COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS
EUROPEAN PARLIAMENT

Public Hearing on

Tackling the culture of market manipulation
- Global action post Libor/Euribor -

Establishing integrity and trust post Libor/Euribor

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Finance Watch would like to thank the Committee on Economic and Monetary Affairs of the European Parliament for its invitation to participate in this hearing.

As an organisation, we are grateful to the ECON Committee for asking the question of how to restore integrity and trust in the wake of the LIBOR scandal. Financial activity consists, by nature, of exchanging promises and what is a promise worth if you do not trust the person making it?

The reality today is that public trust in the fairness of financial activities has been profoundly shaken.

LIBOR and EURIBOR have different definitions, which makes the possibility of rate rigging different. But they have one feature in common: they are calculated from contributions with in-built conflicts of interest and this characteristic is not compatible with the ambition of rebuilding integrity and trust in our financial system.

In the seven minutes I have been given to make this statement, I will highlight four simple measures which, taken together, would establish integrity and trust post LIBOR/EURIBOR.

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1 – SUBJECTING TO PUBLIC CONTROL FINANCIAL ACTIVITIES WITH PUBLIC INTEREST IMPLICATIONS

The banks contributing to LIBOR and EURIBOR trade books of financial instruments (e.g. interest rate swaps…) whose value is linked to those benchmarks and the banks' own cost of funding is by definition linked to them. This means that contributing different figures for LIBOR or EURIBOR can mean more or less profits for a bank. The conflict of interest is clear.

LIBOR, EURIBOR but also commodity and credit indices have a large impact on public interest. As a consequence, we think that their contributions and their calculation process should be controlled by supervisors and not by private organisations, particularly in the context of conflicts of interests just described.

Moreover, the supervisor in charge should have as little proximity as possible with contributors and should have an international mandate in order to ensure that the control is exercised in a neutral and non-complacent manner.

2 - ESTABLISHING CONSISTENCY BETWEEN BENCHMARKS USED FOR SIMILAR PURPOSES

As already stated, LIBOR and EURIBOR have different definitions. This reflects the fact that they were established by different private bodies pursuing different, and often competing, interests.

LIBOR is meant to reflect the cost of borrowing of the bank contributing, whilst EURIBOR is meant to reflect the contributing bank's conviction about the cost at which a prime bank (i.e. not necessarily the contributing bank itself) would offer term deposits to another prime bank.

Today USD LIBOR has 18 contributing banks and EURO EURIBOR has 44.

It could be argued that LIBOR's definition is more demanding but, on the other hand, it could also be argued that having a broader base of contributors makes EURIBOR less prone to manipulation.

These differences only make the debate more difficult to follow and, in turn, feed an ever increasing mistrust of financial activities. This is all the more worrying as those benchmarks are not only massively used by professionals but also as a reference for many retail financial products ranging from money market funds to mortgage loans: there is an important consumer protection dimension to this debate.

Finance Watch welcomes the task forces that have been put together by BIS and IOSCO on this topic and hopes that the question of the consistency of definitions across benchmarks will be addressed in their respective works.

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3 - BASING BENCHMARKS ON EFFECTIVE RATES

In the world of finance, prices that do not reflect transactions have very little, if any, economic meaning.

Basing LIBOR and EURIBOR on effective rates would make contributions reflect a financial reality and would make cheating more difficult.

Finance Watch's response to the recent LIBOR / EURIBOR consultation launched by the European Parliament gives simple remedies to address the technical arguments that have been raised against the use of effective rates. It has to be noted that this would require an evolution of the benchmarks' definitions.

Our conviction is that basing LIBOR and EURIBOR setting on real transactions is not only technically feasible but is also the most effective way of ensuring that contributions to those benchmarks reflect the true cost of banks' liquidity.

4 - MAKING BANKS, OPERATORS AND MANAGERS RESPONSIBLE FOR THEIR ACTIONS

Banks should be held responsible and supervisors should have the power to impose sanctions commensurate with the damage caused. As long as the profits derived from cheating are greater than the potential penalties, there will be an incentive for banks to cheat and the trust of the greater public will not be re-established.

It is also fundamental that operators should be held personally responsible for their actions as is currently discussed in the market abuse debate.

As importantly, bank managers should also be held personally responsible for the actions of the operators reporting to them as manipulations can only result either from complicity between managers and operators or from managers grossly neglecting their duty of controlling operators.

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CONCLUSION

No financial system and indeed no economic system can exist without trust and integrity.

Legislators and regulators have a responsibility to take the measures necessary to avoid a repetition of events feeding, once again, a widespread and profoundly detrimental anti-bank sentiment in society.

We are confident that adopting the four simple measures that we propose, not only for benchmarks such as LIBOR or EURIBOR but also for commodity and credit related benchmarks where similar issues are encountered, will contribute to establishing integrity and therefore trust in financial activities.

Finally, I want to emphasize our conviction that no solution based on self regulation will be up to this ambition as self regulation has proven over and over again to be an oxymoron when it comes to financial services.

END

ANNEX

Summary of the four measures proposed:

1. Subjecting to public control financial activities with public interest implications.
2. Establishing consistency between benchmarks used for similar purposes.
3. Basing benchmarks on effective rates.
4. Making banks, operators and managers responsible for their actions.

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