



## DIAMOND'S NOT FOREVER



BREAKINGVIEWS

## PREFACE

Bob Diamond's career is a microcosm of British banking. In the 16 years he spent at Barclays, the American personified an entire industry.

His arrival heralded the colonisation of British lenders by motivated, mobile - and highly paid - bankers and traders. The rise of Barclays Capital, the investment bank he ran, was fuelled by the global credit boom. Since the onset of the financial crisis, Diamond has exemplified the banking industry's struggle to adapt to new demands from regulators, politicians and customers, while clinging to past practices -- in particular, the payment of colossal bonuses.

Diamond's promotion to the top job at Barclays in 2010 should have been the crowning achievement of an illustrious career. Instead, his two years in charge were defined by conflict and controversy, ending in a rate-rigging scandal and a departure forced by the governor of the Bank of England.

The scandal over manipulation of the London Interbank Offered Rate (Libor) has raised profound questions about Barclays' future shape and direction. Should it continue to combine investment banking and retail banking in a single institution, or should it be split in two? It has also prompted an in-depth examination of the role played by Britain's regulators in monitoring Barclays, in the manipulation of Libor, and in forcing Diamond to leave.

This book spans Diamond's short but stormy tenure as Barclays chief executive. It starts by posing questions about the ability of the bank's non-executive directors to effectively control its new CEO -- something they proved unable to do -- before describing Diamond's faltering attempts to cast the bank and the industry in a better light. It casts a spotlight on the scandal that prompted Diamond's departure, and examines the fallout from the scandal.

The Libor saga is far from over. Every day brings new revelations about the behaviour of banks and the actions of regulators. It is too early to say whether the scandal is the banking industry's "tobacco moment". But it is clearly a defining moment for Barclays. Even without Diamond, the fate of the British bank will be a bellwether for the banking industry in Britain, and elsewhere.

*Peter Thal Larsen  
Assistant Editor, Reuters Breakingviews  
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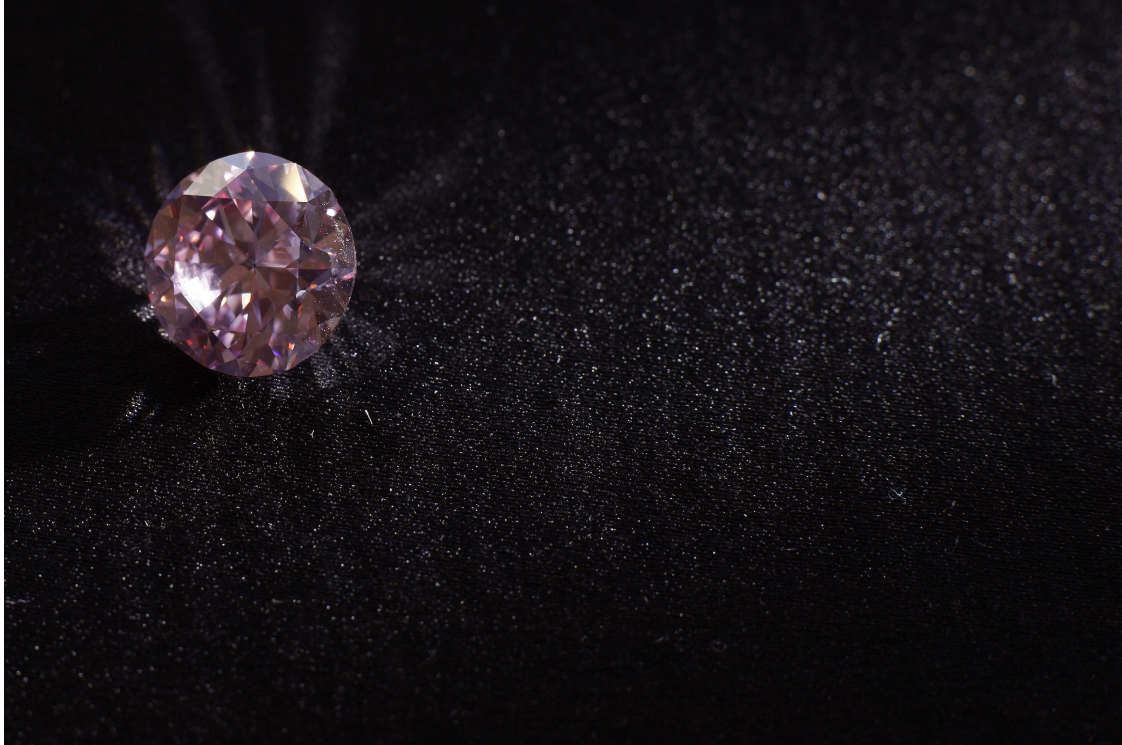
## BOB THE BOSS

### A DIAMOND IS FOREVER

BY PETER THAL LARSEN

Bob Diamond may be the obvious choice to be Barclays' next chief executive. But his elevation to the top job raises the risk that he could become an over-dominant boss. Diamond is a hard-charging personality who comes to his new post with a high profile and a strong track record: in a 14-year career at the UK lender, he has built its investment bank Barclays Capital almost from scratch into its largest profit-earner. Will his colleagues be able to constrain him if he tries to push through risky or grandiose plans? Shareholders and regulators will certainly hope so. But, to make sure, the board should be strengthened.

Diamond's promotion has raised three concerns; one misplaced, two more valid. The first is that the new CEO will favour BarCap at the expense of the bank's retail and commercial lending operations. This seems unlikely. Provided regulators do not force a break-up, Diamond has promised to maintain Barclays' universal banking approach. Increasing its exposure to investment banking would also run contrary to the wishes of investors, who want it to maintain a more even mix. Indeed, the bank Diamond sees as a role model is diversified JPMorgan rather than bulge-bracket Goldman Sachs.



*The "Martian Pink", 12.04-carat Fancy Intense pink diamond, is shown during media preview at Christie's, in Hong Kong. 08/05/2012  
REUTERS/Siu Chiu*

Amid the furore that surrounded his appointment, Diamond's achievements have often been overlooked. When he took charge of BarCap in 1997, it was the unloved rump of the BZW investment bank, most of which had just been sold. Over the next decade, Diamond transformed it into one of Europe's leading trading houses. He completed the transformation in September 2008 by picking up the U.S. arm of failed Lehman Brothers. In the first half of 2010, BarCap accounted for more than 85 percent of the bank's pre-tax profit.

Yet BarCap's rise also involved several dollops of good fortune. The credit boom played to its strengths in trading fixed income, currencies and commodities. When the crisis broke, the bank's decision to hold toxic loans on its books at historical rather than market value allowed it to avoid taking hefty losses.

Even the Lehman deal - now widely seen as a masterstroke - could have played out differently. Diamond's original plan was to buy the whole Wall Street bank, shorn of its toxic assets. That would have left Barclays with a bigger balance sheet to absorb and a knottier integration challenge.

If Diamond wants to emulate JPMorgan's Jamie Dimon he will have to expand Barclays' retail businesses - particularly in the United States. That raises the concern that the bank will embark on an ambitious - and potentially risky - acquisition spree.

Barclays has traditionally been better at building than buying. It was at the vanguard of developing credit cards, and pioneered Exchange-Traded Funds through Barclays Global Investors - a division that Diamond oversaw before it was sold to raise capital. The Lehman deal aside, its acquisitions have been less successful. But the worry is that Diamond, who turns 60 next July, will be in a hurry to make his mark.

Another valid concern is that Diamond lacks the diplomatic skills to guide Barclays through perilous regulatory and political waters in the UK. He has been quick to express his frustration: in the wake of the original, failed, Lehman deal he sent an email to a colleague bemoaning Little England.

In a recent interview he dismissed the comparison of investment banks to casinos as disappointing and not based on fact. That is an implicit criticism of several senior officials, including Mervyn King - governor of the Bank of England and soon-to-be Barclays' chief regulator.

The task of taming Diamond will fall to Barclays' board, and particularly to its chairman Marcus Agius. The former Lazard investment banker has proved an astute if relatively low-profile operator since taking the job in early 2007. He is backed up by heavyweight non-executives including former Morgan Stanley banker David Booth, Reuben Jeffrey, an ex-Goldman Sachs banker and former chairman of the Commodities Futures Trading Commission, and Michael Rake, former senior partner of KPMG.

Nevertheless, Barclays could do with one or two more heavy hitters on the board. Replacing Richard Broadbent, the senior independent non-executive director who has been on the board for seven years, might provide an opportunity to add someone with

more direct knowledge of risk management or financial regulation. Barclays could also add firepower by appointing a deputy chairman.

Diamond would no doubt reject any suggestion that he needs to be reined in. His supporters argue that his track record is one of caution rather than recklessness. Nevertheless, the crisis has shown how a powerful CEO and compliant board could spell financial disaster - not just for shareholders, but for taxpayers. Both Diamond and Barclays avoided many potential pitfalls during the crisis, and for that reason the new CEO deserves the benefit of the doubt. But it is a reflection of banking's altered relationship with society that Diamond will find his every move is closely watched.

*Published on 17 September 2010*



*Barclays PLC President Diamond poses for photographs after being named as the company's next chief executive officer in London. 07/09/2010  
REUTERS/Dylan Martinez*

## RED-FACED

BY JEFFREY GOLDFARB

Bob Diamond's M&A drive just hit a nasty road bump. The Barclays boss, who built and expanded the investment bank before taking over as group CEO last year, put his firm in the deal advice game with impressive speed. Now his bankers have been spanked by a U.S. judge for how they secretly and selfishly manipulated the \$5.3 billion leveraged buyout of food company Del Monte. The episode suggests processes and controls took a

back seat to league tables.

In two-and-a-half years, Barclays has gone from being mainly a top-notch fixed income house to a formidable force in M&A too. Before it bought the U.S. operations of Lehman Brothers, Barclays had little if any merger advisory business to speak of. In addition to his 133 U.S.-based dealmakers, global M&A boss Paul Parker has hired another 124 in Europe and Asia. The firm says it trailed only three of the big boys, including Goldman Sachs, in the value of announced mergers it worked on globally last year.

The Del Monte case, as interpreted by one judge, may reveal how some of these strides were made. According to the Delaware ruling, Barclays at various stages of its work hid from Del Monte important information it had about the buyers, Kohlberg Kravis Roberts and Vestar Capital. The bank also allegedly kept from Del Monte directors that it had been planning to help finance the deal well before getting the board's approval to do so.

What Barclays did may be standard fare in the cut-throat world of banking. Staple financing isn't unusual and conflicts of interest are often gray areas. For its part, Barclays, which wasn't even a named defendant in the lawsuit, says the decision doesn't tell the whole story and that, in any case, it got a good price for Del Monte.

That may be true. But the court's rendition certainly presents the kind of slick back-room dealing outsiders assume goes on everyday on Wall Street. It's just rare the shades are pulled back, particularly in such a run-of-the-mill complaint on behalf of shareholders. Corporate boards and investors won't like what they see.

The judge paints a picture of what Barclays may have sacrificed for its headlong rush into M&A. Diamond and his lieutenants will almost certainly face some uncomfortable phone calls from clients. It could be time well spent, as would using some to conduct a closer review of how its advisory mandates are managed. But that might also slow down Diamond's lofty ambitions.

*Published on 16 February 2011*

## **TOXIC SMELLS**

### **BY GEORGE HAY**

Barclays' costly Protium exit has left a sour taste. The UK bank has decided to reverse a deal that allowed it to avoid marking some of its toxic credit securities to market during the financial crisis. But the cost of unwinding the trade - an \$83 million payment to a group of ex-employees - revives questions about how Barclays entered into it in the first place.

Protium, which was set up in September 2009, was basically an accounting trick. Barclays took \$12.3 billion of toxic assets that were causing concern to investors, and parked them in a separate vehicle, funded with a \$12.6 billion loan. The move allowed Barclays to avoid mark-to-market losses on the assets, which were highly volatile. Instead, it was left with a loan that it would only have to write down if the assets became

permanently impaired.

But there were two problems. First, Barclays' loan ranked below \$450 million of capital put in by Protium's other owners. That meant the vast majority of any losses would be suffered by Barclays, not by the other shareholders.

The second problem was the identity of Protium's other investors. A significant shareholder in the vehicle was C12, a fund run by former Barclays employees. There is no evidence that Barclays entertained any other bids to manage the assets.

Less than two years on, Barclays has decided to take Protium back. This is partly because credit markets have improved - the bank thinks it can offload the assets, which have shrunk to \$10.2 billion, in just three years rather than 10 years as originally planned. But it is also because the structure is proving more expensive: under new Basel regulations, the amount of capital Barclays had to set aside against the Protium loan was due to rise threefold.

Terminating the deal is not cheap, however: Barclays is paying C12 \$83 million to compensate for performance fees that would have been due under the original deal.

True, leaving Protium in place would have cost the bank more. And Barclays may still feel the deal provided it with necessary insurance at a time when credit markets were a lot less rosy than they are today. But on the face of it, the bank has handed former employees a large cheque to compensate them for taking very little risk for 19 months. That leaves a bad taste.

*Published on 27 April 2011*

## **DIAMOND STANDARD** BY PETER THAL LARSEN

Bob Diamond has discovered humility. Ten months after he declared that the period for banks to show remorse was over, Barclays' chief executive has acknowledged the need to rebuild trust. Though the change of tone is refreshing, he must now demonstrate that reality reflects the new ideal.

Diamond's attempt to place banking in a broader social context is welcome – and overdue. His thoughtful lecture on Nov. 3 offered a defence of how and why banks take risks. He explained how they facilitate payments; transform short-term deposits into long-term loans; and smoothe out fluctuations in currencies and commodity prices. These may seem like statements of the obvious. But banks do a poor job of explaining their purpose. Few chief executives are willing to speak out in public. Those that do have tended to rant against regulation, or made veiled threats to relocate their businesses overseas.

That said, many of Barclays' past actions are hard to reconcile with Diamond's newly-stated tests of serving social purpose and meeting real client need. Just think of

mortgage borrowers persuaded to take out superfluous payment protection insurance. Or the Barclays unit that specialised in structuring aggressive tax arbitrage schemes. And while a court in March dismissed a claim that Barclays had mis-sold derivatives to a small San Marino bank, the case raised serious questions about whether the lender had its client's best interests at heart. Diamond's credibility will depend on how he goes about stamping out such behaviour – and how he deals with delinquents.

Regaining public trust also requires two other big changes. First, taxpayer bailouts must end. Diamond agrees that no public money should be put at risk when a lender fails. But the reality is that regulators are still a long way from being able to safely wind down a large, complex bank like Barclays.



*Two men pass closed cashpoints marked with masking tape, outside a Barclays Bank branch being refurbished in City of London. 31/08/2011  
REUTERS/Chris Helgren*

The second issue is pay. This is particularly touchy for Diamond, whose outsize bonuses have long been a source of public envy and anger. He insists that banks have to be competitive when recruiting staff. Meanwhile, the industry's rapidly dwindling profitability means compensation is bound to be squeezed. But bonuses remain one of the main barriers to reconnecting banks with the public. Unless Diamond tackles this issue, any other improvements could easily be overlooked.

*Published on 04 November 2011*



## SOCIAL JUSTICE

BY PETER THAL LARSEN

Barclays' UK rehabilitation is proving a struggle. Just a few months after chief executive Bob Diamond set out the lender's credentials for good corporate citizenship, it has been whacked for avoiding UK tax. The episode is another reminder that banks face higher levels of scrutiny. But the UK government's willingness to jeopardise Britain's predictable tax system is more worrying.

There's nothing illegal about avoiding tax. As long as they obey the law, companies are free to organise themselves in a way that minimises their tax liability. Indeed, their responsibility to shareholders means it would be irresponsible to pay more than necessary. However, avoiding UK tax has become a giant industry in which bankers, lawyers and accountants find new loopholes which the government then closes down. It's an arms race the authorities have tended to lose.

The financial crisis has cast a new spotlight on this practice. For banks which have benefited – directly or indirectly – from taxpayer support, the scrutiny has been particularly intense. UK banks – including Barclays – have signed a code of practice which includes a commitment not to engage in tax avoidance.

Judged by this standard, Barclays' wheezes look hard to justify. The first allowed the bank to avoid paying corporation tax on the profit generated by buying back its own debt at a discount to face value. The second created a credit which could be reclaimed from the government even though no tax had been paid. It's hard to see how the schemes can be reconciled with Diamond's recent statement that banks' activities must "serve a social purpose and meet a real client need".

But that doesn't make it any easier to stomach the government's decision to pass retrospective legislation. Closing the loophole will save 500 million pounds, though Barclays probably accounts for less than 150 million pounds of this, and other companies the rest. The financial gain to the exchequer could be dwarfed by the damage to Britain's reputation for maintaining a predictable tax system – a reputation already dented by the 2009 bank bonus tax and last year's increase in the levy on North Sea oil producers. In the end, both Barclays and the UK government may emerge as losers from the crackdown.

*Published on 28 February 2012*



*Barclays PLC President Diamond waits to pose for photographs after being named as the company's next chief executive officer in London. 07/09/2010  
REUTERS/Dylan Martinez*

## INVESTORS ARE REVOLTING BY GEORGE HAY

Bank shareholders have claimed another scalp. Earlier this week, over half of Citigroup's shareholders voted against the U.S. bank's executive pay plan. Now Barclays, which was facing a similar uprising at its annual general meeting next week, has moved to avoid such a chastening outcome.

Investors were clearly hopping mad about Barclays' decision to award Chief Executive Bob Diamond a 2.7 million pound bonus - 80 percent of the maximum - for 2011. The bank's peace offering noted the "strength of opinion" among shareholders. No doubt Citi's humbling experience concentrated its mind.

Yet as olive branches go, the one extended by Diamond and Chris Lucas, the finance director, is rather limp. Both will forfeit half their 2011 bonus unless Barclays lifts its return on equity - which was a lowly 6.6 percent last year - above its 11.5 percent cost of equity. However, the two men effectively have three and a half years to hit the target. And investors will rightly ask why the other half of the payout is not subject to the same condition.

Some shareholders will welcome the fact that Barclays is showing signs of listening. But the climb down is only partial: investors were also concerned about the lack of

forewarning given about a 5.7 million pound tax equalisation payment Barclays made to Diamond when he became a UK taxpayer.

The bank's U-turn also raises another question: why didn't Barclays' remuneration committee, headed by banker Alison Carnwath and including chairman Marcus Agius, take a tougher line after a performance which Diamond himself described as "unacceptable", and after two of his UK rivals waived their annual payout?

Barclays' last-minute concessions could well head off a Citigroup-style defeat. But it has done little to assuage shareholders' longer-term dissatisfaction.

*Published on 19 April 2012*

## SCANDAL AND RESIGNATION

### MUPPET SHOW

BY ANTONY CURRIE

Barclays has overtaken Goldman Sachs to win the trophy for email idiocy. Back in 2010, the Wall Street firm was hauled over the coals for electronic missives discussing the poor quality of mortgage securities they were trying to offload to clients three years earlier. But the British bank has easily bested that.

Its staff didn't just indulge in lots of chummy collusion - inspiring such responses to traders' requests to fix the bank's Libor submissions as "You heard the man" and "Done ... for you big boy." Nor did they limit incriminating themselves to inserting reminders about fixing the price in electronic calendars - akin to a drug dealer writing "must call cocaine supplier" into his.

No - the Barclays barnstormers also warned each other to keep their dealings a secret. Responding to a thank-you note from a trader writing "when I write a book about this business your name will be written in golden lights" the colleague responds, "I would prefer this not (to) be in any book!"

Another exchange reads "... this is between you and me but really don't tell ANYBODY." They even get caught out on the phone, with a manager saying he was worried about stating the "honest truth" about Libor fixes as it would open "a can of worms."

Goldman's traders were usually more circumspect, often writing "LDL" - meaning "let's discuss live." Regulators must be happy Barclays didn't follow its lead. And Goldman must be relieved that a new leading email knucklehead is born.

*Published on 27 June 2012*

### MALICIOUS LIBOR

BY GEORGE HAY

Barclays' reputation has hit a new low. The UK bank on June 27 received a 290 million pound fine from UK and U.S. regulators for trying to rig the London Interbank Offered Rate (Libor). The UK element is the biggest fine the Financial Services Authority has ever handed out.

The popular post-crunch perception of universal banks is that ordinary retail customers suffer from the fast and loose antics of traders in the investment bank. Over the course of an extraordinary 44-page document, the FSA largely stacks up that stereotype in Barclays' case.



*Chief Executive of Barclays Plc, Bob Diamond, leaves after attending a Treasury select committee hearing at Parliament in London. 11/01/2012  
REUTERS/Luke MacGregor*

To re-cap, Libor is the rate off which most retail and investment bank transactions, including \$554 trillion of interest-rate derivatives, are priced. It is based on submissions by a host of lenders, and these are then crunched by Thomson Reuters. The FSA says Barclays, and potentially other banks, tried to manipulate the rate for the benefit of their trading desks.

The regulator has exposed a severe systems failure at Barclays Capital, the investment banking unit. Derivatives traders and those submitting Libor bids should have been divided by so-called Chinese walls. Instead, between 2005 and 2009, 14 traders submitted 257 requests to try to rig the rate in their favour. The FSA's report shows they were brazen about it. One trader "begs" a submitter to put in a low Libor submission. The submitter responds: "I'll see what I can do". When hearing a submitter will be in late, another knowingly exclaims, "Who's going to put my low fixings in?" And yet another

pledges, "when I write a book about this business your name will be written in golden lights". The submitter responds, "I would prefer this not (to) be in any book!"

Barclays Chief Executive Bob Diamond was in charge of Barclays Capital when these abuses took place. He was responsible for the culture. Unnamed senior executives are indirectly implicated by the FSA in the misleading Libor submissions. And no Chinese walls were put in until December 2009.

In Diamond's favour, other banks are likely to be brought to book, and there is no evidence the attempted manipulation actually worked. He can blame wrongdoing on a small team at the bottom of his organisation.

But the fact that he and three top executives have pre-emptively waived their 2012 bonuses shows how seriously they are taking the ruling. There may still be further repercussions. And the affair weakens Diamond's authority in arguing the firm's case in the debate about future regulation. The full costs of the affair for Diamond and Barclays will be more than just financial.

*Published on 27 June 2012*

## **DIAMOND ABDICATION**

### **BY PETER THAL LARSEN**

Barclays' chief executive has become a liability. A \$450 million regulatory fine imposed after bank employees attempted to rig key interest rates has tarnished Bob Diamond's track record. Added to previous controversies over tax and pay, it undermines his attempts to revamp the UK bank. Though Diamond has been an asset to Barclays for most of his 16-year career at the lender, the bank will find it hard to move on while he is in charge.

It is less than seven months since Diamond argued that banks should "serve a social purpose and meet a real client need". Subsequent events have exposed the gap between his words and Barclays' actions. In February, the bank's use of aggressive tax avoidance schemes prompted the UK government to take the highly unusual step of retrospectively changing the law. In April, Barclays' decision to award Diamond a hefty bonus for 2011 - even though he admitted the bank's performance was "unacceptable" - prompted a shareholder protest.

The fines levied by global regulators - including the largest-ever penalty imposed by the UK's Financial Services Authority - are even more serious. Emails showing traders' casual attempts to manipulate interbank borrowing rates reinforce the widespread public perception of banks as venal and immoral. Worse, the misdemeanours took place at Barclays Capital, the investment banking unit Diamond built up and oversaw until he took the top job at the bank in 2010. It is hard to reconcile such behaviour with his famous rule that the bank has no place for employees who behave like "jerks".



*A man holds a picture of Barclays CEO Robert Diamond during a demonstration by the Tower Hamlets Uncut protest group at Canary Wharf in London. 05/04/2011  
REUTERS/Suzanne Plunkett*

On their own, the fines do not constitute a hanging offence. Other banks are also under investigation over alleged manipulations and could yet face even bigger financial penalties. In time, Barclays' decision to co-operate with the probe and seek an early settlement may look prudent. But in the context of past missteps, Diamond's credibility with regulators, politicians, customers and investors is so low the board should replace him.

Diamond is a charismatic leader who built a global investment bank almost from scratch. Partly as a result of his efforts, Barclays was able to avoid accepting government capital in 2008. But the crisis has altered banks' position in society, while regulation is changing the industry's scale and focus. Diamond's leadership skills, while valuable during the boom, are less well suited to a period of retrenchment.

Replacing Diamond will not be easy. Any new CEO would need clout with regulators and politicians, as well as a deep understanding of investment banking, which still accounts for half Barclays' pre-tax profit and two-thirds of its assets. But there are credible candidates: former JPMorgan investment banking co-head Bill Winters is one. Naguib Kheraj, the ex-Barclays finance director and former CEO of JPMorgan Cazenove, is another.

Barclays' board and its chairman, Marcus Agius, have so far shown little sign of reining in Diamond: they only scaled back his bonus when shareholders threatened a full-scale revolt. The latest setback - and the subsequent 15 percent drop in Barclays' share price

on June 28 - is a good moment to examine whether Diamond is still the asset to Barclays he once was. On balance, the answer is no.

*Published on 28 June 2012*

## DIAMONDS AREN'T FOR EVER BY HUGO DIXON

Marcus Agius said "the buck stops with me", in resigning after the interest-rate rigging scandal. But the buck shouldn't stop with the Barclays chairman. It is appropriate that Agius has fallen on his sword because he hasn't acted as a strong counterweight to Chief Executive Bob Diamond. But the chief executive was responsible for the culture at the Barclays Capital investment banking arm, where the manipulation took place, as well as other lapses.

Diamond has done an extraordinary job expanding BarCap. But it is hard to believe he is the right person to clean it up. In a BBC lecture last year, he said that "the evidence of culture is how people behave when no one is watching".

Not only did several Barclays traders behave badly when he was not watching; he himself was somehow involved in a chain of discussions which led to the bank submitting an artificially low interest rate to disguise an appearance of vulnerability during the credit crisis.



*Barclays bank former Chief Executive Bob Diamond leaves after giving evidence to the Treasury select committee in Westminster, London. 04/07/2012  
REUTERS/Olivia Harris*



The interest-rate rigging scandal isn't the only black mark against Diamond. He received a hefty bonus for last year despite a performance he himself acknowledged was "unacceptable". And he presided over a bank that concocted aggressive tax avoidance schemes.

Barclays may hope that the blood-letting will stop with Agius. But the scandal has a dynamic which may make this hard. The next flashpoint will be on July 4, when Diamond has been summoned to appear in front of the House of Commons Treasury Select Committee. Given that politicians are competing with each other in anti-banker rhetoric, this will be an uncomfortable experience - even if Diamond can argue that Barclays was not alone in manipulating rates.

Beyond that, the spotlight will switch to Barclays' new chairman. Sensibly, the bank is looking both externally and internally; the main inside candidate is Michael Rake, now promoted to deputy chairman. It needs to find someone who both understands banking and is tough enough to find a replacement for Diamond.

*Published on 02 July 2012*

## **WHITE LIES AND HIGHER TRUTHS**

### **BY EDWARD HADAS**

Augustine of Hippo knew nothing of Libor, but he wouldn't have hesitated to condemn Barclays' submission of false estimates of borrowing costs during the 2008 financial crisis. "We must never at all tell a lie," he wrote in 396. St Augustine said it was better to accept being raped or murdered than to utter any falsehood. He would be unmoved by the argument that it was right to fix the numbers to calm frayed financial nerves.

Immanuel Kant endorsed Augustine's rigorous line, but many philosophers have been uneasy with the categorical condemnation of deception. Is it really wrong to praise your host's mediocre cooking? Could a man be blamed for failing to tell the whole truth to a Nazi soldier about a hidden Jewish family? Some lies may be necessary evils. They may be expressing a higher truth - that the hospitality is truly appreciated or that the family truly should not be killed.

There's no excuse for Barclays' manipulation of Libor quotes merely to please its traders. But during a crisis of confidence too much honesty can be bad. An accurate Libor submission would have invited panic in an already frightened market. According to some reports, Paul Tucker, the deputy Governor of the Bank of England, agreed.

Besides, while the artificially low numbers did not reflect market conditions - as most insiders knew at the time - they may well have been a reasonable estimate of the underlying situation. Traders were moved by the fear that one or more major British bank would fail, but a calm analysis would have come to a more sensible conclusion, that governments will almost certainly do whatever is necessary to support the financial system. Indeed, the bank's bids may have been more economically correct than those set by a malfunctioning free market.

A finer moral study of the Libor bids might lead to a harsher judgement. The banks' previous behaviour hardly encourages confidence in their public-spiritedness. But the point is that ethical judgements cannot always be drawn in black and white. In the context of a raging financial crisis, Libor-lying was probably defensible.

*Published on 02 July 2012*

## **LIARS' MARKET**

**BY IAN CAMPBELL**

Economic forecasters make weather forecasters look good. But that is not the function of a rate that measures today's economic weather. When the weather is terrible - a financial hurricane that might tear down banks - does it help if banks report that it's a trifle windy, but nothing to be alarmed about?

No. Lies make matters worse. A market full of lies is one in which trust, the basis of all economic transactions, is broken. And then markets become all the more susceptible to panic.

Market measures must tell the truth, however bad that truth may be. The institution which fiddles with its weights and measures is not one with which others can do business. Nothing is more frightening than institutions that have been corrupted. When market players sense fiddling they become ever more cautious, trusting no one and nothing.

Alarming but true measurements, on the other hand, are curative. If Libor rates are unnervingly high it shows there is a problem that needs to be tackled. The Bank of England, say, may need to ensure that liquidity is provided to solvent institutions while the government ensures insolvent ones are bolstered or closed. Calm will be restored and rates will fall because the storm is being countered by a strengthening of the financial edifice. Solid measures are the only solution.

Pretence and lies, on the other hand, solve nothing. Once supposedly accurate and truthful market rates become no better than market rumours they feed uncertainty and fear. The greatest harm is to distort truth and add to the unknown. When the size and shape of threats are known the world can try to deal with it.

The anemometers must tell us the wind speed honestly and the wind vanes point in the right direction. Mistrust leads to panic and paralysis. Trust is the only way forward. Financial institutions must rebuild it.

*Published on 02 July 2012*



*A still image taken from video shows Bank of England's deputy governor, Paul Tucker, appearing before a parliamentary committee in London. 09/07/2012  
REUTERS/REUTERS TV*

## SECRETS AND LIBOR BY GEORGE HAY

Bob Diamond is going down fighting. The outgoing Barclays chief executive has implicated the Bank of England and potentially the government in the Libor scandal that claimed his scalp and that of one of his lieutenants on Tuesday. He has lobbed a grenade that the BoE must now attempt to defuse.

The inflammable material is contained in evidence Barclays has submitted to a committee of UK lawmakers due to question Diamond on July 4. It includes a contemporaneous note by Diamond summarising a conversation with Paul Tucker about understated Libor submissions back in October 2008. Tucker, deputy head of the BoE, is seen as the frontrunner to be the next governor. On one reading, Diamond's note suggests he implicitly endorsed Barclays submitting Libor submissions, possibly with the nod of government.

On Diamond's version of events, Tucker relayed queries from "senior figures within Whitehall" - home to the offices of the prime minister and the Chancellor of the Exchequer - as to why Barclays' Libor submissions were so high. Tucker supposedly added that "it did not always need to be the case that [Barclays] appeared as high as [it has] recently".

This exchange seems to be the one that the Financial Services Authority mentioned in its report on Libor-rigging last week. So there's little doubt a conversation took place. The note may not be an accurate summary. But if it is, it is open to damaging interpretations.

If Tucker said Barclays' Libor submissions didn't need to appear so high, what could he have meant other than that the bank should lower them? And why did Tucker mention Whitehall if not to legitimise such misstatements? Perhaps there are other explanations but Tucker will now have to respond.

Moreover, the Diamond memo potentially contradicts the FSA account of the exchange. The regulator states that "no instruction for Barclays to lower its Libor submissions was given during this telephone conversation". Well, there's explicit instruction and implicit instruction.

Barclays claims Diamond did not specifically order lower submissions as a result, but he did distribute the note to chief operating officer Jerry Del Missier and to then chief executive John Varley. For his part, Del Missier seems to have gone with the obvious interpretation and instructed Libor submitters to lower their aim. His resignation came at the same time as the evidence was published.

The BoE won't like being dragged into this. But Tucker needs to provide some clarity - fast.

*Published on 03 July 2012*

## **THE BARCLAYS COUNTERFACTUAL**

### **BY HUGO DIXON**

What if Barclays hadn't lowered Libor submissions? The bank certainly reduced its vulnerability by submitting lower rates in the midst of the crisis. But what would honesty have cost? Would Barclays have secured funds from Middle East investors, avoided nationalisation and protected its bosses' bonuses? No one knows, but the timeline is suggestive.

After Lehman Brothers went bust in September 2008, most smart market participants realised that the published Libor rate was not giving an accurate picture of borrowing costs. The UK government also knew this and was keeping a tab on the health of Britain's banks by looking at other measures. So it's possible that Barclays' decision to cut its Libor submissions at three key moments in the autumn of 2008 had no effect on the course of history.

However, it is clear that Barclays was worried about being seen to be an outlier - as a result of submitting rates at which it thought it could borrow that were higher than the competition's. The government also appears to have asked questions about this, indicating that it might have been concerned. What's more, there were good reasons for anxiety. The whole financial world was blowing up while Barclays itself was gobbling up part of the Lehman Brothers carcass.

Barclays originally tried to buy the whole of Lehman before it went bust - a manoeuvre wisely blocked by the UK Financial Services Authority. But the UK bank did acquire Lehman's U.S. operations after bankruptcy for a song, announcing the deal on Sept. 17.

The next day one of the Barclays staff responsible for submitting Libor rates told his manager that he planned to put in a one-month U.S. dollar submission of 4.75 percent - according to the FSA report into the rate-rigging scandal. After that conversation, he cut it to 4.5 percent. This was still 50 basis points above the next highest submission. Would Barclays have been able to proceed with the Lehman deal if it had been even further outside the pack?

A few weeks later, several big banks, including RBS and Lloyds, were shut out of the wholesale money markets and draining liquidity at an alarming rate. The UK government decided it needed to stuff them with capital, partly nationalising them. The final decision was taken on the weekend of Oct. 11-12. Barclays was desperate to avoid nationalisation. The bank was concerned about the danger of government meddling, but the bosses may also have been worried that politicians would curb their fat bonuses. Eventually Barclays persuaded the government to let it raise capital itself privately.

Three days before this fateful weekend, on Oct. 8, one of the Barclays "submitters" said in a phone conversation that a manager had asked him to put in a lower rate than the previous day "to send the message that we're not in the shit". Barclays then submitted a rate that was still the highest but equal with that of another bank. If it had put in a still higher rate, would that have had any effect on the government's willingness to avoid nationalisation?

Barclays then found investors, mostly from Qatar and Abu Dhabi which were prepared to inject 7.3 billion pounds in capital. The proposed deal was announced on Oct. 31. This was two days after the now notorious phone conversation between Bob Diamond, then Barclays' president, and Paul Tucker, then executive director for markets at the Bank of England.



*Staff stand in a meeting room at Lehman Brothers offices in the financial district of Canary Wharf in London September 11, 2008.  
REUTERS/Kevin Coombs*

Exactly what happened in that phone conversation is not clear. But after it, Jerry del Missier, then Barclays Capital's president, passed down an instruction to lower the bank's Libor submission. Would the Middle Eastern investors have been so willing to invest in Barclays if the bank's Libor rates had been even more out of whack? And, if so, would the UK government have had to step into the breach?

It may not be possible to get clear answers to these questions. But somebody - whether MPs, regulators or a judicial inquiry - should definitely ask them.

*Published on 04 July 2012*

## BARCLAYS AFTER BOB

### CAPS LOCK BY GEORGE HAY

Barclays will find it tough to undo Bob Diamond's handiwork. The UK bank's recently departed chief executive spent over 15 years building the firm's investment bank, Barclays Capital, into one of the biggest of its kind in the world. Now the unit's strategic contribution is in doubt following its role in the Libor scandal. But even if Diamond's replacement wanted to get shot of his pride and joy, it would be hard to do.

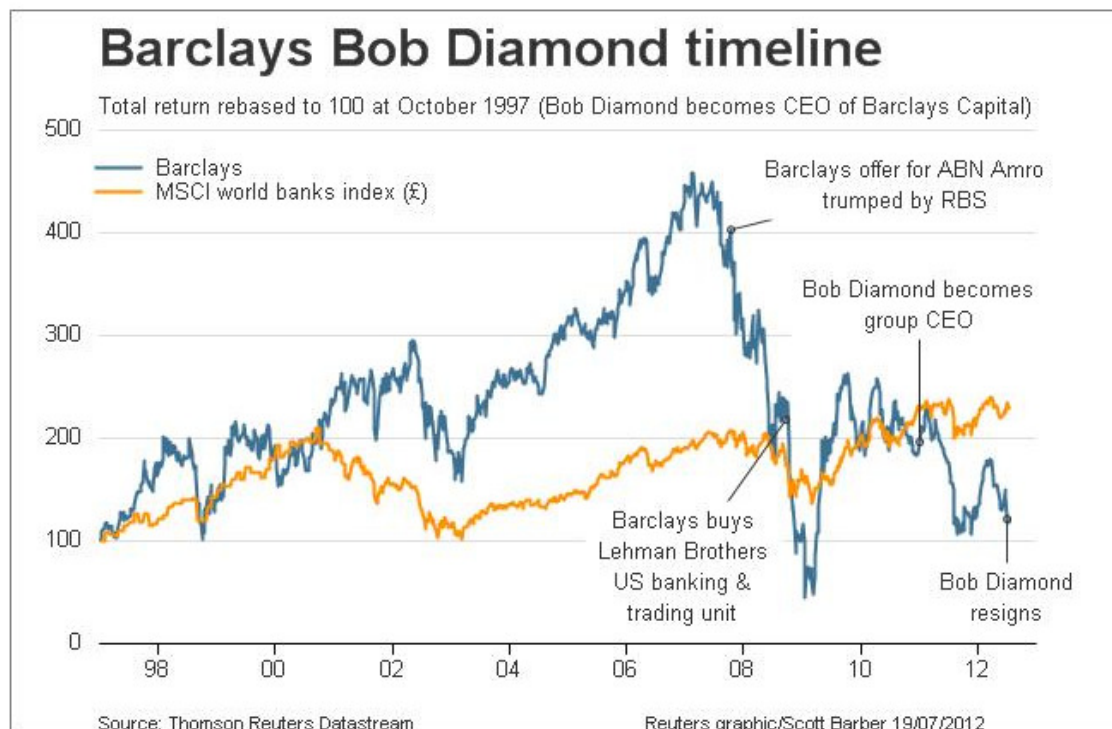
There are instances of successful standalone investment banks - look at Goldman Sachs and Morgan Stanley. But BarCap isn't a Goldman waiting to be spun off. That's because it gets a considerable leg-up from being part of a wider group. The most obvious benefit is that it has tended to be able to fund itself at around 50 basis points cheaper than Goldman and even more than that compared to Morgan, despite the fact that their earnings are equally volatile. Investors can see that BarCap is attached to a too-big-to-fail retail franchise that would have to be bailed out. If BarCap was an independent entity, this benefit might disappear.

BarCap's return on equity in 2011 was only 10.4 percent, below its cost of capital. If it had to pay another 50 basis points on its 168 billion pounds of senior unsecured debt, it would have knocked almost 850 million pounds, almost a third, off its 2011 pre-tax profit. As a standalone entity, BarCap might also have to post more collateral to service its huge repo financing requirements, in turn straining its balance sheet and further lifting the cost of its senior unsecured debt facilities.

What's more, the average duration of BarCap's unsecured wholesale funding is less than three years, compared to more than five for its U.S. peers, according to one analyst. And BarCap is much more leveraged - total assets under U.S. GAAP are 23 times tangible equity, compared to 11 times for Goldman, says the same analyst. BarCap could try and offset higher funding costs by raising more capital. But that would depress returns even further.

With such a shaky profile as a standalone entity, Diamond's replacement would have a job selling BarCap for near its book value, assuming anyone wanted to buy an entity with such a huge balance sheet. The other option would be copying Stephen Hester at Royal Bank of Scotland in his quest to gradually deleverage the investment banking arm. But turning Barclays back into a boring retail bank could take even longer than the fifteen years it took Diamond to set it up.

*Published on 05 July 2012*



## THE PERILS OF INDISPENSABILITY

### BY HUGO DIXON

Was Bob Diamond really irreplaceable? Barclays' board operated for 15 years on the assumption that he was. As a result, the UK bank's chief executive became more powerful - and ever harder to replace. Now that he has been kicked out in the wake of the Libor rate-rigging scandal, Barclays is struggling to find new leadership.

This is an object lesson for all companies, not just banks. Think of two other UK-listed groups which have recently provoked shareholder anger over their bosses' high pay packages: WPP, the advertising giant; and miner Xstrata. In both cases, the boards paid their chief executives so much because they thought they were indispensable.

Barclays is now in a mess. Not only has Diamond quit, his chairman, Marcus Agius, has also said he will resign. Both men ultimately had to go: Diamond had come to epitomise the worst of the City of London's greed, while Agius seemed unable to hold his chief executive in check. Neither man responded to requests for comment.

The manner of their going means the bank is now rudderless at a time when a political storm is swirling around it and a financial crisis is bubbling across the English Channel.

It will be hard to find a good candidate to replace Diamond, given that Barclays has now become a political football and the next boss will have to put up with intense media



scrutiny. Attracting a good chairman won't be easy either, although the deputy chairman, Michael Rake, seems prepared to step into the breach.

Diamond was undoubtedly an entrepreneurial banker. When he took over Barclays Capital in late 1997, the lender's investment banking unit had 135 billion pounds in assets and made 252 million pounds in pre-tax profit. By last year, assets were 1.2 trillion pounds and profit was 3 billion pounds.

This dramatic growth was largely a function of two factors: the multi-year credit boom that lasted until 2007; and Diamond's ability to persuade the Barclays board to pour resources into investment banking. This expansion continued after the crunch, when the bank acquired the largest chunk of Lehman Brothers out of bankruptcy.

Barclays' share price performance, however, has been miserable, more than halving over the near-15 year period. During that time, Diamond and his key lieutenants received hundreds of millions of pounds in compensation. Diamond himself has earned at least 120 million pounds since he joined the board in 2005, according to Manifest, the corporate governance group.

Diamond ran BarCap as a fiefdom, with seemingly little oversight from a series of chairmen and chief executives at the parent bank. Despite the successes, there were problems: sometimes excessive risks were run; the organisation developed fiendishly complicated tax-minimisation schemes for its clients that went right to the border of what was legal; and, of course, it has now emerged that some Barclays traders attempted to manipulate Libor.

Diamond's first slip came in 1998 when BarCap expanded its exposure to Russia just before the Kremlin defaulted and devalued. But Barclays kept him on, fearing that the investment bank would be too fragile if he quit. The idea of Diamond the indispensable was born.

Over the next six years, BarCap expanded so rapidly that Diamond was considered a candidate to be the next Barclays chief executive. In the end, the board chose John Varley. But directors were worried that Diamond would leave and, soon afterwards, gave him the title of president of Barclays in addition to that of BarCap chief executive. That seems to have undermined Varley's authority.

When Varley retired at the end of 2010, BarCap was contributing 79 percent of the whole bank's profit and Diamond was the obvious successor. He then became an even more dominant force in the bank.

In theory, a strong chairman could have acted as a counterweight. But, in Agius, Barclays doesn't seem to have had such a chairman. This became apparent when Diamond was awarded 80 percent of his bonus for last year despite himself describing the results as unacceptable. Almost 27 percent of shareholders voted against the Barclays remuneration report.

The fiasco over this year's pay finally persuaded Barclays' non-executive directors that they needed a new chairman. They told Agius that they wanted him to step down at next year's shareholder meeting. But before they could implement the plan, the Libor scandal blew up.

The board initially decided to hang onto Diamond - in part because there was nobody obvious to replace him. His two top lieutenants - Rich Ricci, BarCap's chief executive, and Jerry Del Missier, Barclays' chief operating officer - were both part of the same brash culture and out of tune with the current zeitgeist.

Agius himself decided to fall on his sword, seemingly thinking this would take the heat off Diamond even though the rate-rigging was an operational matter and so nothing to do with the chairman. But the Bank of England made clear this was not the right response and that Diamond would have to go.

Agius is, therefore, hanging on and running the executive committee on a stopgap basis even though he doesn't appear to have the necessary skills. Meanwhile, the bank is looking for both a new chairman and chief executive.

And the moral of the story? Boards must always counterbalance strong chief executives with strong chairmen and have good succession plans in place. Most importantly, they should never treat anybody as indispensable - in case that is what they become.

*Published on 09 July 2012*



*Diamond, CEO and chairman of Barclays attends a session at the World Economic Forum (WEF) in Davos  
REUTERS/Christian Hartmann*

## RAKE OR BROOM

BY HUGO DIXON

Does Barclays need a new broom or Rake in the chair? The bank would ideally appoint external candidates as both chairman and chief executive to make a clean break with the Bob Diamond era. But if it can't find a strong outsider to be chairman fast, deputy chairman Michael Rake would be a good internal appointment.

Barclays certainly needs some new people to shake up its brash culture. The snag is that the bank has become such a political football that it will be hard to attract top candidates. The most important post will be the new chief executive to replace Diamond. But the more immediate priority is to find a new chairman to replace Marcus Agius. After all, an incoming chief executive will want to know who his chairman will be; equally, an incoming chairman will want to pick his chief executive.

The new chairman needs to be tough, independent-minded and knowledgeable. He also needs to be willing to work virtually full time for perhaps 750,000 pounds a year. This is not the job for somebody who wants to get rich but for somebody who enjoys a challenge and is public-spirited. Possible candidates include Gus O'Donnell, the former cabinet secretary, and Philip Hampton, RBS chairman. But it might not be easy to attract either: O'Donnell may be in line to be next governor of the Bank of England, while Hampton still has a job to do helping turn around RBS.

If there is a dearth of attractive outsiders, Rake would be a good insider. He would, of course, have to give up his existing jobs as chairman of BT and easyJet. Although Rake suffers from association with the Diamond/Agius era, he has pushed for better governance, especially since he became senior independent director last year. He was, for example, instrumental earlier this year in persuading Agius to step down to make way for a stronger chairman at some point. And he was coaching Diamond on ways of improving the bank's confrontational relationship with regulators.

If Barclays can't get a good new broom to clean the Agian stables, a Rake would do the job.

*Published on 11 July 2012*

## LIBORIOUS TASK

BY REYNOLDS HOLDING

The loud legal barking over the Libor deception portends a costly bite. It's unclear who got hurt in the rate-rigging mess, but the growing chatter about lawsuits means the banks behind it will shell out big bucks just fighting mounting lawsuits.

Investors and others claiming harm first sued over a year ago, shortly after U.S. regulators announced investigations. The lawsuits contend that more than a dozen banks started reporting artificially low rates in 2007 to understate their borrowing costs and look healthier in a shaky economy. The suits also claim the banks manipulated rates

to goose profits from trades in Libor-pegged derivatives and swaps.

The evidence was largely circumstantial until last month, when Barclays and regulators on both sides of the Atlantic reached a \$453 million settlement that included making public a slew of smoking-gun emails. New class actions and other lawsuits have been piling up since.

So far, they involve four types of alleged victims. One is firms that held Libor-linked bonds and other securities issued by banks involved in the rate-setting process. Another is public fund managers, like the city of Baltimore, that bought interest-rate swaps with returns based on Libor. A third is investment funds that traded financial instruments like Eurodollar futures tied to Libor. And finally there are investors who lost money on Barclays shares after the bank revealed its wrongdoing.

The lawsuits rely on essentially three legal theories:

### **Antitrust**

The most popular seems to be that the banks colluded to manipulate Libor in violation of U.S. antitrust laws. But as the banks argued earlier this month, there seems to be no evidence they agreed to do so and, in any event, merely reporting a false interest rate doesn't hurt competition in any market for a product, an element necessary to prove a legal violation. So far, the antitrust argument seems a stretch.

But a lawsuit filed on July 6 takes a different tack. It claims seven banks that help set Euribor, the European interbank offered rate, did collude, and asserts there's proof. The Barclays settlement includes evidence that one of the bank's former traders spoke regularly with traders at other financial institutions about manipulating Euribor to benefit their respective derivatives positions. That could mean trouble, especially since damages are tripled in antitrust cases.

### **Racketeering**

In the lawsuit it filed last year, Charles Schwab accused 16 banks of violating not only antitrust laws but also the U.S. Racketeer Influenced and Corrupt Organizations Act, or RICO. Designed to fight organized crime, the law requires a "pattern of racketeering" such as repeatedly committing certain federal crimes like wire fraud. The banks' behaviour may qualify.

If they lied about Libor, they may have committed wire fraud by sending Schwab and other customers information about the phony rate or, as Barclays did, emailing internally about manipulating the benchmark figure. And if they even remotely coordinated their activities, they may have formed the "criminal enterprise" necessary for a RICO violation.

In addition to triple damages, RICO winners can get legal fees and the losers' property. A RICO action seems the most likely to succeed against the banks - and the most effective way to force a hefty settlement.

## Securities fraud

Barclays investors sued the bank on Tuesday for manipulating Libor to make itself look healthier than it was and for lying about being a “model corporate citizen.” When the truth came out, it wiped some \$6 billion off the value of Barclays’ American Depository Receipts in two days. Shares of other Libor-setting banks also fell and could fall further if any are implicated in the scandal, offering other targets for lawsuits.

It’s a typical stock-drop suit that faces the usual challenges, like proving the wrongdoing actually caused the investors’ losses. It may also run into trouble under a recent Supreme Court decision that at least one federal court has ruled makes securities-fraud laws inapplicable to “predominantly a foreign transaction” like buying ADRs.

But the banks’ legal troubles don’t end there. On Wednesday, the attorneys general of Florida, Massachusetts and several other U.S states said they are determining whether they have jurisdiction over the banks and, if so, whether any residents or agencies of their states lost money because of Libor fudging. Federal criminal investigations are also in the works, with prosecutions of bank executives possible, especially with the public still lusting for rolling heads after the financial crisis.

How much all this may ultimately cost the banks is anyone’s guess. Libor-linked securities and other holdings that investors could claim were affected run to at least \$360 trillion. Analysts at Nomura, Morgan Stanley and elsewhere have come up with guesses that range into the billions of dollars for each bank. But proving that one, or even a handful, of false Libor submissions corrupted pricing based on amalgamating 16 different banks’ quotes is no quick or easy task. Investors will have to decide whether they can stomach the legal limbo.

*Published on 12 July 2012*

## REGULATORS AND POLICIES

### THE CHANCING CHANCELLOR

BY ROBERT COLE

With feelings running high, it is scarcely surprising that some politicians, bankers, lobbyists, commentators, and members of the public have drawn hasty conclusions about Barclays and Libor interest-rate fixing. But George Osborne, the British Chancellor of the Exchequer, is in danger of breaching standards of statesmanship that many in the City of London, and elsewhere, might reasonably expect.

Doubts hang over the approach of the UK's government's chief minister of finance on two specific points. The first in his attempts to divert blame onto his predecessors in government.

It is true that Labour politicians including Gordon Brown, the former prime minister and chancellor, and Ed Balls, the current chief opposition spokesman on finance, have questions to answer about the regulatory regime over which they presided. It is also true that comments ascribed to Osborne in the Spectator magazine are open to interpretation, and may have been over-interpreted. But it is surely wrong for someone in Osborne's position to give the impression that certain individuals are implicated, in a direct sense, in wrongdoing. Unsubstantiated, it is at least unbecoming for a Chancellor of the Exchequer to be associated with such accusations.

Secondly, and perhaps more seriously, Osborne has allowed himself to implicate several other banks - including HSBC, RBS, UBS and Citigroup. These banks, he said while in the privileged surroundings of the House of Commons, "are under investigation".

It is apparent that official enquiries into Libor fixing may well engulf banks other than Barclays. But it is unclear, at present, how far the net will be cast and which institutions will be caught. HSBC, for one, has grounds to gripe about the way Osborne phrased his parliamentary answer on June 28. In its 2011 annual report HSBC has declared it "or its subsidiaries have been the subject of regulatory demands for information and are cooperating with their investigations." Is that tantamount to being "under investigation"? Probably not.

George Osborne is right to adopt a robust approach to the deficiencies in banking that are becoming ever more obvious. But he must also understand the importance of preserving, if not enhancing, the credibility of his office. His approach could do with a reboot.

*Published on 06 July 2012*



*Britain's Chancellor of the Exchequer George Osborne, holds his budget case for the cameras outside number 11 Downing Street. 21/03/2012  
REUTERS/Toby Melville*

## **YOU COULDN'T MAKE IT UP** BY HUGO DIXON

Remember the Bank Rate scandal of 1957? The affair, which transfixed the British public two generations ago, had extraordinary parallels with today's Libor scam. It involved a man called Cameron and another named Mynors.

In September of that year, some traders dumped gilts just before the Bank of England hiked rates, allowing them to avoid losses. Two of the institutions that sold were Lazard and Jardine Matheson. Lord Kindersley, managing director of Lazard, and William Keswick, chairman of Matheson & Co, were also part-time directors of the Bank.

The opposition Labour party demanded a judicial inquiry into alleged insider trading. Harold Wilson, then shadow Chancellor of the Exchequer, finally browbeat the Conservative government into agreeing to one. The verdict was that there was no justification for the allegations about improper disclosure of the rate rise. But in the process, the lifestyle of Britain's ruling class - with meetings on grouse moors and gossip at cocktail parties - was exposed for public consumption.

"History does not repeat itself, but it does rhyme," Mark Twain has been quoted as saying. That's true with the two bank rate scandals. Rather than shooting grouse, the social nexus in question is glimpsed in promises of bottles of Bollinger. And Kindersley and Keswick were members of the British establishment, while Bob Diamond, Barclays' former boss, is a brash American.

What's more, 55 years ago there wasn't even a rate called Libor, which is now a benchmark for at least \$360 trillion of contracts around the world. Britain then had capital controls and the BoE rate scandal was a decidedly local affair.

The cast has also been slightly mixed up. Back then Cameron Cobbald was the BoE's governor; now the Cameron in the frame is the prime minister. In 1957 Humphrey Mynors was deputy governor; today Paul Myners, the former City minister, has a walk-on part as the scourge of Diamond in the public debate.

Wilson's mole was a 19-year-old secretary called Miss Chataway - and she certainly chatted away. The Libor scandal has yet to produce an equivalent, although it's hardly needed when traders are reckless on email and the market and even MPs are following every twist on Twitter.

Some nostalgically talk about the good old days of the City of London. But one thing is abundantly clear: financial scandals are as old as the hills.

*Published on 09 July 2012*

## **TUCKER TRIAL**

### **BY PETER THAL LARSEN**

Paul Tucker emerged from his parliamentary ordeal bloodied but still standing. The Bank of England deputy governor offered a convincing denial that pressure from politicians prompted Barclays to rig interbank rates in 2008. But his explanation lacked clarity, while UK parliamentarians pummelled him for failing to heed earlier warnings about the rate-setting process. Though Tucker is still in the race to become the BoE's next governor, the encounter has somewhat damaged his chances.

Tucker's main challenge at the hearing on Monday was to lay to rest any notion of a political conspiracy to pressurise Barclays into lowering its submissions for the London Interbank Offered Rate (Libor). The allegation - prompted by a note written by Barclays' former Chief Executive Bob Diamond following a phone call between the two men in October 2008 - was dispatched when Tucker answered three questions with the same categorical answer: "Absolutely not".

Tucker's own account of his conversation with Diamond was less satisfactory. The central banker said he was concerned that Barclays was signalling distress by borrowing at higher rates than those quoted by other banks. But he didn't explain what he hoped Diamond would do about it. That leaves some lingering doubt about Tucker's version of events, though most observers are probably more inclined to believe his testimony over



Diamond's.

Where Tucker struggled, however, was amid repeated questions over his failure to heed earlier warnings that the Libor process was flawed. Tucker's insistence that he was not aware of such concerns looked thin - particularly as he chaired a meeting at the BoE in November 2007 where participants raised issues over the reliability, albeit not obviously manipulation, of Libor.

Picking over past events may be unfair on Tucker, who spent most of 2007 and 2008 trying to prevent the crisis from dragging down Britain's financial system. However, with BoE Governor Mervyn King due to retire in less than a year's time, any public appearance was bound to become an extended job interview. Tucker's dismissal of political interference by the previous Labour government could also strain relations with George Osborne, Britain's chancellor of the Exchequer, who has tried to use the affair to score political points.

Tucker had little to gain from the hearing, and so deserves credit for emerging still on his feet. But the bruising he suffered will take some time to heal.

*Published on 09 July 2012*

## **GOVERNOR'S EYEBROWS**

BY HUGO DIXON

In the old days it used to be said the Bank of England governor could get his way by raising his eyebrows. The current governor, Mervyn King, seems to have engaged in heavy arm-twisting to get Barclays to remove its former chief executive Bob Diamond. While the bank itself should have got rid of Diamond because he could not credibly engineer a change in its brash culture, the manner of his departure raises tricky questions.

Marcus Agius, Barclays' chairman, told MPs on July 10 that King "made very plain" to him that Diamond "no longer enjoyed the support of his regulators". But on whose behalf exactly was King speaking? The BoE, after all, is not responsible for supervising banks - and won't be until next year. That's still the job of the Financial Services Authority. If King wasn't speaking for the FSA too, he was arguably stepping beyond his authority.

On the other hand, if the BoE governor was speaking on the FSA's behalf, why didn't the regulator itself deliver the message that Diamond should go? And why too did the FSA apparently change its position? After all, the regulator had only just agreed a settlement with Barclays over the Libor rate-fixing scandal. If it had wanted Diamond to go, that would have been the moment to say so.



*Bank of England Governor King leaves the British prime minister's offices at 10 Downing Street in central London. 04/08/2012  
REUTERS/Toby Melville*

A further question is how exactly the regulators managed to twist Barclays' arm. If the FSA doesn't support a bank director in his role, the current mechanism for removing the executive is to deem him no longer "fit and proper". But it seems hard to argue that Diamond didn't meet that test. After all, the lengthy investigation into the Libor scandal did not criticise him personally.

Some people will no doubt say it is good that Diamond has gone and it doesn't really matter how that was engineered. But methods used in difficult situations can easily become precedents.

The BoE is about to become even more powerful next year when it takes over banking supervision. It is important that it operates in a transparent and accountable fashion.

*Published on 10 July 2012*

## **NOT LOOKING GOOD**

BY HUGO DIXON

Publication of a Timothy Geithner memo has put the Bank of England in a tight spot. Geithner, then president of the New York Federal Reserve, wrote to Mervyn King, the BoE

governor, in June 2008 proposing reforms to prevent “deliberate misreporting” of the London Interbank Offered Rate (Libor). That’s hard to square with evidence given this week to British members of parliament by King’s deputy, Paul Tucker, that he only recently found out about allegations of Libor “low-balling”.

Parliamentarians will presumably grill King when he appears before them next Tuesday. One puzzle is why he was so keen to force the resignation of Bob Diamond, Barclays’ chief executive, last week. It will be a little hard for King to say Diamond was aware that low-balling might be taking place but didn’t address it adequately. After all, a similar criticism could be levelled against King himself.

Tucker is in an even hotter seat. That’s because King asked him to follow up Geithner’s memo, and because the deputy governor also had a conversation with Diamond five months later. Some within Barclays interpreted that conversation as an instruction from the BoE to low-ball the bank’s Libor submissions to avoid the appearance that it was in trouble.



*Tim Geithner testifies on Capitol Hill in Washington. 04/05/2010  
REUTERS/Kevin Lamarque*

The BoE says Geithner’s memo did not cite any evidence of deliberate wrongdoing. However, the memo did recommend that best practices should be established to prevent “accidental or deliberate misreporting” - and suggested that adherence to those practices should be vetted by banks’ auditors. The memo also proposed changes to eliminate the incentive banks had to misreport Libor as a way of hiding their

vulnerability.

When Geithner wrote this memo, he had evidence that Barclays was making dishonest Libor submissions. He didn't convey that evidence to King in this memo. Even so, it is hard to read this as anything other than a warning that deliberate misreporting might be occurring. While that's not quite the same as saying it was going on, Tucker looks like he was at best not very open when he told MPs that he only became aware of allegations of low-balling in the last few weeks.

MPs will get a second chance to grill Tucker next week. Until the Libor scandal blew up, he was the front-runner to succeed King as governor next year. He will have to put in a pretty good performance to keep his candidacy **on track**.

*Published on 13 July 2012*

## QUIS CUSTODIET? BY HUGO DIXON

A year ago Rupert Murdoch was probably the most powerful unelected person operating in Britain. The media baron could seemingly choose prime ministers. Then came the phone hacking and police bribery scandal, after which politicians sought to distance themselves from him.

The title of most powerful unelected Briton now probably belongs to Mervyn King, the governor of the Bank of England. Witness the way he dispatched Barclays' chief executive Bob Diamond two weeks ago in connection with the Libor rate-rigging scandal. Whoever succeeds King next year will have even greater powers. After all, responsibility for financial stability and banking supervision is about to be added to the central bank's main task of running monetary policy. It's vital for democracy that this authority is exercised effectively, transparently and fairly.

Who will be King's successor when he steps down? And how will the new governor be made accountable? These questions have been brought into sharp relief by the Libor scandal. The front runner for King's job has seen his chances knocked, while doubts have been raised about the central bank's effectiveness and transparency.

The next governor will need to be something of a superman. Expertise in how to manage financial crises is probably the top requirement given that the euro could blow up and there wouldn't be time for on-the-job learning. Strong management skills are also important as failure to delegate effectively would lead the incumbent to be swamped. Finally, the governor will have to be a good communicator.

Until the Libor scandal broke, Paul Tucker, one of the BoE's deputy governors, was the favourite. He has a strong track record as a crisis manager. But his apparent failure to recognise early warnings that the Libor interest rate was being rigged has made him look naive.

Another candidate is Adair Turner, chairman of the Financial Services Authority, a large chunk of whose functions are about to be merged into the central bank. Although the FSA hasn't covered itself with glory in investigating the Libor affair, most of the abuses occurred before Turner took the helm.

Both men will be grilled by members of parliament this week, Tucker for the second time. If neither impresses, the field will be wide open for other candidates like Gus O'Donnell, formerly Britain's top civil servant, and Mark Carney, governor of the Bank of Canada.

Holding the next governor accountable will be as important as choosing one. The Bank of England was rightly given considerable independence in 1997 to prevent politicians meddling in monetary policy in order to advance their electoral interests. But the institution and its leader have slipped up on enough occasions that leaving them entirely to their own devices isn't a good option either.

For example, King didn't sound the alarm loudly enough during the credit bubble and was slow to act when there was a run on Northern Rock, the mortgage bank, in 2007. He then long resisted any investigations into the Bank of England's own failings in managing the crisis. Now its hands-off approach to the Libor scandal is being revealed.

Based purely on its record, the central bank wouldn't be receiving extra powers. However, the Conservative-led government has tried to pin the blame for the credit crunch on the previous Labour government's policies - in particular, its decision to take away the central bank's responsibility for banking supervision. Hence, it has become politically convenient to reverse that move.

Given this, the priority should be to enhance the Bank of England's accountability. Under the current system, the government sets inflation targets and picks the governor. It also chooses the deputy governors and members of two committees: the monetary policy committee which sets interest rates; and the financial policy committee which will soon be responsible for financial stability. Their independent members help prevent the governor becoming too dominant.

The Bank of England also has a board, called the Court. But this has been largely ineffective. Though it has recently stepped up its scrutiny of the central bank's executives, it is hamstrung because it rightly has no say over policy or who is the governor.

Meanwhile, parliament can call the governor and other senior officials in to give evidence. Although this is a potentially important check to the central bank's power, MPs haven't yet used this tool effectively. Take the ongoing hearings over the Libor scandal. They did a poor job of interrogating Diamond, failing to coordinate their questions and seeming more intent on grabbing headlines than getting to the truth. While the subsequent sessions were better planned, they were still not penetrating enough.

MPs have a chance to raise their game in this week's hearings. A key line of questioning ought to be how exactly King managed to persuade Barclays to get rid of Diamond. Few people will shed tears at Diamond's departure given that he epitomised the City of London's greed. But the FSA - not the central bank - is still Barclays' primary regulator. Parliamentarians should satisfy themselves that the governor did not overstep his authority.

One way of improving democratic control would be to give MPs the right to hold nomination hearings and, in extremis, reject the government's choice for governor and other top positions. Indeed, that's what parliamentarians want. But the government is resisting. If MPs are to change its mind, they must first show they are up to the job.

It won't just be the Bank of England on trial this week. Parliament too will be in the dock.

*Published on 16 July 2012*

## **BANK BOYCOTT**

BY PETER THAL LARSEN, WAYNE ARNOLD

What would happen if banks abandoned Libor? The Barclays scandal has prompted lenders to rethink their role in setting interest rates. A mass boycott of the London Interbank Offered Rate could throw markets into a tailspin. Regulators need to decide urgently how the benchmark for hundreds of trillions of dollars of contracts should be reformed.

No banks have withdrawn from Libor in the wake of the political firestorm that followed Barclays' admission of rate-rigging. But a growing number of institutions are pulling out of arrangements used to determine lesser-known benchmark rates from Dubai to Tokyo. And Paul Tucker, the Bank of England's deputy governor, last week suggested regulators were making contingency plans to deal with a Libor boycott.

There's nothing to stop banks from pulling out. Libor is fixed each day when banks submit the rates at which they would be able to borrow for a range of currencies and maturities. Participation in the panels is voluntary, and changes are not unusual. West LB, the German lender that is undergoing a severe restructuring, recently withdrew from the panel that sets dollar Libor rates.

Moreover, the \$453 million fine imposed on Barclays for rigging Libor shows involvement in setting the rates is anything but risk-free. Dozens of other banks are still under investigation. And the U.S. Department of Justice's launch of criminal investigations suggests banks and their employees could yet face even tougher sanctions.

Unlike Libor, rates like Tokyo's interbank rate, Tibor, Singapore's Sibor and Dubai's Eibor are unlikely to hurt markets or the banks that turn their backs on them. With the downside so low and the legal liability soaring, shunning these "little" Libors is a no-

brainer. Besides, banks may have sound business reasons for pulling out: RBS, for example, is scaling back its operations in Asia.

A Libor boycott could be disastrous. Despite its flaws, the rate is crucial for pricing hundreds of trillions of dollars of loans and derivatives. Avoiding market disruption may be sufficient to prompt banks to overcome their legal concerns and stick with the Libor-setting process for now. But regulators can help by clearly setting out how the Libor benchmark can be reformed or replaced. They need to get on with it.

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## **WATCHDOGS ON THE SPOT**

**BY HUGO DIXON**

The City of London's regulators aren't looking good after a mauling by parliamentarians. The Bank of England governor and the Financial Services Authority chairman each took a blow in the latest hearings into the Libor rate-fixing affair.

Adair Turner, the FSA chairman and a candidate to be next governor, had to explain why he was happy that Bob Diamond should stay running Barclays on June 27 only to change his mind by June 29. His explanation - that, in the intervening period, there had been a public outcry - wasn't terribly satisfactory. Surely, the regulator should be ahead of the lynch mob not responding to it?



*The chairman of the Financial Services Authority, Adair Turner, leaves Downing Street in central London.  
28/05/2012  
REUTERS/Neil Hall*

Meanwhile, Mervyn King, the current BoE governor, had to explain how he failed to spot in 2008 the possibility that Libor was being manipulated despite two red flags: an article in the Wall Street Journal that raised concerns that banks were “fibbing”; and a memo to him from the New York Federal Reserve which recommended measures to prevent “accidental or deliberate misreporting” of the rate.

King’s response was technical: that, in any market, it is normal to have mechanisms to combat misreporting. So the fact that the NY Fed - then headed by Tim Geithner, the U.S. Treasury Secretary - made such a proposal didn’t count as a suggestion that manipulation was taking place. What’s more, neither the NY Fed nor the WSJ provided evidence of misreporting. It is, though, extraordinary that King failed to put two and two together.

The governor also had to answer the charge that he had overstepped his authority by pressurising Barclays’ chairman to get rid of Diamond, given that it is the FSA’s job to supervise banks. King was guilty of double-speak: he thought it appropriate to push out Diamond, even though this wasn’t in his remit, and yet his excuse for failing to spot the Libor scam was that it wasn’t his job.

Parliamentarians, however, didn’t make the charge of abuse of authority stick. They didn’t even ask the obvious question: what exactly did King tell the Barclays’ chairman? With MPs now heading off on holiday, any further inquisition will have to be down to the BoE’s directors. Hopefully, they will take their responsibility seriously.

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### ON THE COVER

*Bob Diamond, Chief Executive of Barclays PLC, stands next to the eighteenth green during the final round of the Scottish Open golf tournament at Castle Stuart golf course near Inverness, Scotland. 10/07/2011  
REUTERS/David Moir*