Eidgenössische Finanzmarktaufsicht FINMA
Autorité fédérale de surveillance des marchés financiers FINMA
Autorità federale di vigilanza sui mercati finanziari FINMA
Swiss Financial Market Supervisory Authority FINMA

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FINMA Investigation into the Submission of Interest Rates for the Calculation of Interest Reference Rates such as LIBOR by UBS AG

FINMA Summary Report UBS LIBOR

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Summary

This summary report of the Swiss Financial Market Supervisory Authority FINMA indicates the reasons for and results of the administrative proceedings conducted by FINMA which were closed by an order. FINMA established in its order that UBS AG ("UBS") severely violated Swiss supervisory law when submitting interest rates for the calculation of interest reference rates, in particular the London Interbank Offered Rate (LIBOR).

During the period under inquiry traders working at UBS made numerous requests asking interest reference rate submitters within the bank to change UBS's submissions in order to benefit their proprietary trading positions. There is evidence that many of these requests were accepted by the submitters; only in some cases does the evidence suggest otherwise. A large part of such requests were made by a single Yen trader based in Tokyo. The same trader also made requests to employees of other banks and independent brokers in order to influence LIBOR submissions.

On a number of occasions during the financial crisis (2007-2009), UBS employees inappropriately gave guidance to submitters. Such guidance was motivated by media concerns and trying to influence the perception of UBS's creditworthiness by financial market participants.

Substantial failings in the system and control processes for LIBOR submissions prevented those responsible at UBS from detecting and acting on the aforementioned occurrences. Internal guidelines, if they existed at all, were either deficient or not properly implemented. Management control of the submission processes was inadequate. Reviews conducted by both Compliance and Group Internal Audit did not notice the misconduct.

While numerous employees and a limited number of managers and senior managers knew of or were involved in the misconduct, FINMA did not find any indication that the bank's top management at that time had any knowledge of the misconduct.

FINMA admonishes UBS for severe violation of the organisational and the proper business conduct requirements under Swiss financial markets laws. Moreover, FINMA has imposed various supervisory measures aimed at further strengthening UBS's interest reference rate submission processes. FINMA ordered UBS to disgorge estimated profits to the Swiss Confederation amounting to CHF 59 million.

The FINMA proceedings took place at approximately the same time as those conducted by the UK Financial Services Authority (FSA), the U.S. Commodity Futures Trading Commission (CFTC) and the U.S. Department of Justice (DoJ).

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1 Interest Reference Rates and Alleged Manipulations in General

For a number of currencies, the London Interbank Offered Rate ("LIBOR") is regarded as the most important interest reference rate. LIBOR rates are calculated in 15 different tenors ranging from overnight up to twelve months rates. They are published for the following currencies: US dollar (USD), Japanese yen (JPY), Swiss franc (CHF), the euro, British pound sterling (GBP), Canadian dollar, Australian dollar, Danish kroner, Swedish krona and New Zealand dollar. Today, a large volume of money market instruments as well as housing, student and credit card debt and other financial instruments rely on LIBOR rates.

LIBOR is administered by the British Bankers' Association (BBA). For each currency, a number of major banks (a "panel") daily submit their cost of borrowing unsecured funds. Each panel bank is asked to base its submissions on the following question: "*At what rate could you borrow funds, were you to do so by asking for and then accepting inter-bank offers in a reasonable market size just prior to 11 a.m. [London time]?*" The highest and lowest 25% of submissions are excluded from the calculation (so-called "trimming"), while the remaining submissions are averaged. The results ("fixings") are calculated and published by Thomson Reuters at about 11.30 a.m. London time. Another interest reference rates is EURIBOR (Euro Interbank Offered Rate, calculated from submissions of 43 panel banks).

Profits and losses on interest rate trading positions can depend on changes to LIBOR or other interest reference rates. Even variations of a reference rate by single basis points ("bp"; one bp equals 0.01 per cent) can influence the profit of a trading position considerably. While the size of the panels and the applied calculation methods limit the influence of a single panel bank on interest reference rates, incorrect submissions by panel banks can still lead to wrong fixings of such rate.

First indications of possible irregularities in the process of fixing LIBOR existed in April and May 2008 when the Wall Street Journal published two articles suggesting that some LIBOR panel banks might have submitted too low in order to mislead the markets about their financial position and creditworthiness. UBS was mentioned by name in the second article. These articles partly triggered the initiation of a review of the LIBOR submission process by the BBA and financial regulators.

Currently, more than a dozen banks worldwide are under investigation by supervisory, criminal and/or anti-trust authorities for alleged inappropriate practices in connection with submissions to interest reference rates.

2 UBS Case

FINMA's inquiry was limited to the years 2006 to 2010. UBS was party to FINMA's proceedings as the entity responsible for the global risk management and for assuring a proper business conduct in all UBS entities across the group.

The main topic of these proceedings was the question whether UBS and its employees violated organisational and proper business conduct requirements when submitting for interest reference rates, in particular for LIBOR.

FINMA's proceedings covered three areas: interference with submissions to benefit proprietary trading positions; interference with submissions for reputational reasons; and systems and controls governing the submission process. Each of these areas is addressed in this report.

2.1 Interference with Submissions to Benefit Proprietary Trading Positions

Up until September 2009, UBS's submissions for LIBOR and other interest reference rates were made by employees ("submitters") at either the short-term ("STIR") or the long-term ("Rates") trading desks for the respective currencies. From October 2007, both STIR and Rates have been part of the business unit Fixed Income, Currencies and Commodities ("FICC") of UBS Investment Bank ("UBS IB"). Traders working at the STIR or Rates desks generally hold considerable proprietary trading positions in interest rates derivatives, which depend on the development of the underlying reference rate.

In September 2009, the submissions of interest rates for the calculation of interest reference rates were reassigned to Asset and Liability Management ("ALM"). ALM is a UBS IB unit that supports UBS's Group Treasury ("GT") with the group liquidity management, does no proprietary trading and is not a profit/loss centre within UBS.

2.1.1 Internal Trader Requests

During the period under inquiry, at least 26 employees of UBS (traders and submitters) were involved in trader change requests. Over 1,100 such requests are documented, mostly by online chat. Such trader change requests are documented among others for the JPY LIBOR, GBP LIBOR, CHF LIBOR and EURIBOR.

A trader change request usually consisted of a trader asking the submitter in charge to move UBS's submission to the interest reference rate in question either up or down, depending on the trader's proprietary trading position. In most cases, such requests were explicitly or implicitly agreed to by the submitter, while only in rare cases were they refused. An example of a trader change request made by Trader A to Submitter B, dating from 13 February 2007 is:

Trader A: “Hi, any chance low 1m again please?”
Submitter B: “Sure, no problem”
Trader A: “Thanks from Friday I’m out of it luckily”
Submitter B: “Good stuff”

Here Trader A asked Submitter B whether it was possible for Submitter B to lower UBS’s submission for the 1-month JPY LIBOR. When Submitter B confirmed that it was, Trader A thanked Submitter B and remarked that his trading position was only dependent on a low 1-month JPY LIBOR until next Friday.

UBS traders working at different trading desks also coordinated with each other about interference with submissions to benefit proprietary trading positions. For instance, on 22 May 2007, Trader C and Trader D had the following discussion:

Trader C: "Hi [D]"
Trader D: "Hi"
Trader C: "we would like higher fixing in 6M if that is ok for you?"
Trader D: "yup – I’m square on 6mos today"
Trader C: "tks very much"

Here Trader C informed Trader D that he would like to have UBS’s submission for the 6-month JPY LIBOR increased to benefit a trading position and asked whether that was OK with Trader D. Trader D confirmed that this was OK, since his trading position for that day was neutral (“square”) with regards to the 6-month JPY LIBOR, i.e. that the profit on his trading position would not be affected by changes in the 6-month JPY LIBOR. Trader C then thanked Trader D for the information.

2.1.2 External Requests

There were not only bank-internal requests but also external requests among JPY traders of various JPY LIBOR panel banks. Over 80 requests by Trader A to his acquaintances at other JPY LIBOR panel banks to change their employer’s submissions are documented. For instance, on 21 May 2009, Trader A contacted Trader E at Bank F:

Trader A: “could you do me favour would you mind moving you[r] 6m l[i]bor up a bit today, I have a gigantic fix I am limit short can’t sell anymore just watch”
Trader E: “I can do that”
Trader A: “thanks”

Here Trader A asked Trader E whether the latter could arrange that Bank F’s 6-month JPY LIBOR rate be submitted higher. Trader A went on to explain that he had a large trading position that would benefit from such an increase which he could not otherwise change or influence. Trader E confirmed that he could do that and Trader A thanked him.

In addition, a small number of trader change requests for JPY LIBOR by traders from other banks to Trader A were documented in 2007 and 2009.

2.1.3 Broker Requests

Brokerage houses arrange trades between interested parties. They also communicate information on these trades and market trends to other market participants. With regard to interest reference rates, such information is often taken into account by submitters of panel banks for their own submissions.

Between 2006 and 2009, Trader A made several hundred requests to different brokers asking them to publish inaccurate information regarding JPY LIBOR. On 22 August 2008, the following conversation took place between Trader A and Broker G (working for Broking House H):

> *Trader A: "obvious could do with low 6m tonight"*
> *Broker G: ":-) yep with you mate, low everything... think [Broker G] is your best broker in terms of value added :-)"*
> *Trader A: "yeah I reckon I owe him a lot more"*

Here Trader A told Broker G that his trading positions would benefit from a lower 6-month JPY LIBOR rate. Broker G apparently accommodated Trader A's request and confirmed that he would try to take influence in order to lower JPY LIBOR rates. He continued by stating that in his opinion, he was Trader A's "*best broker*", what Trader A confirmed.

2.1.4 Specific Conduct at the CHF Desk

During the entire period under inquiry up until September 2009, submitters responsible for UBS's CHF LIBOR constantly rounded their submissions up or down by a quarter to a half bp in favour of UBS's proprietary trading positions. In addition to that, a very small number of specific trader requests were documented.

2.1.5 Specific Conduct at the JPY Desk

A large part of the interference with submissions to benefit proprietary trading positions at UBS can be assigned to Trader A who was a JPY trader with UBS between 2006 and 2009. He worked in Tokyo with functional reporting lines to the persons responsible for the Rates trading activities within the Investment Banking Divisio: A majority of the internal trader change requests, all of the documented external requests and almost all of the broker requests at UBS were made by Trader A. In return for considering his requests, Trader A promised brokers additional business and, in some cases, favoured brokers by concluding so-called "*wash trades*" (fictitious trades without commercial motivation) that created a pecuniary benefit to brokers.

Trader A realised large net profits for the Rates desk and for UBS with his trading activities. The large number of requests he made indicates a continuing approach by Trader A to interfere with UBS's submissions to benefit his proprietary trading positions.

2.2 Interference with Submissions for Reputational Reasons

2.2.1 Background

From the summer of 2007, the conditions of the interbank lending market started to deteriorate. The illiquidity lasted well into late 2008. In October 2007, December 2007 and April 2008, UBS had to announce write-offs totalling about CHF 45 bn. On 16 October 2008, the Swiss government came to the assistance of UBS: the Swiss Confederation underwrote CHF 6 bn in mandatory convertible securities and the Swiss National Bank (SNB) took over USD 39 bn of illiquid assets by way of a separate fund entity (StabFund).

UBS's Group Treasury (GT) is primarily responsible for the balance sheet, liquidity management and financial risk control of the UBS group. Short-term funding of the group is done by STIR in consultation with GT. The Head of GT reports directly to the Group Chief Financial Officer.

Evidence suggests that during the period under enquiry, GT and Asset and Liability (ALM) employees gave improper guidance on UBS's LIBOR submissions on a number of occasions, as is outlined below.

2.2.2 Conduct in 2007

On the afternoon of 9 August 2007, Senior Manager I sent an email to a number of employees in FICC advising them to "*err on the low side*" for submissions "*to protect our franchise in these sensitive markets*". On 10 August, UBS's submission for the overnight USD LIBOR rate dropped by 50 bps. Within a day, UBS had gone from submitting one of the highest rates in the panel to submitting the lowest. It is not entirely clear for how long such guidance was maintained, in any case, it was still mentioned in a conversation between traders on 5 September 2007.

2.2.3 Conduct in 2008

On 1 April 2008, UBS communicated an additional write-off of USD 19 bn and its chairman Marcel Ospel announced his resignation within a month. On 10 April 2008, Senior Manager I and Senior Manager J discussed the growing deviation between UBS's funding costs and its USD LIBOR submissions. Senior Manager J commented in a chat that GT would not be happy with submitters if they submitted the true funding costs.

On 16 April 2008, the Wall Street Journal published an article that suggested that some LIBOR panel banks submitted too low. Further to this, the BBA announced on the same day that any member bank found to be misquoting rates would be banned from the panel. On 17 April 2008, two USD submitters discussed that the guidance from management was that UBS should be "*in the middle of the pack*" with its submissions and that GT was telling management to give such guidance.

On 29 May 2008, the Wall Street Journal published a new article about five banks allegedly submitting LIBOR rates that were too low. UBS was mentioned therein by name. On 2 June 2008, Senior Manager J informed Employee K that submitters had been instructed to move their submissions "*closer to the external issuance rates*", i.e. closer to UBS's true funding costs.

On 9 June 2008, BBA announced a number of changes to LIBOR. The next day, USD LIBOR rates fixed almost 10 bps higher, the biggest change in months. UBS's submission had increased by 10 bps. There is evidence that UBS tried to follow the BBA guidance to move LIBOR submissions closer to the issuance rate (funding costs). Over the next days, UBS's submissions became the highest of all panel banks. But between 16 and 18 June 2008, UBS's submissions fell back into the range of the other panel banks. On 18 June 2008, Submitters L and M discussed that Senior Manager N had given instructions "*to get in line with competition by Friday, [20 June 2008]*".

On 11 December 2008, Submitter M instructed that during her vacation UBS's submissions should be "*roughly in the middle of the pack*".

2.3 Deficient Systems and Controls

2.3.1 Applicable Internal Guidelines and Procedures

During the period under inquiry, UBS had a number of group-wide policies in force which were inter alia also applicable to interest reference rate submissions, traders, submitters and their superiors. UBS's Code of Business Conduct and Ethics "*sets out the principles and practices that UBS expects all of its employees and directors to follow unreservedly both in letter and in spirit*". It was first published on 8 March 2005 and has been revised several times since. The Code includes principles on fair dealing and fair competition as well as identifying, managing and avoiding conflicts of interest. UBS IB's Core Compliance Principles were first published in May 2005 and revised on 13 October 2012. Those principles expect employees to "*abide by high standards of business conduct*" and report misconduct and compliance issues to management and the compliance departments. The Core Compliance Principles are further detailed by a number of divisional and regional compliance guidelines.

UBS's earliest written directive regarding LIBOR submissions dates from February 2005 and is limited to operational details. The "*UBS Procedures for Submissions to BBA LIBOR Fixing*" were first published in August 2008 and revised in December 2009. They present BBA's requirements in short form and briefly describe UBS's LIBOR submission process. The procedures set up an exception reporting to track differences between UBS's submission, UBS's funding costs and/or the actual LIBOR fixing on that day. The December 2009 revision adds among other things specific provisions on record keeping. None of the LIBOR submission procedures contained any references to potential conflicts of interest, e.g. relating to traders and/or submitters. They also contained only very limited practical guidance for submitters on how to submit. In addition, the August 2008 procedures were never circulated among submitters and no formal training was conducted with respect to the procedures. The exception reporting provided for in the procedures was not executed properly.

For EURIBOR and other interest reference rates, UBS had no specific directives or guidelines in force during the period under inquiry.

2.3.2 Submitters and Management Control

Submitters at the STIR or Rates desks were in general traders with more or less pronounced interests in the desk's proprietary trading positions. These simultaneous responsibilities led to inherent conflicts of interest. In some cases, submitters had their workplace next to traders with an interest in the interest reference rate the submitters were contributing to. None of the improper trader change requests were reported by submitters to UBS's legal and compliance department. On average, the variable part of the remuneration of submitters and traders accounted for 200 to 500 percent of their base salary. Inherent personal incentives therefore existed to benefit proprietary trading positions of the bank during the period under inquiry.

Before the August 2008 procedures, submitters were not subject to any specific management oversight with respect to LIBOR submissions. Submissions were not reviewed by management. The improper trader change requests made during the period under inquiry were not detected, were ignored or tolerated by responsible management (2-3 levels below UBS's Group Executive Board). The undue influence exercised by traders was never escalated to the compliance department. At least one employee put in charge of management control over submitters in September 2008 (Manager J) was not entirely isolated from trading activities.

2.3.3 Compliance and Group Internal Audit

During the period under inquiry, FICC Compliance twice reviewed the LIBOR submission process: first between June and August 2008 and then again in July 2009. While the risk of improper attempts to influence submissions was recognised in the first review, the analyses made came to the result that there was no correlation between the submissions and UBS's trading positions. From today's perspective, the analysis was inadequate. The second review led to the reassignment of the LIBOR submission process to Asset and Liability Management (ALM), which does not have proprietary trading positions. Other recommendations of the second review, such as introducing systematic checks of submissions, were not implemented. In the period under inquiry, FICC Compliance neither discovered nor was notified of any improper behaviour with regards to the interest reference rates submissions.

Between January and May 2009, Group Internal Audit ("GIA") conducted an audit of STIR. GIA inspected the 2008 FICC Compliance review and the August 2008 procedures, but did not mention the LIBOR submission process in its audit report and did not recommend any additional review.

2.4 Findings

2.4.1 Inappropriate Organisational Assignment of the Submission Process

During a large part of the period under inquiry, the organisational assignment of the interest reference rate submission process within UBS was inappropriate. Both the STIR and Rates desks responsible for the submissions until August 2009 had inherent conflicts of interest as the desks traded in proprietary positions.

2.4.2 Inadequate Risk Identification and Risk Management

The UBS employees involved had to be clear on the fact that interfering with interest reference rates submissions was contrary to both UBS's internal guidelines and regulations established by the bodies regulating these rates. However, there was no awareness about this improper behaviour or the associated legal and reputational risks.

During the entirety of the period under inquiry, UBS did not recognise the risk that its employees could unduly influence UBS's submissions for interest reference rates. Neither management, FICC Compliance nor GIA recognised properly, much less addressed the inherent conflicts of interest in the submission processes.

The consequences of this deficient risk identification were inadequate risk mitigation measures. Before August 2008, no formal procedure existed for interest reference rate submissions. The LIBOR submission procedures of 2008 and 2009 did not adequately govern the submission process and did not address potential conflicts of interest. In addition, the procedures were not properly communicated and implemented. For interest reference rates other than LIBOR, UBS had no specific directives in force during the entirety of the period under inquiry. The financial incentive system in place for both submitters and traders may have fostered their improper behaviour.

2.4.3 Inadequate Supervision

Until August 2008, there was no management control over interest reference rate submissions at UBS. During the entirety of the inquiry period, none of the supervisors of both traders and submitters realized the improper trader change requests. In some instances, employees with management functions were directly involved in trader change requests.

2.4.4 Proper Business Conduct Requirements

Each of the trader change requests, external requests and broker requests violated a number of UBS's policies and guidelines. Contrary to the provisions of UBS's Code of Business Conduct and Ethics, employees used unfair business practices to obtain competitive advantages. Employees made improper requests to adjust the reference rates and potentially false statements, contrary to UBS's Core Compliance Principles. Each inappropriate communication between traders and submitters violated a number of additional principles contained in UBS's policies such as provisions on information barriers or the need-to-know principle. Misconduct was not reported as stipulated in UBS's guidelines. Moreover, the requests violated a number of rules of the bodies (e.g. the BBA) regulating the respective interest reference rates. The requests pursued an objective that ran contrary to the definitions of the interest reference rates and were driven by profit considerations.

Guidance given by employees from GT and ALM to submitters violated UBS's Code of Business Conduct and Ethics and Core Compliance Principles as well as applicable rules of the governing bodies. These statements pursued an objective that ran contrary to the definitions as well as the underlying spirit of the interest reference rates. In contrast to the influence by traders on submitters to benefit proprietary trading positions this conduct was not driven by profit considerations but rather by concern about UBS's franchise during the financial crisis. Further, the requirements of the benchmark owners applying to the submissions were not always entirely clear. Nevertheless, the guidance should not have been issued and violated the proper business conduct requirements.

In summary the conduct of UBS's employees was inappropriate. Such conduct is attributed to the bank. FINMA therefore concludes that UBS as an institution severely violated the organisational and the proper business conduct requirements.

2.5 Measures

Since discovery of the improper conduct relating to interest reference rate submissions, UBS has taken a number of measures aimed at preventing such misconduct in the future. Specifically, UBS's procedures for LIBOR submissions were fundamentally revised, corresponding procedures for EURIBOR submissions were implemented, an overarching Benchmark Submissions Policy has been put into place and various measures such as trainings, oversight and compliance review have been adopted.

In connection with the findings of the internal investigations, UBS dismissed numerous employees. Other employees had at the time already left the bank, were reprimanded, temporarily suspended and/or had their salary reduced. That measure included managers and staff. FINMA did not find any indication that the bank's top management at that time had any knowledge of either interference with submissions to benefit proprietary trading positions or interference with submissions for reputational reasons.

In the order, FINMA admonishes UBS for severe violation of the organisational as well as the proper business conduct requirements under Swiss financial market laws. Additionally, FINMA has imposed various supervisory measures aimed at further strengthening UBS's interest reference rate submission processes. FINMA orders UBS to disgorge estimated profits to the Swiss Confederation amounting to CHF 59 million.

After extensive inquiries FINMA closed its supervisory proceedings against UBS with an order on 14 December 2012. The order is subject to appeal at the Swiss Federal Administrative Court.