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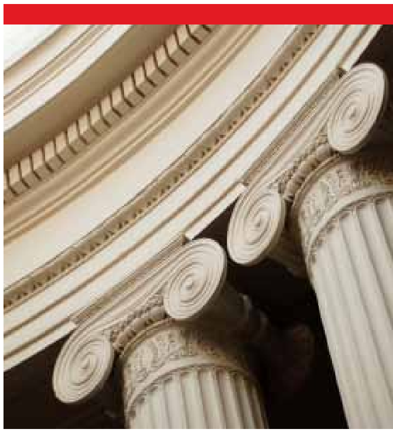

It All Falls Down: As banks continue to settle Libor-rigging charges with regulators, institutional investors consider pursuing individual actions

Stacey P. Slaughter & Thomas F. Berndt

Three of the world's leading banks—Barclays, UBS, and the Royal Bank of Scotland—have admitted to manipulating the London Interbank Offered Rate ("Libor"), the world's leading short-term interest rate benchmark, for numerous currencies over the course of several years. With regulators from various countries pushing forward in their investigations, and a multitude of class actions being filed, institutional investors with large exposures to Libor-linked instruments are considering pursuing individual actions.

Libor is the average interest rate at which a panel of the world's largest banks report they could borrow unsecured funds from other banks in the London wholesale money market for maturities ranging from overnight to one year. Libor is calculated for 10 different currencies and is a primary interest-rate benchmark used to price numerous financial instruments, including mortgage loans, student loans, credit card debt, bonds, and various derivative products. The value of derivatives and other financial products tied to Libor is estimated to be at least $350 trillion.

The British Bankers' Association consults a reference panel of between six and eighteen banks for each currency calculated. Between 2007 and 2010, the U.S. dollar Libor panel consisted of sixteen banks: Bank of America, Bank of Tokyo-Mitsubishi, Barclays Bank, Citibank, Coöperatieve Centrale Raiffeisen-Boerenleenbank, Credit Suisse, Deutsche Bank, HBOS, HSBC, JPMorgan Chase, Lloyds Banking Group, Norinchukin Bank, Royal Bank of Canada, The Royal Bank of Scotland Group ("RBS"), UBS, and WestLB AG.

At approximately 11:00 a.m. (GMT) each morning, each panel bank reported its estimated costs to "borrow funds, were [it] to do so by asking for and then accepting interbank offers in reasonable market size, just prior to 11.00 London time."[1] Libor is calculated by discarding the four lowest and four highest reported rates, and averaging the remaining eight.

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Beginning in August 2007, and corresponding with the financial crisis, Libor began to behave erratically and became decoupled from other financial indicators that had historically functioned as benchmarks.

While Libor has historically remained high during times of financial uncertainty — reflecting banks' reluctance to lend unsecured funds to one another without receiving a higher risk premium — the U.S. dollar Libor remained surprisingly low during the financial crisis. This led to concern that Libor's abnormal behavior was the result of manipulation. Economists speculated that both the desire to appear financially sound and the potential to profit from Libor-based holdings incentivized panel banks to artificially suppress Libor.

In early 2011, domestic and foreign regulators began to investigate whether certain panel banks had manipulated Libor. In July 2011, investigators expanded their probe to include yen-based Libor and the Tokyo Interbank Offered Rate ("Tibor").

In exchange for cooperating with the investigation, UBS disclosed in a July 26, 2011, SEC filing that it had "been granted conditional leniency or conditional immunity from authorities . . . including the Antitrust Division of the DOJ, in connection with potential antitrust or competition law violations related to submissions for Yen Libor and Euroyen Tibor." The DOJ Antitrust Division's conditional leniency program is reserved for corporations reporting "illegal antitrust activity."

On February 17, 2012, the *Wall Street Journal* reported that a "cooperating bank, which unnamed sources identified as UBS AG told Canadian investigators that those involved in the alleged scheme [to manipulate Libor] 'were able to move' the yen Libor at times between 2007 and June 2010." Notably, from 2006 to 2009, thirteen of the sixteen banks on the USD Libor panel were also on the Yen Libor panel.

In June 2012, as part of a non-prosecution agreement, Barclays agreed to pay to U.S. and U.K. regulators $453 million. In that agreement, Barclays admitted publicly that "[o]n at least a few occasions from approximately September 2007 through at least approximately May 2009, Barclays submitted improperly low Libor contributions."[2] The agreement cites numerous internal Barclays emails demonstrating that its Libor submitters knowingly submitted false rates at the request of Barclays traders to benefit Barclays' trading positions and that management instructed submitters to stay "within the pack" by submitting rates "in line" with other panel banks.

By August 2012, the investigation expanded to include panel members HSBC, RBS, and Lloyds Banking Group.

In December 2012, UBS paid $1.5 billion to settle charges of Libor manipulation with U.S., U.K., and Swiss regulators. In connection with the settlement, a Japanese subsidiary of UBS, UBS Securities Japan, agreed to plead guilty to U.S. criminal charges of felony wire fraud. U.S. authorities also unsealed a criminal complaint against two former UBS traders for their alleged role in the scheme. As part of the settlement, UBS admitted that "[f]rom as early as 2001 through at least June 2010, . . . [UBS] derivatives traders requested, and sometimes directed, that certain UBS Libor, Euroyen Tibor, and Euribor submitters submit benchmark interest rate contributions that would benefit the traders' trading positions, rather than rates that complied with the definitions of Libor, Euroyen Tibor and Euribor."[3]

On February 6, 2013, the Royal Bank of Scotland ("RBS") agreed to pay $612 million to settle Libor-manipulation charges with U.S. and U.K. regulators in connection with charges concerning the Yen Libor and Swiss Franc Libor. As part of the settlement, RBS's Japanese unit agreed to plead guilty to a U.S. criminal charge of fraud. The settlement reveals that RBS traders in London, Singapore, and Tokyo succeeded in moving Libor. One communication from an RBS trader, released as part of the settlement, stated that Yen Libor "is a cartel now" and "its [sic] just amazing how libor fixing can make you that much money."[4]

The Justice Department and Commodity Futures Trading Commission are now also investigating inter-dealer brokers ICAP, PLC and R.P. Martin Holdings Ltd., which serve as middlemen for banks seeking counterparties for hard-to-trade assets and assist some banks with their submissions for Libor.

The cumulative effect of the alleged Libor manipulation is substantial. For example, academic articles suggest that U.S. Libor was underpriced as follows:

From	To	Manipulation
Aug. 2007	Aug. 2008	12 basis points
Sept. 2008	Dec. 2008	100 basis points
Jan. 2009	Mar. 2010	40 basis points

Considering that an estimated $350 trillion of derivatives are tied to Libor, manipulating the benchmark by up to 100 basis points (or 1%) can improperly shift enormous amounts of wealth.
In addition to government scrutiny, numerous civil lawsuits alleging Libor manipulation have been filed against panel banks.

Many of these actions—consisting of both putative class actions and individual suits—have been consolidated into multidistrict litigation proceedings in the United States District Court for the Southern District of New York.

The plaintiffs—holders of Libor-tied instruments—allege that, in knowingly submitting false borrowing rates, panel banks violated the Sherman Act, the Racketeer Influenced and Corrupt Organizations Act ("RICO"), the Commodities Exchange Act ("CEA"), and numerous state laws. Defendants in the Libor MDL have filed joint motions to dismiss these claims.

Defendants attack the plaintiffs' Sherman Act claims by arguing: (1) plaintiffs do not plausibly allege a conspiracy, (2) plaintiffs fail to allege a restraint of trade, (3) plaintiffs have not suffered an "antitrust injury," and (4) plaintiffs who are indirect purchasers lack antitrust standing. Given that nearly all of the current plaintiffs assert antitrust claims, the court's ruling on these issues will significantly impact the course of the litigation.

With regard to plaintiffs' RICO claims, Defendants cite the Private Securities Litigation Reform Act, which states that claims actionable under the securities laws cannot be brought under RICO. Thus, to the extent plaintiffs allege fraud in connection with the sale of securities, they are precluded from bringing RICO claims.

Lastly, Defendants attack both plaintiffs' RICO and CEA claims on the grounds that these two statutes do not apply to conduct occurring outside of the United States. Plaintiffs respond by arguing that significant parts of the alleged conspiracy occurred within the United States. Not only are three of the defendant banks U.S.-based, but also plaintiffs' CEA claims are based on instruments purchased on the Chicago Mercantile Exchange.

While more than thirty Libor-related suits have already been filed, a large number of potential plaintiffs are likely awaiting the court's ruling on the pending motions to dismiss the class actions, which are scheduled for oral argument on March 5, 2013.

As the litigation continues, one can expect investors and other entities with large exposures to Libor-linked financial holdings to consider opting out of class actions and pursuing individual actions. Each investor's portfolio would need to be reviewed on an individual basis to determine its potential losses from Libor manipulation. In general, institutional investors (for example, insurance companies, mutual funds, hedge funds, and pension funds) appear to be more likely to have significant losses from Libor-linked holdings which might warrant individual actions.

The wealth of evidence already uncovered by regulators will no doubt give civil litigants a head start on their investigations. Though much will be learned through discovery in the growing number of civil suits, thus far the global conspiracy appears larger than many could have imagined.

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1. British Bankers' Association website definition of Libor, available at http://www.bbalibor.com/bbalibor-explained/definitions.
2. Statement of Facts incorporated into the non-prosecution agreement dated June 26, 2012, between the U.S. Department of Justice and Barclays Bank PLC, at ¶ 49, available at http://www.justice.gov/iso/opa/resources/9312012710173426365941.pdf. More information about the Barclay's non-prosecution agreement can be found on the Department of Justice website, at http://www.justice.gov/opa/pr/2012/June/12-crm-815.html.
3. Statement of Facts incorporated into the non-prosecution agreement dated December 18, 2012, between the U.S. Department of Justice and UBS AG, at ¶ 20, available at http://www.justice.gov/iso/opa/resources/6942012121911725320624.pdf. More information about the UBS non-prosecution agreement can be found on the Department of Justice website at http://www.justice.gov/opa/pr/2012/December/12-ag-1522.html.
4. More information about the RBS deferred prosecution agreement can be found on the Department of Justice website at http://www.justice.gov/opa/pr/2013/February/13-crm-161.html.

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The Next Wave of Asset-Backed Securities Litigation: Student Loans

Janet C. Evans and Katherine S. Barrett Wiik

A recent report authored by the Consumer Financial Protective Bureau and U.S. Department of Education highlighted concerns about the private student loan industry, which has generated more than $150 billion in outstanding student loan debt. As with the mortgage market, the secondary market was a driving force behind the widespread issuance of private student loans. Wall Street underwriters and issuers of student loan asset-backed securities (SLABS) were hungry for high volumes of student loans that could be securitized into SLABS with little additional collateral. SLABS generated significant revenue for the underwriters and passed the risk of loan default on to the investors—much like what occurred on Wall Street with the securitization of residential mortgage-backed securities (RMBS) that produced hundreds of millions in profit for the investment banks, billions in losses for investors, and spawned high-stakes litigation across the country.

It has become evident that as with the mortgage industry, this secondary-market demand for student loans led to a loosening of underwriting standards. More student loans were offered to borrowers with lower credit scores. During the SLABS boom, lenders intensified their efforts to market directly to students. Financial aid offices were often cut out of the equation, which led to a much smaller percentage of private student loans having a school certify the borrower's need for funds for educational purposes.

Undergraduate students at for-profit colleges and universities turned to private student loans at rates much higher than their counterparts attending not-for-profit institutions. The Department of Education reports that student loan defaults are at their highest rates since 1997, with sharp increases for students attending for-profit institutions. Fifteen percent of borrowers attending for-profit institutions defaulted in their first two years of repayment.

Institutional investors who purchased SLABS believing they were purchasing investment-grade bonds are beginning to ask the same questions about SLABS as they have about RMBS. What information was available to underwriters of SLABS concerning factors like the borrower's creditworthiness, educational program, school certification, and likelihood of being able to repay the loan? What due diligence was done to ensure the information about the borrowers was true? Did underwriters screen for fraud in loan origination? What information was passed along to the rating agencies and investors? Did the SLABS offering materials accurately reflect the risks as known or knowable to the underwriters?

If student loan default rates continue, SLABS losses could become significant as did RMBS-related losses. If these losses escalate as they are expected to do, institutional investors should analyze their portfolios with care and examine potential remedies under federal and state law.

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Found Fraud in your Foreign Securities? What to do now. Examining the current implications of *Morrison v. National Australia Bank*

Katherine K. Bruce and Richard R. Zabel

You are an institutional investor, and as part of your most basic investment strategy you regularly invest in foreign securities to help achieve a diversified investment portfolio. Sometimes your American-based broker goes through the New York Stock Exchange, and sometimes your broker reaches out to foreign exchanges—the world is, after all, flat. But what if something went wrong with your foreign investment and you wanted to seek redress for what you found out to be an underlying fraud. Could you? If a foreign company perpetrates fraud through its American subsidiary, or if you simply acquired your security on a foreign exchange, the answer is probably no. In fact, in today's world, because of the United States Supreme Court's decision in the case *Morrison v. National Australia Bank*, you may not be able to simply file a lawsuit in federal court.

In *Morrison*, the Supreme Court essentially put an end to U.S.-based litigation of cases that involve securities bought and sold on foreign exchanges. Morrison's implications are also much further reaching than just the so-called "foreign-cubed" class actions specifically underlying the decision. As new cases move through the system and policies and other global factors shift, courts and litigants continue to try to determine the boundaries of the *Morrison* decision. This means that any and all institutional investors who invest in foreign securities or purchase through foreign exchanges should be aware of the potential implications of the decision when entering foreign markets.

The Case and Reactions

In *Morrison v. National Australia Bank*, the Supreme Court decided that manipulative or deceptive conduct in connection with the purchase or sale of securities abroad is not protected by U.S. securities laws. The Court held that there was "no affirmative indication in the Exchange Act that §10(b) applies extraterritorially," and therefore United States securities law applies only to "the purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869, 2883, 2888 (2010).

The Court's decision addressed uncertainty within the federal appellate circuit regarding whether the Securities Exchange Act applied to foreign transactions. A number of courts, particularly the Second Circuit (as happened in this case), had developed and utilized the so-called "conduct and effects tests" which examined 1) "whether the wrongful conduct had a substantial effect in the United States or upon United States citizens" (the effects test), and 2) "whether the wrongful conduct occurred in the United States" (conduct test).[1] In *Morrison*, the Supreme Court noted that such a test lacked any "textual or extratextual basis" and it instead shifted to a so-called "transactional test."[2] Specifically, the Court focused on the fact that the conduct and effects test was not reflected in the Exchange Act, was therefore against the presumption against extraterritoriality, and was developed to "resolve matters of policy"—something the Court roundly rejected as creating

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unpredictable and inconsistent application of §10(b).[3] The Court firmly stated: "The results of judicial-speculation-made-law—divining what Congress would have wanted if it had thought of the situation before the court—demonstrate the wisdom of the presumption against extraterritoriality."[4]

The underlying case in the *Morrison* decision involved a so-called "foreign-cubed" class action—a class action on behalf of *foreign investors* who had acquired the common stock of a *foreign corporation* through purchases effected on a *foreign securities exchange*. Specifically, Plaintiffs had acquired National Australia Bank's ("NAB's") common stock on the Australian Securities Exchange. Their claims involved allegedly false and misleading statements made to class members about the profitability of one of NAB's wholly-owned subsidiaries—a United States Corporation. Plaintiffs alleged that the subsidiary's United States-based executives overstated the company's value and then NAB used that value in its financials; the Plaintiffs then sued under Section 10(b) of the Securities Exchange Act of 1934 and corresponding Rule 10b-5. The Court affirmed the lower courts' dismissal of this case because the Exchange Act could not apply when the securities purchased were not listed on a U.S. exchange and when "all aspects of the purchases complained of by [the] petitioners . . . occurred outside the United States."[5]

Proponents of the *Morrison* decision hailed it as providing clarity for foreign companies engaging in activities in the United States, and for curbing the alleged onslaught of oftentimes unmeritorious securities litigation in the Unites States as a result of such far-reaching and broad securities laws. However, within a month of *Morrison*, in recognition of some of the limits of the decision, Congress responded by partially reversing the decision through a Section of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") which gave the SEC and DOJ authority to bring certain enforcement actions involving foreign securities, and using the "old" conducts and effects test. Specifically, this new Section of Dodd-Frank provided the district courts of the United States with jurisdiction over SEC and DOJ enforcement actions where fraud involves:

> (1) conduct within the United States that constitutes a significant step in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.[6]

In addition to disagreement over the success of the *Morrison* decision, Courts have continued to try to ascertain how far reaching the decision in fact is. Some of the current implications of the decision as worked out in practice and through lower court decisions to date are examined briefly below.

The Legal and Practical Implications

Purchase through a foreign exchange trumps other factors

The Morrison result can be looked at in terms of two types of transactions: 1) those relating to the purchase or sale of a security listed *on an American stock exchange*, and 2) those relating to the purchase or sale of *any other security in the United States*. It is important for institutional investors to understand the implications of both, but this section will focus only on the "listed on an American stock exchange" requirement.

First, courts have essentially blocked suit for any scenario where the security is purchased on a foreign exchange. For example, an investor in a cross-listed security will *not* have a Section 10(b) claim, even though the foreign issuer tends to benefit from the investor confidence that can be gained from cross-listing. Similarly, at least one court has held that the purchase of an American Depository Receipt[7] ("ADR") through the over-the-counter-market does not qualify as "being listed on an American stock exchange" for the purposes of *Morrison*. Finally, even where a transaction is initiated in the United States, for example, where a broker-dealer or investment adviser perpetrates fraud from the United States, if the transaction is through a foreign exchange, *Morrison* holds that Section 10(b) cannot apply.

Thus, investors need to have a deep understanding of where their final transactions are executed and should use that information when deciding just how "far away" they want to invest.

Foreign Courts, State Courts and Arbitration

Once an investment has been executed on a foreign exchange, then institutional investors must know their options. Perhaps the most profound effect of the *Morrison* decision for any intuitional investor in foreign securities is the need to prepare for and understand alternate venues for litigation.

Once an investment has been executed on a foreign exchange, then institutional investors must know their options. Perhaps the most profound effect of the *Morrison* decision for any intuitional investor in foreign securities is the need to prepare for and understand alternate venues for litigation.

First, international arbitrations are becoming increasingly common and, in fact, increasingly favored, in cross-border disputes. But international arbitrations are different from U.S.-based litigation and will change the strategy of any investor and their counsel when it comes to seeking remedies for fraud. (See "*Trial Tactics in International Arbitrations: Proceedings are Fast-Paced and Compressed*," by Robins, Kaplan, Miller & Ciresi L.L.P. attorneys Jan M. Conlin and Thomas C. Mahlum for information on what to expect in international arbitrations.)

Second, where the parties have not signed agreements to arbitrate or otherwise do not agree to arbitrate, investors may find themselves in need of foreign counsel and litigating in systems that vastly differ from the United States' litigation system—this may include less protection for investors or procedural differences like condensed discovery.

Finally, as we have seen time and time again with shifts in U.S. securities law, when barriers are created for wronged plaintiffs who would normally seek redress in federal court, they often turn to state court. *Morrison*-like cases have already started to filter into state courts, and in many cases, those courts are declining to dismiss them. Investors may want to consider state-based securities claims, but should prepare for differences often encountered in state courts such as prolonged litigation processes, less-sophisticated juries, and different procedural mechanisms.

Class actions in this area are seriously limited and coalitions are king

Finally, securities class actions have been robust in the United States like nowhere else. *Morrison* has and will limit the ability of any investor to join in a 10b-5 class action for a broad-based securities fraud scheme with foreign elements as we had seen so often before the decision. For example, in the suit *Rosenbaum Partners, et al. v. Vivendi Universal, S.A., et al.*, investors from all over the globe, including the U.S., brought a class action based on false and misleading statements made by *Vivendi* to its shareholders and others about the company's health and liquidity. After the *Morrison* decision, claims in the *Vivendi* case were dismissed despite a jury verdict in favor of Plaintiffs. This result shows that investors may have to look to forming small but powerful coalitions with other institutional investors when they are wronged by fraudulent foreign schemes rather than relying on the class-action mechanism.

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Conclusion

The effects of *Morrison* are far reaching. Simply being uncertain about whether a broker ultimately executes your securities transactions on a U.S. or foreign exchange could dramatically impact the recourse available to any institutional investor when wronged. Investors need to understand the reach of *Morrison* and its impact on legal options so as not to unwittingly give up remedies with respect to their foreign investments. Specifically, investors need to educate themselves about alternate means of recourse such as international arbitration or "coalition-based" suits.

1. *See id.* at 2878-81.
2. *Id.* at 2888.
3. *Id.* at 2880.
4. *Id.*
5. *Id.* at 2888.
6. Sec. 929Y of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
7. An ADR is a negotiable security that represents an ownership interest in a specified number of shares in a foreign company and is traded on a U.S. exchange.

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