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Libor – or should that be Lie-bor?

Libor, in simple terms, is the estimated interest rate at which banks lend to each other. It comes under the aegis of the Financial Services Authority (FSA) and, more specifically, the British Banking Association (BBA). Various leading banks submit their costs for borrowing unsecured funds to Thomson Reuters (one of the world's leading sources of information for businesses and professionals), and Thomson Reuters work out an average rate which is published daily after 11am. The Libor rate is important as it serves as a basic reference for all sorts of financial instruments, such as variable rate mortgages, future contracts, various currency deals, interest rate swaps and all kinds of loans.

As any business borrowing money will tell you, the interest rates they are asked to pay for loans usually are based on Libor, plus an addition of x basis points. As we all know by now, the banks understated the costs at which they could borrow. Thus far, only Barclays has been publicly and severely pilloried and, indeed, fined nearly £300m for their wrongdoing. This low-balling first appears to have happened in September 2007, when the sub-prime mortgage crisis turned into a major credit crunch. The banks did so in order to present themselves in a better light by indicating that they were able to borrow at relatively low rates. It is worth remembering that the credit crunch by then had become so severe that it threatened a complete meltdown of the banking system.

Well, you will say, a lower Libor rate therefore would be bad for the banks and good for businesses who borrow money from them. However, lending by banks to businesses was virtually non-existent at that time, so submitting unrealistically low borrowing costs to Thomson Reuters did not affect the banks negatively – indeed, it made them look stronger than they were in reality. Of course, the banks by that time had become increasingly aware of the fact that the quality of their loan books looked extremely shoddy, and they were worried about their own survival.

But it got worse, as we now hear accusations that traders within a bank were openly talking to their colleagues at that bank's money market desk, asking them to fix rates to suit their own deals, and such blatant manipulation of transactions clearly constitutes market abuse.

Such lines of communications within banks are completely taboo, and so-called Chinese Walls have been established to avoid potential conflicts of interest. However, as a wit once observed: a Chinese Wall is something the grapevine grows over...

Two weeks ago, after being handed the record fine by the FSA, Barclays saw the resignations of CEO Bob Diamond and his right hand man, COO Jerry del Missier, after the earlier resignation of Barclays Chairman Marcus Agius, although the latter remains in the post until a successor is found.

Let us now move on to the Treasury Select Committee (TSC), whose job it is to scrutinize HM Treasury's various agencies' expenditure, policy and administration. These agencies include, among others, the Bank of England (BoE) as well as the FSA. Competently led by MP Andrew Tyrie, the TSC currently is tasked with conducting an all-party inquiry into the banking industry amidst the outcry of the Libor rigging scandal. They have been questioning some of the main players in this sorry saga, and we already have had to endure the unedifying spectacle of seeing leading personalities of the financial world engage in a bit of finger-pointing.

For instance, Bob Diamond told the TSC just over a week ago that Jerry del Missier had "misunderstood or miscommunicated" a telephone conversation between Diamond and Deputy BoE Governor Paul Tucker in 2008, whereas the former COO on Monday claimed he was given a clear order by Bob Diamond to lower the Libor rates, an order he passed on to the money market desk. Did the head of the money market desk not question an order which so blatantly went against their clearly defined modus operandi concerning such a sensitive area as Libor reporting, the MPs asked? According to Jerry del Missier, no questions were asked, nor did he discuss the matter further with his own boss, Mr. Diamond. At least, Mr. del Missier couldn't remember any such queries or discussions, which is very strange indeed and begs the question how he, the head of the money market desk and the CEO justified earning such huge salaries and bonuses.

It is also quite curious that Jerry del Missier has been promoted to COO only last month, and TSC members have claimed that both the BoE and the FSA had been "asleep" in letting that happen.

In fact, the Barclays boss did write a short contemporaneous, if rather opaque, note of that telephone conversation, but unfortunately Paul Tucker at the BoE end did not. Quite funny, really, bearing in mind that when one rings one's bank to obtain an account balance or a new cheque book, one is invariably told that the call is or may be recorded, usually supposedly for training purposes. A pity the CEO of a major bank and the Deputy BoE Governor didn't apply such prudence to their own activities.

On Tuesday, BoE Governor Sir Mervyn King stated that he had only heard about Libor rigging two weeks ago, which is somewhat at odds with the fact that way back in May 2008, Mr. King discussed that very subject with other central bank governors at a meeting in Basel. Furthermore, Timothy Geithner, who was then president of the Federal Reserve Bank of New York (he now is US Treasury Secretary), sent an email to Mr. King shortly afterwards in June 2008, suggesting the need for more transparency and better auditing to ensure accurate Libor reporting. The email was passed on to Paul Tucker, and the BBA was also informed.

When giving evidence to the TSC, Sir Mervyn King told the MPs that his concerns about "misreporting of Libor" in 2008 must not be confused with "evidence of misreporting". Well, that's alright then.

Indeed, Barclays claim that their managers actually told the New York Fed in 2008 that they were deliberately understating Barclays' borrowing costs, and they also told the FSA. In spring 2008, the BBA launched a review into Libor submissions, but somehow no one thought it worth pursuing the matter further in any meaningful way. Bearing in mind that Libor "inaccuracies" at the time of a full-blown banking crisis were hardly at the top of anyone's agenda, the shenanigans continued or, even worse, were *allowed* to continue.

We will have to wait for further revelations about this fiasco – undoubtedly, we will hear more from the BBA, the FSA and others – but we can reasonably assume that so far we have seen only the tip of the iceberg. Another twelve banks are rumoured to be under investigation, among them Lloyds, RBS and HSBC. This is no surprise, as back in 2008, both HBOS (since acquired by Lloyds) and RBS clearly were weaker banks than Barclays, yet their Libor submissions at the time were *lower* than Barclays. This sorry mess will prove extremely costly, both in reputational damage and financial compensation. Morgan Stanley reckon that the Libor scandal could cost the banks collectively some £14billion (yes, billion!) in terms of fines, restitution and legal costs. That figure is simply mind-blowing, and it comes hard on the heels of mis-sold payment protection insurance (PPI) to private individuals and interest rate swaps (i.e. interest rate hedging products) to small and medium sized businesses! Banks have already set aside some £8billion for the former, and potential compensation concerning the latter has not yet been properly assessed.

Apart from the fact that these recent banking scandals have hurt bank customers, consumers and businesses financially, one has to ask oneself whom, in anyone, one can trust nowadays. Not surprisingly, the press has engaged in a bit of conjecture, suggesting that maybe, just maybe, the oil price, and therefore the price we pay for petrol, could also have been rigged. Too fanciful to be credible? Well, it would take collusion between oil companies, hedge funds and, yes, you guessed it, banks to achieve such devious machination.

Having said that, we were amazed to learn only yesterday that HSBC, who had come through the credit crunch relatively unscathed due to its predominant exposure to Asian markets, has engaged in more than a bit of skulduggery. We are talking about multi-billion-dollar money laundering for terrorists, drug gangs and rogue regimes! This fraudulence has been exposed in America – after a year-long investigation by the Senate's Committee on Homeland Security – and HSBC is bracing itself for a fine that could even dwarf the one handed out to Barclays. So far only HSBC's global head of compliance has resigned. If the fine of over $600m handed down to ING bank for breaking American sanctions against Iran and Cuba is anything to go by, the HSBC fine could be eye-watering.

Another side effect of these banking scandals is that other events, equally and probably more important, have been relegated away from the front pages and headline news. Europe is still in a mess, and the agreement reached in June has yet to show any meaningful progress in resolving the deep seated problems. More sticking plasters and more kicking the can further down the road, but little real action despite no less than 20 (!) Eurozone summit meetings in the last two years.

The UK also has its own problems, evidenced by the IMF (International Monetary Fund) cutting Britain's growth forecast. In April, the IMF predicted GDP growth of 0.8% for this year, but this has now been reduced to 0.2%. In other words, Britain's economy appears to have come to a near standstill. Of course, the UK is not immune to the Eurozone's plight, and sterling has strengthened by some 5% against the euro, which does not help our competitiveness in the export market.

The rest of the world is faring slightly better, with the IMF predicting overall global growth at 3.5% for this year and 3.9% in 2013 – America is expected to register growth of 2% and 2.3% respectively – but there are some concerns over China managing to avoid a hard landing, and emerging market economies also have slowed down. Still, it is rather depressing that we have to hope that events elsewhere help us escape long-term economic stagnation in this country.

Compare this latest IMF prediction of 0.2% UK GDP growth for this year with their prediction when the coalition was formed back in 2010 – the IMF then predicted 2012 GDP growth of 2.6% – and you can see why Shadow Chancellor Ed Balls is having a field day criticising the current government, whilst conveniently forgetting that he was Gordon Brown's right hand man when public spending went through the roof, leaving a toxic economic legacy to any incoming government.

However, George Osborne has not impressed to date – just think of the laughable 'granny', 'pasty' and 'caravan' taxes in the last Budget! He is running out of chances to improve things, and the coalition would do better to address the real issues facing the country rather than squabbling over House of Lords Reform and the Review of Parliamentary Boundaries. Talking of squabbling, the weekly shouting match that masquerades for PM Questions Time is also getting us nowhere. You would have thought that a country faced with serious problems would seek ways towards more consensual government rather than slinging insults at each other across the floor of the House of Commons.

The markets have been comparatively quiet against this backdrop of economic uncertainty. America's S&P 500 recorded an upswing of 8.5% since the beginning of the year, whilst the Shanghai Composite showed a negative 1.7%. All the other major indices are somewhere between those two.

This relative calm is unlikely to change over the near future, allowing us all to enjoy the Olympics, always assuming you are not unlucky enough to live in London during the Games, and no, we won't even mention the security shambles or G4S.

Let us hope the weather improves!

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