, we found no evidence of the FSA receiving any information from the BBA regarding potential lowballing by individual firms.

Did the FSA consider whether it should take action in relation to individual firms?

118. In addition to the comments outlined in paragraph 116, we noted other comments that suggested there were concerns about the effectiveness of the BBA’s review (for example, comments c, d and e in part 3 of Communication 36). There was also commentary that LIBOR increases after the BBA announced its review were evidence that submissions had been too low (see part 3 of Communication 36, comments a, b and f), although one firm was reported separately as commenting that the announcement had also “*pushed [up] the cash rates as US investors were spooked by the move.*”

119. We recognised that the activities of contributing to or administering LIBOR were not ‘regulated activities’ as defined under the Financial Services and Markets Act 2000. However, the following comments made by FSA staff, although these comments were in the minority, suggested there was awareness that the FSA had a role or the ability to take action in relation to lowballing:

- The discussion about the CFTC (Communication 40) when a member of staff within the Markets Division commented that “*we can visit any banks which have made significant increases in their returns to the BBA*”.
- The discussion about the CFTC (Communication 40), when a member of staff within Enforcement Division noted “*the FSA does not have supervisory responsibility for the BBA rate setting mechanism although [...] we do have prudential supervisory responsibility over the FSA authorised banks providing the information to the BBA.*”

In addition, of course, the FSA did ultimately take enforcement action (in relation to the FSA's Principles for Businesses).

120. We also noted that Enforcement Division had a role of coordinating international requests for information and was one of the areas approached during the CFTC's initial contact with the FSA. There was no indication that there was any consideration of whether LIBOR submissions should have been investigated further at that stage.

121. There were several areas of context that we noted in this period which would have influenced the FSA's actions:

- There continued to be communications referring to dislocation caused by deteriorating market conditions (including the impact of tiering – see paragraph 68) interacting with structural issues in the LIBOR fixing process (see paragraph 69). For instance, an FSA staff member's understanding of the claim from the non LIBOR Panel Bank (Communication 30, which we considered was a more direct reference to lowballing) was that it was motivated by that bank being disadvantaged in relation to its own particular funding costs and investments due to tiering, particularly as it was a small bank.
- We observed communications in the period that recognised LIBOR dislocation, but did not indicate that there was also lowballing. These included:
 - Communications received by the FSA, such as a research paper by JP Morgan dated 16 May 2008 which concluded *"In our view, the LIBOR fixing process is not broken; BBA Libor broadly reflects the borrowing costs of top tier large banks. Differences between Libor and other indices can largely be explained by the composition of the Libor panel. The main limitations of Libor are due more to lack of liquidity in the market rather than any bias in the fixing process"*. There were also observations on 20 May 2008 attributed to two LIBOR Panel Banks, referred to in FSA communications on market conditions, that *"Comments in the press around LIBOR reflected their view that LIBOR posted up through 6 months are 'accurate'"*.
 - Within the FSA, a note dated 25 April 2008 from a member of staff within Strategy and Risk Division, commenting on money market movements and the future of LIBOR, concluded *"LIBOR isn't broken: the present level of term LIBOR rates accurately reflects current liquidity conditions"*. As highlighted in Communication 48, there was also analysis carried out by the Banking Sector team which concluded that the 29 May 2008 Wall Street Journal article contained inaccuracies.
- As in previous sections, in the context of the financial conditions at the time, the overriding priority for the FSA was dealing with the severely weakened financial positions of individual regulated institutions, rather than the accuracy of LIBOR submissions.
- Although two media articles (Communications 42 and 43) reported that an article within the March 2008 Bank for International Settlements Quarterly Review commented on the potential for lowballing, as we highlighted in paragraph 95 of Subsection 3.2.2, the article's main conclusion was that there was: *"no indication that fixings were manipulated"*.

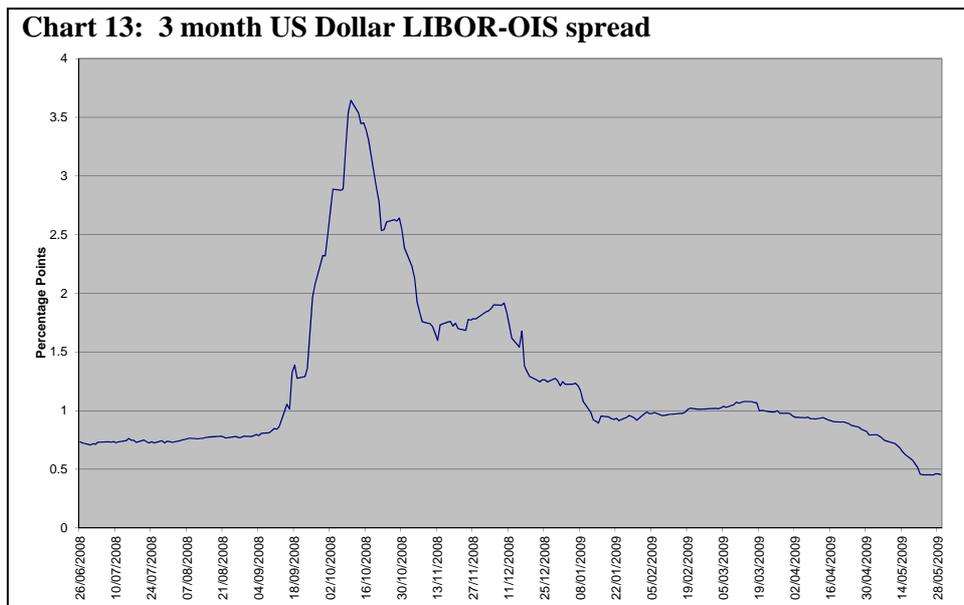
3.4 26 June 2008 to 31 May 2009

122. Stressed market conditions continued at the beginning of this period, with LIBOR-OIS spreads remaining wide, although relatively stable, throughout July and August 2008 (see Charts 12 and 13).

123. From September 2008, market conditions deteriorated significantly; LIBOR-OIS spreads widened sharply following the collapse of Lehman Brothers on 15 September 2008 and the sale of Merrill Lynch to Bank of America the same day. Many financial institutions were reported as experiencing difficulties and stock markets were volatile - the FTSE 100 index fell by 381.7 points on 10 October 2008 in its highest daily fall since the crash of 1987. The US Dollar LIBOR-OIS spread reached a historic high of 365bps on 10 October 2008 and the Sterling LIBOR-OIS spread to 299bps on 6 November 2008.

124. The interventions of central banks meant that, towards the end of 2008, LIBOR-OIS spreads began to fall, indicating a relative improvement in market conditions. Further significant market events included the Bank of England's reduction of its base rate to a historic low of 0.5% and the initiation of its quantitative easing programme on 5 March 2009.





Charts 12 and 13 source data: Thompson Reuters and Bloomberg

3.4.1 Communications and their circulation

125. We have identified 25 sets of communications in the period 26 June 2008-31 May 2009. These comprise:

- two internal FSA communications on market conditions/LIBOR;
- four Market conditions and Market Intelligence updates from the Bank of England;
- 16 communications from firms on fixings/submissions; and
- three events – engaging with the BBA’s further work on the LIBOR fixing process; liaising with the CFTC; and responding to contact from the Office of Fair Trading (OFT).

126. We provide further information on these events and communications below, including to whom the communications were circulated.

Communication 50 (event)

Contact by the CFTC	26 June 2008	Event
Further to the approach in April 2008 (see Communication 40), the CFTC contacted the FSA in June 2008 regarding media coverage on whether certain banks were under-reporting LIBOR. There were discussions between the CFTC, the FSA and the BBA that ultimately led to further investigations and the financial penalties imposed on firms.		
We set out the relevant communications below, under the following headings:		
<ol style="list-style-type: none"> 1) Initial contact by the CFTC 2) Discussions with the BBA 3) Information requests to firms 		
<u>1) Initial contact by the CFTC</u>		
The CFTC emailed a member of staff within Enforcement Division on 26 June 2008 and attached the Wall Street Journal (WSJ) article of 29 May 2008 (see Communication 48) which referred to five LIBOR contributor banks. Enforcement Division referred the CFTC to the Director of Market Division and to a member of staff within the Prudential Risk	26 June 2008 – CFTC emailed staff below director level within Enforcement Division.	

<p>Division (PRD), noting that that member of staff had dealt with the earlier questions.</p> <p>On 27 June 2008, the CFTC called the Director of Enforcement Division, following up with an email on 30 June 2008, also attaching the 29 May 2008 WSJ article. After discussion with the Managing Director of Wholesale and Institutional Markets, the Director of Enforcement Division informed the CFTC on 30 June 2008 that the Director of the Banking Sector should be the main point of contact.</p> <p>The first record we have that this was discussed at the meeting of the executive was the minutes of ExCo on 1 July 2008 which noted that the Director of Enforcement Division <i>“had received information from the US CFTC regarding potential LIBOR mis-quoting and would keep ExCo informed.”</i></p> <p>A subsequent email sent from the Director of Enforcement Division to ExCo on 1 July 2008 noted that the CFTC wanted to <i>“‘reach out’ to the five banks mentioned to ask them for information on a voluntary basis to assess where there was any deliberate under reporting or collusion”</i>. This would be taken forward as part of the CFTC’s <i>“false reporting statute which applies to inter-state commerce, which in their view, includes the world.”</i></p> <p>In response to a further question from the FSA on 14 January 2009, the CFTC confirmed that its sphere of authority included the Chicago Mercantile Exchange (CME) LIBOR futures contract and the CME Eurodollar futures contract, which are based on LIBOR.</p> <p>On 7 July 2008, the Banking Sector team produced a draft note to send to the CFTC that highlighted perceived flaws in the WSJ’s analysis (based on an earlier internal note - see Communication 48). However, we did not find any evidence of the FSA sending the note to the CFTC.</p>	<p>27 June 2008 – the CFTC called the Director of Enforcement Division.</p> <p>30 June 2008 – the email from the CFTC was forwarded by the Director of Enforcement Division to:</p> <ul style="list-style-type: none"> • the Managing Director of Wholesale and Institutional Markets; • the Director of the Banking Sector; and • a member of staff below director level within Enforcement Division. <p>1 July 2008 – the email was sent to:</p> <ul style="list-style-type: none"> • the Chairman; • ExCo; • the Director of Markets Division; and • the Director of the Banking Sector. <p>The Director of Strategy and Risk Division forwarded the email to staff within Strategy and Risk Division.</p> <p>7 July 2008 – the draft note for the CFTC was circulated within the Banking Sector team, including to the Director.</p>
<p><u>2) Discussions with the BBA</u></p>	
<p>During the period, the CFTC drew up a list of information that it wanted from the BBA about the LIBOR fixings process. This section records the relevant FSA communications we found in relation to this requested information.</p>	

<p>a) On 9 July 2008, a conference call took place between the FSA, BBA and CFTC. We have not found any record of the call.</p> <p>b) On 10 September 2008, the CFTC wrote to the BBA requesting information.</p> <p>c) On 16 October 2008, the CFTC wrote to the FSA asking it to obtain information from the BBA, which was the BBA's preferred route for providing it.</p> <p>d) On 29 October 2008, the FSA discussed this internally and then agreed to this approach, noting it would be on a voluntary basis as the FSA did not regulate the BBA. A letter was sent to the BBA on 5 November 2008 outlining this approach and forwarding on the information request from the CFTC.</p> <p>e) According to an internal FSA email, the BBA confirmed on 17 November 2008 its willingness to cooperate on this basis. The FSA enquired as to the BBA's progress in collating the information on 2 December 2008, 10 December 2008 and again on 12 January 2009.</p> <p>f) On 13 January 2009, the BBA wrote to the FSA noting that it was considering legal advice on the provision of information. The FSA again enquired as to the BBA's progress on</p>	<p>a) 9 July 2008 – Participants in the call were:</p> <ul style="list-style-type: none"> • the Director of Enforcement Division; • the Director of the Banking Sector; and • representatives from the BBA and CFTC. <p>b) 10 September 2008 – the request for information was sent to the Director of Enforcement Division, who forwarded it to the Director of the Banking Sector.</p> <p>c) 16 October 2008 – the request was sent to a member of staff below director level within Enforcement Division. This email was forwarded on to the Director of Markets Division, the Director of the Banking Sector and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • Wholesale Firms Division (WFD); • Enforcement Division; and • General Counsel's Division. <p>d) 29 October 2008 – a member of staff below director level within Enforcement Division proposed a response to be sent to the CFTC. This was sent to a member of staff below director level within Markets Division and copied to the Director of Markets Division and staff below director level in:</p> <ul style="list-style-type: none"> • Markets Division; • WFD; • Enforcement Division; and • General Counsel's Division. <p>Later on 29 October 2008, the member of staff below director level within Enforcement Division confirmed that a response had been given to the CFTC. This was sent to a member of staff below director level within Markets Division.</p> <p>On 5 November a member of staff below director level from Enforcement Division sent the letter to the BBA (we have not located a copy of the letter).</p> <p>e) 17 November 2008 – an email conversation was held between the BBA and a member of staff below director level within Enforcement Division.</p> <p>f) 13 January 2009 – the BBA emailed the Director of the Banking Sector and a member of staff below director level within</p>
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<p>23 January 2009.</p> <p>g) On 27 January 2009, the BBA emailed the Director of the Banking Sector attaching a draft response. This included reference to the International Monetary Fund report (see paragraph 136) and an article within the Bank for International Settlement's quarterly report (see paragraph 95) which included commentary on the accuracy of LIBOR fixings.</p> <p>h) On 30 January 2009, the Director of the Banking Sector confirmed that the FSA was content for the response to be sent to the CFTC. It was sent on 3 February 2009.</p>	<p>Enforcement. The FSA enquiry was sent from a member of staff below director level within Enforcement Division.</p> <p>g) 27 January 2009 – the BBA emailed the Director of the Banking Sector. This was forwarded on to a member of staff below director level within Enforcement Division.</p> <p>h) 30 January 2009 - The Director of the Banking Sector emailed the BBA, copying in a member of staff below director level within Enforcement Division and a member of staff below director level within the Banking Sector team.</p>
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3) Information requests to firms

<p>Between October 2008 and May 2009, we identified a series of communications between the FSA, CFTC and a number of submitting banks regarding the provision of information to the CFTC. These included requests to firms sent by the FSA's Enforcement Division and the FSA being informed of requests received directly by firms from the CFTC.</p> <p>As part of this, we observed that on 16 March 2009, a LIBOR Panel Bank asked the FSA's Enforcement Division whether it wanted to attend a presentation to the CFTC on how it determined LIBOR submissions. The FSA declined on 18 March 2009 - a member of staff below Director level within the FSA's Enforcement Division noted internally that they thought it was "<i>more for the CFTC's benefit</i>".</p>	<p>The requests for information from the CFTC were circulated internally within the FSA to the Director of Markets and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • Wholesale Firms Division; • Prudential Risk Division; and • Enforcement Division.
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Communication 51 (event)

<p>Following the publication of the BBA consultation document on 10 June 2008, the FSA liaised with the BBA on:</p> <ul style="list-style-type: none"> • the BBA's feedback statement (published on 5 August 2008); and • a paper on the governance and scrutiny of the LIBOR fixing process (published on 17 December 2008). <p>We set out below communications we found, relating to each of these papers.</p>	
<h4><u>1) The BBA's feedback statement</u></h4>	
<p>In response to a request from the FSA on 24 July 2008, the BBA sent the FSA a draft copy of its feedback statement on 28 July 2008.</p>	<p>24 July 2008 – an email request to the BBA was sent by a member of staff below director level within Markets Division and copied in the Director of Markets Division.</p>

<p>Comments provided by the FSA to the BBA on 30 July 2008 were coordinated between Markets Division and Prudential Risk Division and included asking the BBA:</p> <ul style="list-style-type: none"> • to explain more about the operation of its Foreign Exchange and Money Markets Committee (the independent committee responsible for the operation and development of LIBOR); and • to provide timescales for revising the scrutiny process. <p>The BBA acknowledged the FSA’s submission on 30 July 2008 and provided a response on it on 5 August 2008. The BBA sent a revised draft of the Feedback Statement to the FSA on 5 August 2008 and a final version later that day.</p> <p>The final version of the feedback statement included the following statements:</p> <ul style="list-style-type: none"> • <i>“The respondents all supported the enhancement in the governance and scrutiny procedures for BBA LIBOR and the BBA will be releasing further details as soon as is practicable.”</i> • <i>“Respondents [...] considered that BBA LIBOR is a fundamentally robust and accurate benchmark, with contributors inputting rates that they believe to reflect future funding costs.”</i> • <i>“A number of respondents noted that BBA LIBOR has been the subject of inaccurate and misconceived commentary in some areas of the media and that needs to be addressed.”</i> • <i>“..although recent comments have focused on US Dollar LIBOR, this has been due to a period of unprecedented stress in the market.”</i> <p>In relation to a subsequent discussion, a member of staff from the Banking Sector team made the following comment on 10 November 2008 about the BBA’s LIBOR review: <i>“[The proposals] were not quite as radical as we would have wished, but they did address some concerns about the rate setting process”</i>.</p>	<p>28-30 July 2008 – the BBA’s draft feedback statement and subsequent FSA comments on it were sent to the Director of Markets Division and the Director of the Banking Sector. They were also sent to the Bank of England and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • Wholesale Firms Division (WFD); and • Prudential Risk Division (PRD). <p>5 August 2008 – the BBA’s response to the comments and the near final draft of the feedback statement were circulated to the Director of Markets Division, the Director of the Banking Sector and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; and • WFD. <p>The final feedback statement was sent to the Managing Director of Wholesale and Institutional Markets.</p> <p>The discussion was circulated to the Director of the Banking Sector and to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • Financial Stability Division; • Strategy and Risk Division; and • Retail Policy and Conduct Division. <p>The comment was also included in a letter to the OFT on 12 January 2012 (see Communication 65).</p>
<p><u>2) The BBA’s paper on governance and scrutiny</u></p>	
<p>On 19 November 2008, the BBA sent the FSA a draft paper on its proposals for the governance and scrutiny of the LIBOR fixing process.</p>	<p>19 November 2008 – the draft paper was sent to the Director of Markets Division. This was forwarded on to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division;

<p>A member of staff within the Markets Division provided a response on 21 November 2008 asking for a meeting with the BBA and commenting:</p> <ul style="list-style-type: none"> • <i>“governance and scrutiny were key areas which we raised [...] during the initial consultation [...] as areas which would benefit from much greater transparency and certainty. Your proposals, on first reading, certainly appear to go a long way to addressing these issues.”</i> <p>In an exchange of emails within the FSA, a member of staff below director level within Wholesale Firms Division commented on 25 November 2008: <i>“On the whole, much more progress by the BBA.”</i></p> <p>The FSA met the BBA on 9 December 2008. According to an update provided to the Director of the Markets Division, the FSA asked for a reference to the FSA to be removed and commented: <i>“Otherwise we’re actually reasonably impressed with these proposals as they address many of the concerns we raised originally.”</i></p> <p>The BBA published the final version of the governance and scrutiny paper on 17 December 2008. This paper included reference to plans to introduce two new sub-committees for rate fixing and oversight, and a new disciplinary procedure.</p>	<ul style="list-style-type: none"> • WFD; and • PRD. <p>It was forwarded on 9 December 2008 to a member of staff below director level within the Banking Sector team.</p> <p>21 November 2008 – the response was copied to the Director of Markets Division.</p> <p>The email was circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; and • Prudential Risk Division. <p>9 December 2008 - A member of staff below director level within Markets Division attended the meeting with the BBA.</p> <p>The final version of the governance and scrutiny paper was publicly available.</p>
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Communication 52

Market conditions update	11 September 2008	Bank of England
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“[In the context of USD LIBOR fixings] Several contacts have highlighted the theory that Libor is not truly reflective of actual inter-bank lending offer rates for many institutions.”</i> 	<p>The Bank of England Markets Morning Update was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division; • a member of staff below director level within Markets Division; • a member of staff below director level within Wholesale Firms Division (WFD); and • a member of staff below director level 	

	<p>within Strategy and Risk Division.</p> <p>We were able to confirm that this email was circulated to a member of staff below director level within Markets Division.</p> <p>The email was forwarded on to staff below director level within:</p> <ul style="list-style-type: none"> • WFD; • Prudential Risk Division; and • Wholesale and Prudential Policy Division.
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Communication 53

Update on funding positions of two LIBOR Panel Banks	19 September 2008	External Firm
<p>This email summarised a discussion with the firms on their funding positions. It included the following comment from Barclays:</p> <ul style="list-style-type: none"> • <i>“USD Libor rates are described as ‘wide and wonderful’ – they are no guide to where cash is being dealt.”</i> 	<p>The email was circulated to staff within the supervision team within Major Retail Groups Division including to the Director.</p> <p>This email was copied to the Bank of England.</p>	

Communication 54

Email from Barclays entitled ‘Liquidity update – Monday 22 nd September’	22 September 2008	External Firm
<p>The email, forwarded on to the FSA by Barclays Compliance, included the following comment:</p> <ul style="list-style-type: none"> • <i>“The O/N [overnight rate] is trading okay and there is some turnover in periods out to 1 week. In other periods there are no offers to support the Libor fixings”.</i> <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee. We did not find a copy of this record in the FSA files.</p>	<p>The email was circulated to staff below director level within the supervision team within Major Retail Groups Division.</p>	

Communication 55

Update on funding positions of two LIBOR Panel Banks	23 September 2008	External Firm
<p>This email summarised a discussion with the firms on their funding positions. It included the following comment attributed to Barclays:</p> <ul style="list-style-type: none"> • <i>“USD Libors are ‘nonsense’ and do not relate to cash levels – they noted 1 month Libor at 5.0% / 4.5%, which is well away from where they were bidding.”</i> 	<p>The email was circulated to staff within the supervision team within Major Retail Groups Division including to the Director.</p> <p>This email was copied to the Bank of England.</p>	

Communication 56

Email from Barclays entitled ‘Barclays Barcap Liquidity Update – Tuesday 23 rd September’	23 September 2008	External Firm
<p>The email, forwarded on to the FSA by Barclays Compliance, included the following comment:</p> <ul style="list-style-type: none"> • <i>“We had the latest round of \$TAFs [Term Auction Facility] earlier [...] the stand out detail was the</i> 	<p>The emails of 23 and 24 September 2008 were circulated to staff within the supervision team within Major Retail Groups Division.</p>	

<p><i>[stop out] rate which at 3.75 was 55bp above the 1month BBA Libor, probably more evidence that Libors are fixing too low.”</i></p> <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee.</p> <p>This issue was commented on further by Barclays in the following day’s liquidity update email:</p> <ul style="list-style-type: none"> • <i>“Seeing secured money trade above the official fixing rate (as in the 1month \$TAF yesterday) again brings into question the integrity of those fixing rates. The excuse that money markets are frozen does not justify fixing 3 month \$ Libor at 3.47 when the bid is so strong at 4.25 and we have heard it trade in small size to a large European bank at 4.75.”</i> <p>An article in the Wall Street Journal (WSJ) article entitled ‘Libor’s Accuracy Becomes Issue Again’ of 24 September 2008 also referred to the TAF. This was summarised as follows in a Securities Industry and Financial Markets Association (SIFMA) ‘Global SmartBrief’:</p> <ul style="list-style-type: none"> • <i>“For the second time in 2008, accuracy of Libor came into question as doubts arise about whether financial institutions are understating borrowing costs. On Monday, the rate for the 28-day Federal Reserve term-auction facility was 3.75%. The facility requires banks to put up collateral, so its rate should be lower than Libor. The one-month dollar Libor was 3.19% on Monday and 3.21% on Tuesday.”</i> <p>The WSJ article included the following comment:</p> <ul style="list-style-type: none"> • <i>“...the rate for the Fed auction should be lower than Libor. But on Monday, the rate for the 28-day Fed facility was 3.75%, which was much higher than Libor. On Monday, the one-month dollar Libor rate was 3.19% while Tuesday’s rate was 3.21%.”</i> 	<p>The SIFMA ‘Global SmartBrief’ was circulated to the Director of Financial Stability Division.</p> <p>The media article was not located in FSA files although we noted that it was publicly available.</p>
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Communication 57

<p>Sterling Markets Division Market Intelligence Summary</p>	<p>25 September 2008</p>	<p>Bank of England</p>
<p>The note included the following comments:</p> <ul style="list-style-type: none"> • <i>“The increased guess-work around Libor fixings revived the recriminations among Libor setting banks over who was pushing fixings higher. Many pointed the finger at [LIBOR Panel Bank 1], but [LIBOR Panel Bank 1] noted that they [sic] fixings were set off any term lending they picked up (e.g £15mn from a local authority on Tuesday). Either way, it attracted unwelcome attention, said [LIBOR Panel Bank 2].”</i> 	<p>The note was attached in an email and circulated to an FSA mailing list entitled ‘BoE Markets’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list also included:</p> <ul style="list-style-type: none"> • the Managing Director of Wholesale and Institutional Markets; • the Director of Markets Division; 	

<ul style="list-style-type: none"> • <i>“Some Libor setting banks were also very worried that the media would start questioning the Libor fixing process, given that the 3-mth US dollar Libor fixing was at times (including today) almost 50bps below the equivalent ICAP New York Funding Rate; there was 1bp difference a fortnight ago. This was despite the Libor rate being set when US markets were closed.”</i> 	<ul style="list-style-type: none"> • the Director of Wholesale Firms Division (WFD); • the Director of the Banking Sector; • the Director of Financial Stability Division (FSD); • the Director of Wholesale and Prudential Policy Division; and • the Director of Strategy and Risk Division (SRD). <p>It also included staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • FSD; • Major Retail Groups Division; • WFD; and • SRD. <p>We were able to confirm that this email was circulated to the Director of WFD.</p>
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Communication 58

Email from Barclays entitled ‘Liquidity update – Thursday 25 th September’	25 September 2008	External Firm
<p>The email, forwarded on to the FSA by Barclays Compliance, included the following comment:</p> <ul style="list-style-type: none"> • <i>“If \$ Libors were more market reflective (at least of the bid side for cash) the spread would be much higher.”</i> <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee.</p>	The email was circulated to staff within the supervision team within Major Retail Groups Division.	

Communication 59

Email from Barclays entitled ‘Barclays Liquidity Update’	30 September 2008	External Firm
<p>This email, forwarded on to the FSA by Barclays Compliance, included the following comment:</p> <ul style="list-style-type: none"> • <i>“Since the start of the month 3 month Libors have risen, USD 124bp, EUR 31bp and GBP 55bp. At the same time the OIS yields have fallen, USD 45bp, EUR 28bp and GBP 22bp on accelerating cut views. That rise in the 3 month \$ Libor still does not reflect the true USD liquidity conditions as cash is bid 50bp to 150bp higher than the fixing without any real offer.”</i> <p>This email was one of the contacts disclosed by Barclays to the Treasury Committee.</p>	The email was circulated to staff within the supervision team within Major Retail Groups Division.	

Communication 60

Note of Market Conditions meeting	14 October 2008	Internal FSA
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“A LIBOR Panel Bank have expressed [...] concerns [...] A lack of confidence in the \$ Libor rate, and associated hedging difficulties of the LIBOR reset risk.”</i> 	<p>The meeting was chaired by the Director of Financial Stability Division (FSD) and attended by staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • FSD; • Major Retail Groups Division (MRGD); • Wholesale Firms Division (WFD); • Retail Firms Division (RFD); and • Strategy and Risk Division (SRD). <p>The note of the meeting was circulated to:</p> <ul style="list-style-type: none"> • the Chairman; • ExCo; • the Director of Markets Division; • the Director of the Banking Sector; • the Director of FSD; • the Director of MRGD; • the Director of WFD; • the Director of Treating Customers Fairly Division (TCFD)/the Insurance Sector; • the Director of Retail Policy and Themes Division/the Asset Management Sector; and • the Director of Communications Division. <p>It was also circulated to a senior advisor, staff working on the Supervisory Enhancement Programme and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • FSD; • MRGD; • WFD; • RFD; • Wholesale and Prudential Policy Division; • Prudential Risk Division; • SRD; • General Counsel’s Division; • TCFD; • the Asset Management Sector team; • Small Firms and Contact Division; and • Communications Division. <p>In addition it was circulated to the Bank of England and the Treasury.</p>	

Communication 61

Update on funding positions of two LIBOR Panel Banks	15 October 2008	External Firm
<p>This email summarised a discussion with the firms on their funding positions. It included the following comment:</p> <ul style="list-style-type: none"> • <i>“Barclays note that some UK banks are posting low for GBP Libor, but they know that they are not attracting funding at these levels.”</i> 	<p>The email was circulated to the Director of Major Retail Groups Division (MRGD) and staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • Financial Stability Division; and • Prudential Risk Division. 	

Communication 62

Note from a LIBOR Panel Bank summarising its views of wholesale funding conditions	16 October 2008	External Firm
<p>This note (and a subsequent note dated a week later) included the following comment:</p> <ul style="list-style-type: none"> • <i>“LIBOR fixings – although lower – are not reflective of market activity”.</i> 	<p>Both notes were circulated to an FSA mailbox that was used to collate information on firms’ liquidity. We understood that this mailbox was monitored by staff below director level within supervision divisions and Prudential Risk Division.</p> <p>The emails were also copied to the LIBOR Panel Bank’s supervision team.</p>	

Communication 63

Views from a non LIBOR Panel Bank about wholesale funding conditions	17 October 2008	External Firm
<p>Two notes were sent to the FSA on 27 October 2008, dated 17 and 24 October respectively. They included the following comments:</p> <ul style="list-style-type: none"> • <i>“Current Gbp Libor fixings do not reflect the true picture of offers in the interbank market if and when they do materialise.”</i> • <i>“All Libor fixings have also registered large reductions but where they are fixing and where they are trading is a wholly different story.”</i> 	<p>Both notes were circulated to an FSA mailbox that was used to collate information on firms’ liquidity. We understood that this mailbox was monitored by staff below director level within supervision divisions and Prudential Risk Division.</p>	

Communication 64

Update on funding positions of two LIBOR Panel Banks	22 October 2008	External Firm
<p>This email summarised a discussion with the firms on their funding positions. It included the following comment:</p> <ul style="list-style-type: none"> • <i>“They [Barclays] believe that the improvement in Libor is ‘an overstatement’, and indicate that firms are not necessarily funding where they post for the fixing.”</i> 	<p>The email was circulated to the Director of Major Retail Groups Division (MRGD) and staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • Financial Stability Division; and • Prudential Risk Division. 	

Communication 65 (event)

Contact by the Office of Fair Trading (OFT)	5 November 2008	Event
<p>On 5 November 2008, the CEO of the FSA met the CEO of the OFT. Summaries of the discussion noted that the OFT was “contemplating looking at [...] LIBOR” and that the FSA CEO would consider and respond on the FSA’s view.</p> <p>The CEO’s Office asked the Director of the Retail Policy and Conduct Risk Division (RPCRD)/the Asset Management Sector to consider.</p> <p>In an exchange of emails between FSA staff on 10 November 2008, the following comments were made by a member of staff below director level within the Banking Sector team:</p> <ul style="list-style-type: none"> • “The setting of LIBOR is not a regulatory activity – it is a process organised and run by the BBA.” • “we would not be keen on an OFT investigation at the present time...the BBA has itself recently conducted a review of the LIBOR process, and made some changes.” • “More importantly, the OFT would need to be very careful about the market (and political) implications of a decision to investigate LIBOR at the present time.” <p>On 10 November 2008, the Director of RPCRD/the Asset management sector emailed the OFT commenting: “This is not an area in which we consider that regulatory intervention is likely to be needed, given the recent changes that the BBA has made. Are you aware of such work in progress or contemplated? We ought to discuss.” On 11 November 2008 it was agreed a further meeting would be held to discuss. We have found no record of this meeting taking place.</p> <p>Between 12-13 November 2008, there were email exchanges between FSA staff about the OFT’s interest in LIBOR. The understanding was that this stemmed from discussions between the OFT and the Competition Commission on what areas might merit a review. The email comments noted that the concern</p>	<p>A note summarising the meeting of the CEOs was circulated to the Director of Retail Policy and Conduct Risk Division (RPCRD)/the Asset Management Sector and staff below director level within RPCRD.</p> <p>The note was circulated to the Director of Small Firms and Contact Division/the Retail Intermediaries and Mortgage Sector.</p> <p>A member of staff below director level within RPCRD forwarded the email to a member of staff below director level within the Banking Sector team on 10 November 2008 asking for information. The reply copied in the Director of the Banking Sector and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • Financial Stability Division (FSD); and • Strategy and Risk Division (SRD). <p>The email exchange was between a member of staff below director level within the Banking Sector team and a member of staff below director level within RPCRD. The exchange also copied in the Director of the Banking Sector and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • FSD; and • SRD. <p>These comments were forwarded on to the CEO’s Office on 11 November 2008.</p> <p>The Director of RPCRD/the Asset Management Sector forwarded the response to the OFT to the Director of the Banking Sector on 11 November 2008. It was also copied to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; and • RPCRD. <p>The email exchanges were between the Director of Markets Division, the Director of RPCRD and staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; 	

appeared to be the potential for collusion amongst submitting banks to the detriment of consumers or other banks. A comment from a member of staff within RPCRD noted the incentives might be for banks involved to set LIBOR at higher than competitive levels.

On 13 November 2008 the OFT contacted RPCRD asking questions about the LIBOR setting process, including whether the FSA was “*aware of any complaints about the LIBOR in terms of how it is set (not the rate)*”. These questions were passed to a member of staff below director level within the Banking Sector team who commented that “*the real centre of expertise in the FSA on LIBOR is in the markets area – it is a market rate setting mechanism, rather than a banking service*”. Using input from the Markets Division, RPCRD provided a response to the OFT on 19 November 2008. The FSA responded to the question on complaints by referring to a particular case where a bank had not passed on a reduction in the base rate to customers, noting that it was not related to the setting of LIBOR. The OFT was asked to address further questions to the Markets Division.

On 27 November 2008, the OFT contacted the FSA commenting “*We are still doing some thinking on the LIBOR*” and asked questions about the rate fixing process. A member of staff within the Markets Division responded on 28 November 2008 providing some information on how the LIBOR fixing process operated and its impact on banks’ funding.

On 12 January 2009, the FSA CEO wrote to the OFT saying “*On the subject of LIBOR, as I am sure you are aware, this is a process organised and run by the BBA. At the present time, the FSA would not encourage a further investigation into LIBOR as the BBA has recently conducted its own review of the process and made some changes. While these may not have been as far reaching as some may have hoped for, they did address some concerns regarding the rate setting process and were accepted by the market.*”

The letter also stated “*More importantly, we believe there may be financial stability implications of announcing an investigation at the present time, due to the LIBOR-OIS spread being such a key indicator of funding costs*”. (The 3 month Sterling spread at the time was 136bps, having fallen from around 300bps at its peak at the beginning of November 2008.)

We found no further correspondence on this issue within the review period.

- Wholesale Firms Division (WFD);
- Prudential Risk Division (PRD); and
- RPCRD.

The questions from the OFT were sent to a member of staff below director level within RPCRD. The questions were forwarded to a member of staff below director level within Markets Division and copied to the Director of Markets and staff below director level within:

- Markets Division;
- the Banking Sector team;
- WFD;
- PRD; and
- RPCRD.

The answers to be provided to the OFT were discussed over email amongst the staff listed above. A member of staff below director level within RPCRD provided the response to the OFT directly.

The OFT contact on 27 November 2008 was to a member of staff below director level within Markets Division. A member of staff below director level within RPCRD was copied into the initial contact and response.

The letter of 12 January 2009 (incorrectly dated as 2008) was located in the FSA’s records management system.

Communication 66

Note for record of a supervisory visit to review a building society's treasury function	6 November 2008	External Firm
The note included the following comment: <ul style="list-style-type: none"> “The society were concerned at the way LIBOR rates were set. The society felt that the rates did not have any resemblance to real market activity, and in particular where the larger banks were prepared to take deposits.” 	The note was located in the relevant firm's area of the FSA's records management system.	

Communication 67

Market conditions update	18 November 2008	Bank of England
The report included the following comment: <ul style="list-style-type: none"> “There has been some improvement in the FX swap market, although the associated cost of borrowing dollars remains significantly more expensive than implied by Libor fixings.” 	<p>The report was attached in an email and circulated to a Bank of England mailing list entitled 'FSA & HMT Markets updates'.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> the Chairman; the Director of the Banking Sector; the Director of Financial Stability Division (FSD); a member of staff below director level within Markets Division; a member of staff below director level within Wholesale Firms Division (WFD); and a member of staff below director level within Strategy and Risk Division (SRD). <p>We were able to confirm that this email was circulated to a member of staff below director level within SRD.</p> <p>The note was forwarded by the member of staff below director level within SRD to:</p> <ul style="list-style-type: none"> the Chairman; the CEO; the Managing Director of Wholesale and Institutional Markets; the Managing Director of Retail Markets; the Managing Director of Operations; and the Company Secretary. <p>In addition to the above, the note was also forwarded to a number of directors including the Directors of all Divisions in Retail Markets and Wholesale and Institutional Markets. Other directors that had been forwarded the email included the Directors of:</p> <ul style="list-style-type: none"> SRD; General Counsel's Division; Enforcement Division; Communications Division; and 	

	<ul style="list-style-type: none"> • Internal Audit Division. <p>The note was also forwarded to staff below director level within:</p> <ul style="list-style-type: none"> • Markets Division; • the Banking Sector team; • FSD; • Major Retail Groups Division; • WFD; • Retail Firms Division; • Prudential Risk Division; • Wholesale and Prudential Policy Division; • SRD; • Retail Policy and Conduct Risk Division; • the Asset Management Sector team; • General Counsel’s Division; • the Retail Intermediaries and Mortgage Sector team; • Financial Crime and Intelligence Division; • the Specialist Supervision Unit; and • Communications Division.
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Communication 68

Note for record of a liquidity meeting with Barclays	11 December 2008	External Firm
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“Barclays described their LIBOR settings as ‘honest’, something they don’t believe to be the case for all participants. They see elevated funding cost as a small price to pay for term funding. They continue to be at the higher end for \$ though £ has fallen back in line. They questioned whether some firms had been somewhat disingenuous with their LIBOR fixings.”</i> 	<p>The meeting was attended by staff below director level within:</p> <ul style="list-style-type: none"> • Major Retail Groups Division (MRGD); • Wholesale Firms Division (WFD); and • Prudential Risk Division (PRD). <p>A note of the meeting was sent to the above staff.</p> <p>On 23 December 2008, the note was sent to the New York Federal Reserve Bank and to staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • WFD; and • PRD. <p>On 12 January 2009 a member of staff below director level within WFD forwarded an email with the meeting note attached (along with a number of meeting notes with other financial institutions) to a senior advisor and members of staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • WFD; • Wholesale and Prudential Policy Division; and • PRD. 	

Communication 69

Email entitled 'BBA LIBOR 5 DEC TO 12 DEC'	15 December 2008	Internal FSA
<p>The email, which provided LIBOR data between these dates, included the following comment:</p> <ul style="list-style-type: none"> • <i>“these rates do not necessarily denote where cash is being dealt.”</i> 	<p>The email was circulated to staff below director level within:</p> <ul style="list-style-type: none"> • Major Retail Groups Division; and • Permissions, Decisions and Reporting Division. <p>It was also copied to the Director of Major Retail Groups Division.</p>	

Communication 70

Update on funding position of Barclays	4 February 2009	External Firm
<p>This email summarised a discussion with Barclays on its funding position. It included the following comment:</p> <ul style="list-style-type: none"> • <i>“Barclays note that while GBP Libors are unchanged, that the market still has fully priced in a cut of 50bps tomorrow. They note that perhaps the Libor settings are not reflecting their purpose.”</i> 	<p>The email was circulated to the Director of Major Retail Groups Division and staff below director level within:</p> <ul style="list-style-type: none"> • the Financial Stability Division; • Major Retail Groups Division; and • Prudential Risk Division. <p>It was also sent to the Bank of England.</p>	

Communication 71

Update on funding position of a LIBOR Panel Bank	9 March 2009	External Firm
<p>This email summarised a discussion with a LIBOR Panel Bank on its funding position. It included the following comment:</p> <ul style="list-style-type: none"> • <i>“LIBOR fixings do not represent what’s going on in the market.”</i> 	<p>The email was circulated to staff below director level within a supervision team within Major Retail Groups Division.</p>	

Communication 72

Note providing information on a LIBOR Panel Bank’s liquidity position	17 March 2009	External Firm
<p>The note included the following comment:</p> <ul style="list-style-type: none"> • <i>“Sterling Libors have crept lower, but this is purely on market sentiment and not indicative of levels traded ([the LIBOR Panel Bank] comment that Sterling Libors do not reflect true levels).”</i> <p>The same comment was included in a briefing note prepared the following day by a member of staff below director level within Major Retail Groups Division for a call between the Tripartite authorities on liquidity conditions.</p>	<p>The note was prepared by a member of staff below director level within Major Retail Groups Division (MRGD). The note was circulated to staff below director level within:</p> <ul style="list-style-type: none"> • MRGD; • Wholesale Firms Division (WFD); and • Prudential Risk Division (PRD). <p>The briefing note was circulated to the Directors of:</p> <ul style="list-style-type: none"> • the Banking Sector team; • Financial Stability Division (FSD); and • MRGD. <p>It was also circulated to staff below director level within:</p> <ul style="list-style-type: none"> • FSD; • MRGD; • WFD; • Retail Firms Division; and • PRD. 	

Communication 73

Market conditions update	18 March 2009	Bank of England
<p>The report included the following comment in the context of Sterling LIBOR:</p> <ul style="list-style-type: none"> • <i>“Contacts were unsure why Libors continued to edge down, with the fixings remaining disconnected from the small volume of lending in the market.”</i> 	<p>The note was attached in an email and circulated to a Bank of England mailing list entitled ‘FSA & HMT Markets updates’.</p> <p>From other communications in the period that used the same mailing list we inferred that the list included:</p> <ul style="list-style-type: none"> • the Chairman; • the Director of the Banking Sector; • the Director of Financial Stability Division (FSD); • a member of staff below director level within Markets Division; • a member of staff below director level within Wholesale Firms Division; and • a member of staff below director level within Strategy and Risk Division (SRD). <p>We were able to confirm that this email was circulated to the Directors of the Banking Sector and FSD.</p> <p>The email to which the report was attached was also forwarded on to a member of staff below director level within SRD.</p>	

Communication 74

Update on funding position of Barclays	20 March 2009	External Firm
<p>This email summarised a discussion with Barclays on its funding position. It included the following comment:</p> <ul style="list-style-type: none"> • <i>“Libors continue to edge down, but Barclays question their reliability given that there is little activity to support them.”</i> <p>The same comment was included in an FSA internal email entitled ‘Update on major banks retail and wholesale funding’ on 23 March 2009.</p>	<p>The email was circulated to the Director of Major Retail Groups Division and staff below director level within:</p> <ul style="list-style-type: none"> • Financial Stability Division (FSD); • Major Retail Groups Division (MRGD); • Wholesale Firms Division (WFD); and • Prudential Risk Division. <p>The second email was sent to the Chairman’s Office (not including the Chairman), the CEO’s Office (including the CEO), the Managing Director of Retail Markets and the Directors of:</p> <ul style="list-style-type: none"> • the Banking Sector; • FSD; and • MRGD. <p>The second email was also sent to staff below director level within:</p> <ul style="list-style-type: none"> • FSD; • MRGD; and • WFD. <p>Both emails were sent to the Bank of England and the Treasury.</p>	

3.4.2 Commentary on the period 26 June 2008 to 31 May 2009

127. This section provides commentary on the communications listed in Subsection 3.4.1.

Part 1 - The extent to which communications indicated potential lowballing

128. During this period, we found one communication that we considered more directly referred to potential lowballing. This was the note for record of a meeting with Barclays (Communication 68) which stated: *“Barclays described their LIBOR settings as ‘honest’, something they don’t believe to be the case for all participants [...] They questioned whether some firms had been somewhat disingenuous with their LIBOR fixings.”*

Part 2 – Comments on the awareness within the FSA of the significance of the communications

129. There was a wide circulation of what we considered to be the key communications in the period, including the contact with the CFTC (Communication 50), the BBA (Communication 51) and the OFT (Communication 65). However, where information was received by teams within Supervision Divisions, we did not find evidence that the communications were circulated or escalated widely outside Supervision to other relevant Divisions. For instance, Communications 53 to 56, 58, 59, 61 to 64, 66 and 68 to 71 were not circulated to the Banking Sector team or Markets Division.

130. We did not find that any communications relating to potential lowballing were escalated to the FSA Board during this period. Similarly to the previous periods, LIBOR rates were mentioned as part of ‘general market conditions’ updates provided to the June 2008 and April 2009 Board meetings. However, these references were used to illustrate funding conditions at the time and made no reference to lowballing.

131. We have discussed in previous sections whether there was sufficient clarity of responsibilities within the FSA. In this period, we observed different areas of the FSA generally working well together in dealing with external bodies, although there were two exceptions where there was a lack of clarity over responsibilities or where there could have been better coordination:

- The Director of Enforcement asked the Director of the Banking Sector to take forward the liaison with the CFTC, whilst the Markets Division took the lead in dealing with the BBA. With regard to dealing with the OFT, a member of the Banking Sector in contrast noted *“the real centre of expertise in the FSA on LIBOR is in the markets area – it is a market rate setting mechanism, rather than a banking service”*. However, we acknowledged that the Markets Division and Banking Sector kept each other informed of developments on these issues.
- In relation to a question from the OFT on whether there had been any complaints about the rate fixing process, a member of staff within Markets Division asked a member of staff within Retail Policy and Conduct Risk Division (RPCRD) to respond (both were below director level). We inferred this was because the query was interpreted as solely relating to instances of consumer impact. However, we have not identified RPCRD being involved or aware of many of the communications in this period (or earlier), so staff within this division were not best placed to deal with this. And, as highlighted below, information was not shared with the OFT which might have been relevant to its consideration of any further investigation.

Part 3 – Comments on what actions the FSA took in relation to the communications

132. During this period, the FSA undertook three main areas of activity in relation to LIBOR:
- a) engaging with the BBA's further work on the LIBOR fixing process;
 - b) liaising with the CFTC to obtain information from the BBA and certain contributor-panel firms, which led to the eventual enforcement investigations by the FSA and the CFTC; and
 - c) responding to contact by the OFT.

For each of these, we comment briefly on the action taken.

a) Engagement with the BBA

133. The FSA engaged with the BBA during this period, providing comments on the BBA's feedback statement and its further work on governance and scrutiny over the LIBOR fixing process.

134. Communications we found in this period reflected a view within some areas of the FSA that the proposals in the BBA's feedback statement, published on 5 August 2008, "*were not quite as radical as we would have wished, but they did address some concerns about the rate setting process*" (Communication 51).

135. However, the limited comments that the FSA felt it needed to make on the BBA's paper on governance and scrutiny and communications published on 17 December 2008, together with the following comments made by FSA staff at the time (Communication 51, part 2), suggested that the FSA recognised that progress had been made:

- "*governance and scrutiny were key areas which we raised [...] during the initial consultation [...] as areas which would benefit from much greater transparency and certainty. Your proposals, on first reading certainly appear to go a long way to addressing these issues*"; and
- "*On the whole, much more progress by the BBA.*"

136. We recognised that in addition to the comments on the BBA's statement, there were other factors that might explain why additional action was not taken:

- as we have explained in Subsection 3.1.2, market conditions interacting with structural issues continued to cause dislocation (for example, 'tiering' of funding rates across banks - see paragraph 68). A report by the Association of Corporate Treasurers of 23 February 2009 noted that: "*Several banks were reluctant to accept that the market did not regard them as the strongest of credits and had suggested that the panel banks must have been under estimating their real cost when submitting to the calculation panel. More recently, there has been more acceptance that a bank's cost of funds will be dependent on its perceived credit standing.*" On structural issues in the LIBOR fixing process (see paragraph 69), several communications in this period suggested that a lack of transactions contributed to perceptions that LIBOR fixings did not reflect market conditions (for example, Communications 54, 73 and 74).
- the context of the financial crisis which peaked during this period, meant that the FSA's supervision resources were stretched to breaking point in dealing with the implications of the financial crisis for firms' capital and liquidity positions. Moreover, given that LIBOR rates were increasing, there was focus on the prudential impact of this and feedback from firms that LIBOR fixings and submissions were too high.

- the International Monetary Fund’s October 2008 ‘Global Financial Stability Report’ (a draft of which the FSA was sent in August 2008) contained a section entitled ‘Is the LIBOR fix broken?’. Although recognising that the integrity of US dollar fixing process had been questioned by some market participants and the financial press, and welcoming the BBA’s review of LIBOR, the Report noted: *“U.S. dollar LIBOR remains an accurate measure of a typical creditworthy bank’s marginal cost of unsecured U.S. dollar term funding.”* The Report also highlighted that there was little difference in rates when comparing US Dollar LIBOR fixings with an alternative measure introduced by the money market broker ICAP.

137. In any event, the FSA was working with the CFTC to obtain information from individual firms. We explain this in the following paragraphs.

b) Liaison with the CFTC

138. We noted that during this period, the focus of the CFTC and the FSA was on obtaining information from the BBA and certain LIBOR contributor-panel banks. We observed that the FSA facilitated the CFTC’s information requests.

139. We observed that the FSA engaged fully with the CFTC, facilitating requests to both the BBA and to firms to obtain further information. As highlighted in part 2 of Communication 50, the FSA’s Enforcement Division declined an invitation to attend a LIBOR Panel Bank’s presentation to the CFTC in which it planned to explain the process by which the bank made its US dollar LIBOR submission. However, given the FSA was coordinating its activities with the CFTC at this point, we did not consider this to be material. There were also some delays in obtaining information (for instance, from the BBA – see Communication 50), but we observed that the FSA was proactive in trying to expedite.

c) Responding to contact by the OFT

140. We noted that the OFT raised in a routine bilateral with the FSA’s CEO in November 2008 that it was contemplating looking at LIBOR (Communication 65). After internal discussion and liaison between the OFT and the FSA, the Director of the Retail Policy and Conduct Risk Division informed the OFT that *“This is not an area in which we consider that regulatory intervention is likely to be needed, given the recent changes that the BBA has made.”* The FSA’s CEO later informed the OFT in January 2009 *“On the subject of LIBOR, as I am sure you are aware, this is a process organised and run by the BBA. At the present time, the FSA would not encourage a further investigation into LIBOR as the BBA has recently conducted its own review of the process and made some changes. While these may not have been as far reaching as some may have hoped for, they did address some concerns regarding the rate setting process and were accepted by the market”* and that *“More importantly, we believe there may be financial stability implications of announcing an investigation at the present time, due to the LIBOR-OIS spread being such a key indicator of funding costs”*.

141. As noted above, at this point in time, the FSA considered that the BBA’s review of the LIBOR fixing process had made progress in addressing the FSA’s concerns about weaknesses in the process. There was also focus within the FSA of the financial stability implications of high LIBOR fixings and spreads. In that respect, we noted that one of the comments in Communication 65 (during the email exchanges dated 12-13 November 2008) referred to fact that the impact of any collusion, if it existed, would be to increase

LIBOR fixings. We noted that the FSA's letter repeated the phrase 'at the present time' and therefore did not rule out the OFT conducting work on LIBOR in the future.

142. On the other hand, the FSA had received the communications we have set out in the three previous sections which suggested that lowballing might have been a possibility. In addition, at this point, the FSA was engaged with the CFTC, which was investigating lowballing.

143. One of the questions the OFT asked the FSA in November 2009 was whether it was aware of any complaints about the LIBOR setting process. A member of staff below director level responded to the OFT by referring to a particular case where a bank had not passed on a reduction in the base rate to customers. We considered that some of the communications we have referred to in this and the previous sections could have been considered to be 'complaints' about the LIBOR fixing process (in particular the email from a Non LIBOR Panel Bank - see Communication 30), and shared with the OFT at this point.

4. Conclusions, lessons to be learned and recommendations

144. This chapter contains the following sections:

- 4.1 Conclusions;
- 4.2 Lessons to be learned and recommendations; and
- 4.3 Summary of recommendations.

145. Section 4.1 sets out our judgements and overall conclusions about the appropriateness of the FSA's responses at the time to the communications we set out in Chapter 3. It also shows our answers to five key questions that we consider may arise, based on the communications and commentary in Chapter 3.

146. After considering the material in this report, we draw out six lessons for the FSA and future regulatory authorities (Section 4.2). The FSA has already published a number of lessons which are relevant to this review, through its Internal Audit report on 'The Supervision of Northern Rock: a lessons learned review' (the Northern Rock Report, April 2008) and its Board report on 'The failure of the Royal Bank of Scotland' (the RBS report, December 2011). These reports covered periods that overlapped with the review period for this report, so there are some common lessons. In addition, the October 2012 publications describing the approaches of the FCA and PRA ('FCA approach document: Journey to the FSA' and 'The Bank of England, Prudential Regulation Authority: The PRA's Approach to Banking Supervision') also covered certain areas that are relevant here. In order to address the lessons, we raise nine recommendations (Section 4.2, summarised in a table as Section 4.3).

147. While our scope focused on identifying any communications related to lowballing, we also searched the 97,000 documents we reviewed for any references to trader manipulation. We did not find any such references.

4.1 Conclusions on the appropriateness of the FSA's responses

148. Overall, we found many communications that indicated LIBOR dislocation. Such communications increased between April and June 2008. During the review period, the FSA's focus was on the impact of the deteriorating market conditions for individual firms' capital and liquidity positions and in some cases their very viability. The FSA recognised that LIBOR dislocation was caused by structural issues in the LIBOR fixing process interacting with the deteriorating market conditions (see paragraphs 67 to 69) and it fed into the BBA's review of that process.

149. Of the 97,000 documents and emails we reviewed, we highlight 74 sets of communications in this report that we considered contained either a direct reference to lowballing or a reference that could, in our judgement, have been interpreted as such. We judged 26 of the 74 communications to include a direct reference, of which the significant majority were received between April and June 2008 (covered in Section 3.3 of Chapter 3). These 26 communications included the telephone calls from Barclays in March and April 2008 (Communications 28 and 37) already in the public domain through the Enforcement Final Notice. We consider those two communications were the clearest contacts we found that indicated that an individual bank was lowballing. In relation to the communications that did not have a direct reference to lowballing, we consider that they could have provided such an indicator, particularly when considered in aggregate.

150. By contrast, we also observed material that recognised LIBOR dislocation, but did not conclude that there was also lowballing (for example, the conclusions of an article within the March 2008 Bank for International Settlements Quarterly Review (see paragraph 95) and the October 2008 International Monetary Fund's Global Financial Stability report (see paragraph 136)).

151. **Based on the body of communications and the FSA's responses to them, we conclude that the FSA should have:**

- **considered the possibility and likelihood of lowballing (particularly in the period from April 2008), rather than assuming the only problems with LIBOR were those caused by structural issues in the LIBOR fixing process interacting with deteriorating market conditions (lesson 3). In addition, we consider the FSA should have been more proactive before April 2008 in contacting the BBA to pursue the structural issues;**
- **been more inquiring and challenging of the information in individual communications and more sensitive to the accumulation of the communications (lessons 3 and 4);**
- **ensured that communications were analysed, circulated and escalated in an appropriately targeted manner (lessons 2, 4, and 5). This would have helped make it clearer what action might be required and by whom, and identify linkages between communications so that they could be considered in aggregate. This was particularly the case for information received by supervisors, especially in relation to Barclays (although we recognised the supervisory team's competing priorities and resource constraints¹⁹);**
- **given explicit consideration to the FSA's responsibilities for regulated firms' conduct in relation to the Principles for Businesses and the potential for (and impact of) lowballing, rather than being focused solely on the BBA's oversight role for the LIBOR fixing process, particularly after the BBA announced its review (lesson 1); and**
- **clarified roles and responsibilities within the FSA, including for dealing with external bodies (see paragraph 131); sought clarification of the roles and responsibilities of external bodies (see paragraph 110); and sought clarification of the roles and responsibilities between Tripartite authorities - particularly given the relevant communications being circulated by the Bank of England (lesson 2).**

152. **Overall, we conclude that the FSA's focus on dealing with the implications of the financial crisis for the capital and liquidity positions of individual firms, together with the fact that contributing to or administering LIBOR were not 'regulated activities', led to the FSA being too narrowly focused in its handling of LIBOR-related information. This was both in terms of challenging and inquiring about that information, and considering its conduct responsibilities in relation to the Principles for Businesses and any potential for consumer or market detriment. Our view is strengthened by the fact that the FSA did go on to take enforcement action in relation to the FSA's Principles for Businesses.**

¹⁹ The failure of the Royal Bank of Scotland Financial Services Authority Board Report, December 2011, p80, showed that the Barclays' supervision team comprised four staff and 0.5 of a manager at October 2007. This team also provided sectoral support across the Major Retail Groups Division, for example, on liquidity monitoring.

Key Questions

153. In addition to the conclusions above, we provide answers to five key questions that we consider may arise from the communications and commentary in Chapter 3.

Q. In relation to communications about LIBOR, was the FSA's approach before April 2008 appropriate?

154. The FSA took no specific action in relation to LIBOR submissions until the BBA announced its review of the LIBOR fixing process in April 2008. The context of this period was that FSA senior management was focused on dealing with the implications of the financial crisis for the capital and liquidity positions of individual firms. For example, the FSA was undertaking significant work on Northern Rock's capital and liquidity position and the quality of its mortgage book, ahead of the Government bringing it into public ownership in February 2008. Moreover, there were concerns about the impact of widening spreads and banks' costs of funding in general.
155. Compared to the period after April 2008, the communications contained relatively few direct references to potential lowballing: they referred to dislocation more generally. Where communications referred to panel banks having an incentive to submit rates no higher than other panel banks (Communications 10, 12 and 28), the FSA was focused on the deteriorating market conditions and the structural issues in the LIBOR fixing process, rather than considering whether the communications also indicated that firms might be lowballing.
156. We consider that the FSA should have been more proactive in contacting the BBA to pursue the structural issues in the LIBOR fixing process inferred from the communications. It is important to note though, that a meeting of the Bank of England's Sterling Money Markets Liaison Group (Communication 5) was attended by a representative of the BBA and this included a discussion on LIBOR fixings.
157. Within this period, we also considered whether more could have been done in response to the communications that contained more direct references to potential lowballing. Those included the communications from Barclays (Communications 14 and 28) and the internal analysis within Communication 20 (notwithstanding the assumptions and potential technical errors set out in paragraphs 87 to 88).
158. Moreover, as far as fixings were concerned, although there were some references to fixings being too high compared to market activity in the period, the majority of references concerned LIBOR fixings being low. We consider that this should have raised questions as to whether there were factors other than the interaction between deteriorating market conditions and structural issues leading to problems with LIBOR.
159. We conclude that it was understandable that the FSA's focus in the period up to April 2008 was on structural issues in the LIBOR fixing process and their interaction with the deteriorating market conditions. However, we also conclude that the FSA should have been more inquiring and challenging of the information in individual communications and more sensitive to the accumulation of the communications it received in this period.

Q. Should the FSA have influenced the BBA more and pushed for more radical changes to the LIBOR fixing process?

160. The BBA announced a review into the LIBOR fixing process on 16 April 2008 and the FSA focused on feeding into that review. We conclude that, in relation to the effectiveness of the fixing process, the FSA's approach here was understandable given that the BBA was responsible for overseeing the process. We also conclude that the FSA developed clear objectives for its engagement with the BBA and engaged actively in relation to the BBA's consultation paper, feedback statement and the paper on governance and scrutiny. We consider that the appropriate areas of the FSA were involved in the FSA's input to the BBA's review, in terms of technical knowledge and expertise.

161. The BBA published a consultation paper on 10 June 2008. Following responses, the BBA published a feedback statement on 5 August 2008 and a paper on governance and scrutiny of the LIBOR fixing process on 18 December 2008. The communications we found indicated that the FSA considered that its concerns on the fixing process had largely been addressed by the time of the publication of the BBA's governance and scrutiny paper.

162. However, we conclude, with the benefit of hindsight, that there was opportunity for the FSA to have pressed the BBA for a more radical outcome with more wide-reaching proposals (along the lines of what was subsequently included in the Wheatley Review). As an example, we observed the FSA and BBA discussed other changes such as broadening the definition of the LIBOR, which was not taken forward at this time, but was in the Wheatley Review.

Q. Should the FSA have started initial inquiries into lowballing earlier than June 2008?

163. Ahead of the CFTC contacting the FSA at end-April 2008 (in response to media articles), there was no indication that there was any consideration within the FSA of whether LIBOR submissions should be investigated further. Once the CFTC did contact the FSA, we have noted in paragraph 110 that there was a misunderstanding within the FSA about the CFTC's scope of jurisdiction at this point in time. It is difficult to judge what the impact of this was, if any, but it may have led to a missed opportunity to share information and intelligence and engage more fully with the CFTC at that stage (end-April).

164. Between April and June 2008, the FSA's focus was on feeding into the BBA's review. We noted that this review proposed measures to improve the fixing process, but did not conclude whether the BBA had identified any instances of lowballing, nor did it lead to any banks being removed from the LIBOR panel.

165. The CFTC contacted the FSA again at end-June 2008 (following media articles that named specific banks in relation to potential lowballing) and requested help in obtaining information from the BBA and certain LIBOR contributor firms. The FSA engaged fully with the CFTC. After the review period, the FSA received clear information from firms indicating that there had been misconduct relating to LIBOR submissions. It then opened up its own formal investigations which have subsequently resulted in action in relation to breaches of the FSA's Principles for Businesses (as described in Final Notices for Barclays, UBS and RBS).

166. Based on the body of communications received by this period, we consider that the FSA should have been more proactive in inquiring into individual firms' LIBOR submissions between April and June 2008. Had it done so, this might have led to the Enforcement investigations being concluded several months sooner.

Q. Did FSA staff or senior management 'turn a blind eye' to concerns about firms potentially lowballing because of the potential financial stability implications?

167. We have explained that FSA senior management was focused on dealing with the implications of the financial crisis for the capital and liquidity positions of individual firms. Liquidity issues were a particular focus for banks during that time and banks' LIBOR submissions were seen by some commentators as a measure of their ability to raise funds. A potential implication of a panel bank submitting higher LIBOR submissions than other panel banks would be to signal to the market that it had liquidity problems, which could in turn increase its funding costs. If the bank was not able or not willing to pay those increased funding costs, that could have had financial stability implications.

168. We asked ourselves whether FSA staff or senior management 'turned a blind eye' to concerns about firms potentially lowballing because of the possible financial stability implications. We cannot put ourselves back in the mindset of the time; however during our interviews FSA management have stated this was not the case.

169. We noted that there was a reference in the FSA's letter of January 2009 to the OFT to '*the financial stability implications of announcing an investigation at the present time*' (Communication 65). However, by that time the FSA had already engaged with the BBA on the LIBOR fixing process and was working with the CFTC to obtain information from LIBOR panel banks. Nevertheless we recognise that the FSA's response to the OFT could be seen as being at odds with the work it was conducting with the CFTC. We questioned whether the FSA should have informed the OFT that it was working with the CFTC. It was normal FSA practice not to disclose the existence of formal requests for assistance from an overseas authority unless permission had been obtained from the overseas authority. We found no documented evidence of the FSA considering whether it was appropriate to seek the CFTC's permission to share information, although the then CEO informed us on enquiry that it was his understanding that this point had been considered. We noted that the FSA's letter included the phrase 'at the present time' and therefore did not rule out the OFT conducting work on LIBOR in the future.

Q. The CFTC initiated the contact with the FSA and the requests for information from individual firms. In the absence of contact from the CFTC, would the FSA have investigated the LIBOR submission processes of individual firms?

170. We noted that the CFTC considered it had a clear regulatory remit to investigate firms through its 'false reporting statute' and through its authority over the Chicago Mercantile Exchange (CME) LIBOR and Eurodollar futures contracts. By contrast, the activities of contributing to or administering LIBOR were not 'regulated activities' as defined under the Financial Services and Markets Act 2000. We noted that the focus of the CFTC's second contact in June 2008 was on the Wall Street Journal article of 29 May 2008 (Communication 48), but the FSA was focused on questioning the accuracy of the underlying analysis (rather than being more inquiring by considering the substance of the article) and had drafted a note to send to the CFTC to that effect.

171. We did not find any evidence that suggested the FSA was considering inquiring into firms' LIBOR submissions, prior to the contact from the CFTC in June 2008. As we explained above, in the context of dealing with the financial crisis, we considered the FSA was not sufficiently focused on its responsibilities for regulated firms' conduct in relation to the FSA's Principles for Businesses and the potential for (and impact of) lowballing. Nevertheless, we cannot put ourselves back in the mindset of the time and do not consider that it is possible to answer this question fully from the available information.

4.2 Lessons to be learned and recommendations

Lessons in relation to the action taken by the FSA related to LIBOR

Lesson 1: Activities outside the regulatory perimeter and their implications

172. We questioned whether there was sufficient understanding across relevant areas of the FSA of the significance of LIBOR and its potential implications for the FSA. As we have explained, the activities of contributing to or administering LIBOR were not 'regulated activities' as defined under the Financial Services and Markets Act 2000 - the BBA was responsible for overseeing the LIBOR fixing process. However, the FSA was responsible for regulated firms' conduct in relation to the FSA's Principles for Businesses.

173. This leads us to question whether there were other non-regulated activities undertaken by authorised firms, where wrongdoing by those firms could breach the Principles for Businesses, pose a threat to the soundness of firms, or potentially cause significant consumer detriment. It will be important for the FCA and PRA to have an awareness of significant such non-regulated activities and to consider how to apply their risk and governance frameworks to them. Where appropriate, the new regulatory authorities should also define clear roles and responsibilities in relation to those activities, including for handling related information (see lesson 4 below).

174. A second category of activities is non-regulated activities undertaken by unauthorised firms, where the FSA is currently discussing potential approaches. We recognise that in some instances the FSA and future regulatory authorities will decide not to take any action but we endorse the consideration of such activities and achieving clarity on the approaches for the FCA and PRA.

175. We raise related lessons on roles and responsibilities (lesson 2) and inquiry and challenge (lesson 3) below.

1.1 We question whether there might be other significant non-regulated activities, where wrongdoing by regulated firms in relation to those activities could breach the FSA's Principles for Businesses, pose a threat to the soundness of those firms, or potentially cause significant consumer or market detriment.

We recommend that FCA and PRA senior management consider how such activities will be identified and assessed by the new regulatory authorities' risk and governance frameworks, so that risk-based prioritisation decisions can be made in relation to them.

Lesson 2: Roles and responsibilities

Clarity between regulatory authorities

176. We observed that many of the communications we explain in this report were received in the context of the prudential supervision of firms, for example liquidity updates. Such information will be provided to the PRA in future and not to the FCA.

177. Therefore, clear responsibilities for sharing and acting on LIBOR-related information will be important between the FCA and the PRA (in consultation with the Bank of England where necessary) and the other regulatory authorities. In addition to clear roles and responsibilities, we recognise the need for the application of judgement and ‘nous’ by staff within the future regulatory authorities.

Clarity within the FCA and PRA

178. The Wheatley review recommended statutory regulation of the administration of, and submissions to, the LIBOR process and that the FCA establish a clear set of rules for submitters and administrators of LIBOR. It will therefore be important for the FCA to establish clear responsibilities relating to LIBOR internally, as well as between authorities.

2.1 We recommend that FCA senior management satisfies itself that there is a clear division of responsibilities relating to LIBOR between the authorities in the new regulatory framework, including for receiving and sharing LIBOR-related information and for acting on that information where necessary. If FCA senior management finds that the division of responsibilities is not clear, it should act with PRA senior management and other regulatory authorities to seek clarification.

2.2 We recommend that FCA senior management (in consultation with the PRA if necessary) establish clear internal roles and responsibilities relating to LIBOR.

Lesson 3: Inquiry and Challenge

179. We identified a number of instances where we conclude that the FSA should have been more inquiring by asking questions and challenging the information it received and been more sensitive to the accumulation of the communications and the linkages between the different sources of information.

180. We consider this links to the required cultural characteristics for the FCA. FCA senior management will expect staff to be more inquiring and questioning about what is going on around them, to ensure they collaborate better with others both within the FCA and externally. Similarly, the PRA’s approach will be forward looking and rely significantly on judgement, with staff expected to be rigorous.

3.1 We recommend that FCA and PRA senior management embed the lessons from this review appropriately in the cultures of the regulatory authorities. This should include ensuring that staff are sufficiently inquiring and challenging and that they maintain the necessary breadth of perspective.

Lesson 4: Use of information and intelligence

181. The Northern Rock report raised recommendations to improve information and intelligence sharing. The relevant recommendations from that report were:

- As an important element in developing the FSA's desired culture, alertness to the potential benefits of passing on and receiving intelligence should be reinforced as a principle for all staff behaviour (recommended action 4.7).
- Management should clarify supervisors' responsibility in relation to the use of analysts' reports and market data in the supervision of their firms (recommended action 4.2).

182. We recognise the work undertaken by FSA senior management to address the Northern Rock recommendations relating to the use of information and intelligence. From our review, we highlight those recommendations and consider that further work is required to embed them in the FCA and PRA. Related to lesson 1 above, we consider that it is important for the new regulatory authorities to have clear responsibilities for dealing with intelligence from external sources including analysts' reports, media articles and market data. For example, we set out seven media articles related to LIBOR in Chapter 3. We have updated in recommendations 4.1 and 4.2 below the wording of the Northern Rock recommendations to reflect the new regulatory authorities.

183. In relation to information and intelligence, the FCA's approach document described how its new Policy, Risk and Research (PRR) function would gather and use a wide range of data, information and intelligence from across the FCA, firms and elsewhere to help identify and assess risks in financial markets. This would include economic and market analysis, consumer complaints and enquiries, media analysis, and intelligence from consumer organisations and professional firms.

4.1 As an important element in developing the desired culture of the FCA and PRA, alertness to the need to share intelligence appropriately should be reinforced as a principle for all staff behaviour. For the FCA we recommend that the new Policy, Risk and Research Division develops clear success measures for its target operating model that take account of this lesson from our review.

4.2 FCA and PRA senior management should clarify responsibilities in relation to the use of information from external sources including analysts' reports, media articles and market data.

Lesson 5: Circulating and escalating information

184. We found that many communications, for example, market conditions updates and summaries of liquidity updates from major firms, were circulated widely across the FSA. We conclude that FSA staff should consider the most appropriate recipients for information and should indicate more clearly the intended purpose of the information, for example 'for action' or 'for information'. This is particularly important when circulating information to senior management, who received some hundreds of emails daily during the review period.

185. Although we noted in lesson 4 that some communications were circulated widely, we also found some instances where we considered that information had not been escalated appropriately. We have noted some of the communications from Barclays, not escalated to senior management, which more directly referred to potential lowballing (for example, Communications 28 and 37).

5.1 We recommend that FCA and PRA senior management establish effective working arrangements for the circulation and sharing of information, including to whom information should be circulated and the action required of the recipient.

5.2 We recommend that the FCA and PRA senior management establish effective working arrangements for the escalation of information.

Lesson 6: Record keeping

186. A number of the communications we found as part of our review had not been dealt with in accordance with the FSA's records management requirements at the time. For example, the majority of emails we found had not been filed within the FSA's record management system, and some potentially significant conversations (for example, Communication 14 with Barclays had not been recorded at all). This was not in compliance with the FSA's records management policy.

187. We noted a number of instances where we could not confirm whether planned action had been taken because we could not find related records (for example, Communications 32 and 50).

188. The Northern Rock report noted similar difficulties in finding material on Northern Rock and other sample firms on the FSA's then records management system. That report noted the importance of effective records management for information sharing and audit trail purposes and raised the following recommendation:

- Directors should ensure that their divisions have agreed, documented records management standards and that these are complied with (recommended action 7.7).

189. We note that a new electronic document management system was implemented in the FSA after the end of the review period. The future regulatory authorities are reviewing policies and standards related to record keeping.

190. We raise recommendation 6.1 for two reasons. The first is the instances where we could not find records of emails or telephone calls relating to LIBOR on the electronic records management system used at the time and where we could not confirm whether planned action had been taken. Second, we note inconsistent application of the FSA records management requirements as a cause of one of the data gathering limitations in relation to our review that we set out in Annex 1.

6.1 We recommend that, in developing their records management policies, FCA and PRA senior management include success measures and key performance indicators (KPIs) that take into account the lessons raised in this review and the review's inherent data gathering limitations.

4.3 Summary of recommendations

Lesson	Recommendation(s)
The regulatory perimeter	
1: Activities outside the regulatory perimeter and their implications	<p>1.1 We question whether there might be other significant non-regulated activities, where wrongdoing by regulated firms in relation to those activities could breach the FCA and PRA Principles for Businesses, pose a threat to the safety and soundness of those firms, or potentially cause significant consumer or market detriment.</p> <p>We recommend that FCA and PRA senior management consider how such activities will be identified and assessed by the new regulatory authorities' risk and governance frameworks, so that risk-based prioritisation decisions can be made in relation to them.</p>
Roles and responsibilities	
2: Roles and responsibilities	<p>2.1 We recommend that FCA senior management satisfies itself that there is a clear division of responsibilities relating to LIBOR between the authorities in the new regulatory framework, including for receiving and sharing LIBOR-related information and for acting on that information where necessary. If FCA senior management finds that the division of responsibilities is not clear, it should act with PRA senior management and other regulatory authorities to seek clarification.</p> <p>2.2 We recommend that FCA senior management (in consultation with the PRA if necessary) establish clear internal roles and responsibilities relating to LIBOR.</p>
Culture of the regulatory authorities	
3: Inquiry and challenge	<p>3.1 We recommend that FCA and PRA senior management embed the lessons from this review appropriately in the cultures of the regulatory authorities. This should include ensuring that staff are sufficiently inquiring and challenging and that they maintain the necessary breadth of perspective.</p>
How the regulatory authorities use and record information and intelligence	
4: Use of information and intelligence	<p>4.1 As an important element in developing the desired culture of the FCA and PRA, alertness to the need to share intelligence appropriately should be reinforced as a principle for all staff behaviour. For the FCA we recommend that the new Policy, Risk and Research Division develops clear success measures for its target operating model that take account of this lesson from our review.</p> <p>4.2 FCA and PRA senior management should clarify responsibilities in relation to the use of information from external sources including analysts' reports, media articles and market data.</p>
5: Circulating and escalating information	<p>5.1 We recommend that FCA and PRA senior management establish effective working arrangements for the circulation and sharing of information, including to whom information should be circulated and the action required of the recipient.</p> <p>5.2 We recommend that the FCA and PRA senior management establish effective working arrangements for the escalation of information.</p>
6: Record keeping	<p>6.1 We recommend that, in developing their records management policies, FCA and PRA senior management include success measures and key performance indicators that take into account the lessons raised in this review and the review's inherent data gathering limitations.</p>

Annex 1: Limitations of data gathering

1. In the course of its review, Internal Audit reviewed approximately 97,000 electronic records and selected paper records, and conducted interviews with 20 key current and former colleagues. We consider that we have performed sufficient work to draw our conclusions. However, in any review of this nature there are inherent limitations, particularly given the time elapsed since the review period. The five main limitations here related to:
2. The existence of relevant records. This was dependent on compliance with the FSA's records management policy. It is possible that information was received by or discussed within the FSA, relating to inappropriate or potential lowballing, which was not recorded during the review period. It is also possible that records created had been deleted prior to our review. By way of an example, we did not identify the full set of Barclays' communications as listed by Barclays in their submission of evidence to the Treasury Committee²⁰ during the course of our review. To mitigate these risks we carried out interviews with and reviewed the email records of certain current and former colleagues. However, email records for some former staff had been deleted six months after they had left the FSA in line with the prevailing FSA records management policy (which has since been changed). It was therefore not possible to retrieve those emails.
3. The awareness of relevant records. During our search of email records a number of emails relevant to our review were circulated to a distribution list rather than to individual recipients. These were internal FSA distribution lists and external distribution lists, for example set up by the Bank of England. We have sought to identify the recipients of those emails; however we were unable to establish complete lists. Similarly, the FSA used shared mailboxes to send and receive emails and it has not always been possible to identify all individuals who may have had access to these mailboxes at the time.
4. Searching electronic records. The records management system used during the review period contains tens of millions of individual documents. It was not possible to search a small proportion of those documents for the search term we used because they were protected by a password (or because the documents had been scanned into the FSA's records management system and scanned text is not always recognised). Where we identified a password protected document that contained the search term in the title of the document we sought to gain access. Our review identified a total of 31,123 documents that were protected by password. Only two of these documents contained the search term 'IBOR' in the title and both were subsequently opened and reviewed.
5. Searching paper records. The FSA's paper records are archived and stored off-site. During the review period, the FSA was increasingly using electronic records rather than paper records. However it is possible that relevant paper records may have been received and archived. We have reviewed the records of material sent to archive; however those records are high-level descriptions of the contents of boxes rather than detailed descriptions of individual documents and it is possible that relevant documents may not have been identified.
6. Audio Files. The FSA does not routinely record calls made by staff however a number of audio files were retrieved by our data gathering exercise. We applied the search term to

²⁰ 'Supplementary information regarding Barclays settlement with the Authorities in respect of their investigation into the submission of various interbank offered rates (AMENDED)'.

these files and this did not identify any relevant files. However, we were informed that the search tool applied to audio is not particularly reliable due to distortion, variation of accents etc. Therefore, we reviewed a judgement-based sample of audio files. We did not identify any potentially relevant information.

Annex 2 – Terms of Reference

INTERNAL AUDIT DIVISION FINAL TERMS OF REFERENCE LIBOR REVIEW

1. On 27 June 2012, the FSA published a Final Notice in which it announced a £59.5mn fine for Barclays Bank Plc ('Barclays') for breaches of Principles 2, 3 and 5 of the FSA's Principles for Businesses in relation to LIBOR and EURIBOR ('LIBOR').
2. The question has arisen, in relation to inappropriate LIBOR submissions in order to avoid negative media comment, whether this is something of which the FSA was or should have been aware at the time it was occurring. This is particularly in view of Barclays' disclosure of a number of contacts that it had with the FSA between 6 December 2007 and 30 September 2008, three of which are referenced in the Final Notice.
3. Consideration of this question is also given in the light of the following:
 - references by external parties to communications with the FSA on this issue;
 - the FSA's input to the British Bankers' Association's review of LIBOR, which began in May 2008; and
 - media articles related to LIBOR submissions in 2007 and 2008.
4. The FSA's Chairman has asked Internal Audit to set out the facts relating to contacts with the FSA or awareness within the FSA relating to 'inappropriate LIBOR submissions to avoid negative media comment' and, if it is possible from the available information, to form a judgement about the appropriateness of the FSA's responses at the time.
5. Internal Audit will search FSA records to identify relevant communications, including from Barclays and the other firms which are under investigation, contact with other authorities and any relevant discussions at FSA senior management level. Internal Audit will also interview key FSA current and former staff and, if appropriate, speak to relevant external authorities.
6. The Final Notice explained that Barclays made inappropriate LIBOR submissions in order to avoid negative media comment during the period September 2007 to May 2009. Internal Audit will focus on reviewing records between January 2007 and May 2009; it will extend the searches to an earlier or later period should this be considered appropriate.
7. Internal Audit will report directly to the Audit Committee.

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