WEALTH MANAGER
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Morgan Stanley: what $22bn Libor hit could mean for UK banks.

by Dylan Lobo on Jul 13, 2012 at 07:49

Morgan Stanley fears UK banks could bear the brunt of the Libor rate-rigging scandal as overall costs for the 12 banks involved soar above the $22 billion mark.

In the most detailed note on the scandal to be release so far, the investment bank attempts to assess the impact it will have on the dozen banks caught up in the investigation.

It believes the eventual costs for the banks could breach $22 billion, with legal costs going beyond the $14 billion mark.

Morgan Stanley sees the Libor issue as a ‘particularly contentious’ one for UK banks after Barclays was the first bank to settle the claims.

‘The political climate in the UK appears more hostile to perceived bank wrongdoing than in a number of other jurisdictions,’ Morgan Stanley explained.

It also pointed out that UK authorities are tackling the banks on two fronts, through the launch of a parliamentary inquiry and via a formal investigation by the Serious Fraud Office.

Morgan Stanley offered the following predictions for the three UK banks involved.

Lloyds

‘We expect Lloyds may be less likely to settle for wrongdoing in the trader manipulation case as scope of its investment banking operations is much smaller than its peers’.

‘That said, there may be a greater risk at HBOS (which was acquired by Lloyds) of wrongdoing for inappropriate submissions to avoid negative media/market perceptions.’

Royal Bank of Scotland

‘Media reports suggest that the fine for RBS could be £150 million. If accurate, that could indicate a lower level of wrongdoing than Barclays.

‘We would expect RBS, as a state-controlled bank undergoing significant change, to try and settle early and draw a line under the issue.’

HSBC

‘In common with many of its peers, HSBC has significant trading operations. However, given the low funding cost versus peers, and defensive liquidity profile of HSBC, we could see less likelihood that it would have the necessity to “lowball” Libor submissions.’

The legal threat

Morgan Stanley came to the overall $22 billion figure by adding up the potential regulatory fines, along with damages to investors and counterparties.

So far only Barclays has admitted it manipulated the Libor rate,for which it was punished with a £290 million fine.

Lawyers have warned that the biggest risk for banks is possible class action rather than regulatory fines, which have been described as a mere ‘drop in the ocean’ in comparison.

The report also highlights the potential risk from class action, estimating each bank would pay an average of $400 million in individual damages ranging from $60 million to $1.1 billion. Overall it estimates litigation costs could reach the $14 billion mark.

It also suggests RBS and Deutsche may face the highest legal cost because they have the largest exposure to interest-rate derivative holdings.

Morgan Stanley, which is not among the 12 banks being probed, estimates the fines will trim between 4% and 13% of banks’ earnings for 2012.

The analysts behind the report, led by Betsy Graseck, said: ‘[The estimates] are the result of significant assumption, but we hope to at least provide a framework for how to assess the Libor litigation risk.’

THE NEW YORK OBSERVER

Morning Read

Dimon Set to Tell Whale Tale on Heels of $4.4 Billion Loss: Wall Street Roundup

By Patrick Clark 7:27am

London broil: JPMorgan lost $4.4 billion on derivatives trades made by the firm’s chief investment office, according to a company press release, short of high-end estimates of as much as $9 billion. Meanwhile, a diclosure filed with the Securities and Exchange Commission says that employees may have lied to conceal the scope of losses. JPMorgan’s chief investment office will no longer trade the credit derivatives that lead to the losses. Bruno Iksil, the JPMorgan trader known as the London Whale, has left the firm, The Wall Street Journal reports, along with Achilles Macris and Javier Martin-Artajo, two of Mr. Iksil’s superiors in JPMorgan’s chief investment office. Jamie Dimon &

Co. are hosting what is said to be a two-hour presentation to report second-quarter earnings and break down the firm's recent trading losses. Listen to it here.

Libor-ated: It surfaced earlier in the week that the Federal Reserve Bank of New York had raised concerns about Barclays Libor submissions as early as 2008. Now *The New York Times* has gotten its hands on a May 2008 email from then-New York Fed president Tim Geithner suggesting improvements to the rate-setting process. Ten Democratic senators signed a letter to Attorney General Eric Holder and Mr. Geithner (now Treasury secretary) among others urging a response to the Libor scandal: "We urge you to direct your staff to thoroughly investigate the banks and the process involved in setting Libor for any wrongdoing. Banks and their employees found to have broken the law should face appropriate criminal prosecution and civil action."

Libor liabilities: Alphaville, with the aid of a Morgan Stanley research report, looked at what Libor is likely to cost the banks (something like $450 million to $850 million per bank in fines; about $400 million per bank in litigation costs). Naked Capitalism, also with Morgan Stanley research, speculates to what bankers gained from rigging-rates, and comes up with a roughly $290 million to $360 million per bank in additional compensation over the course of four years.

Futures fiasco: Doubts about PFGBest, the Iowa-based futures broker that filed for bankruptcy this week after regulators discovered that the firm was missing more than $200 million in client funds, go back as far as 2004, The Times reports: In that year, a client wrote to the PFGBest's regulators about potential misuse of client money, and in 2009, a tipster asked the National Futures Association to review the broker's bank account. Reuters, which has been in front of this story from the start, reports that PFGBest founder Russell R. Wasendorf may have lost more than $100 million through his investments in Romanian real estate.

Plan B: Vanguard Group is considering a move into retail banking, which could provide the mutual fund giant with a backup plan pending potential changes to the regulation of money market funds.

Paid up: Wells Fargo will pay a $125 million fine to settle charges that it discriminated against minority borrowers.

Date with lawmakers: HSBC executives will face questions from the Senate's Permanent Subcommittee on Investigations regarding the bank's anti-money laundering efforts.

FRANCE 24 INTERNATIONAL NEWS 24/7

13 July 2012 - 17H56

Morgan Stanley tips LIBOR costs at 12 bn euros

A man looks out of a window at the Barclays bank headquarters in Canary Wharf in east London. A scandal over interbank rate rigging focused on the LIBOR reference rate could cost 11 banks -- including Barclays -- around 12 billion euros ($14.7 billion), a Morgan Stanley study said Friday.

AFP - A scandal over interbank rate rigging focused on the LIBOR reference rate could cost 11 banks, including Barclays Bank, around 12 billion euros ($14.7 billion), a Morgan Stanley study said Friday.

The study only looked at 11 of 18 banks that set the London Interbank Offered Rate (LIBOR) in dollars each day, and did not explain why the other seven were not included.

Morgan Stanley, a US-based investment bank, estimated that each of the 11 banks under consideration would be fined a comparable amount, with the exception of Barclays, which would benefit from having reached an agreement with regulatory authorities before the others.

The total amount in fines, including the one to be paid by Barclays, was tipped to amount to 5.67 billion euros.

But Morgan Stanley also forecast additional costs stemming from the affair of around 6.38 billion euros.

LIBOR is a flagship instrument used all over the world, affecting what banks, businesses and individuals pay to borrow money.

The LIBOR rate is calculated daily by data provider Thomson Reuters, on behalf of the British Bankers' Association using estimates from banks of their own interbank rates.

Barclays was already fined £290 million ($452 million, 360 million euros) by British and US regulators for attempted manipulation of LIBOR and EURIBOR, its euro equivalent, between 2005 and 2009.

Three senior executives, including the bank's chairman and its chief executive, have resigned to acknowledge their share of responsibility in the matter.

Britain's House of Commons is to set up a parliamentary investigation of the affair and the Serious Fraud Office is to launch a criminal probe.

In Brussels, the European Commission has said it will investigate all key rates on interbank markets.

In the United States, the Congress plans to question Treasury Secretary Timothy Geithner and Federal Reserve Chairman Ben Bernanke later this month about the bank-rigging scandal, which threatens to spill over from London to Washington.

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FINANCIAL TIMES

From COMPANIES 4:33pm

JPMorgan hit by $4.4bn trading loss

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US bank indicates London CIO traders masked shortfalls .

- JPMorgan's restatement of first-quarter results
- FT Alphaville JPMorgan earnings call
- Lex Investment banking
- In depth US bank

Stock Market & Financial Investment News

News Breaks

July 13, 2012

11:18 EDT	BCS	**NY Fed submits documents on Barclays-LIBOR matter to Congress** The Federal Reserve Bank of New York said on its website that it submitted documents related to the Barclays-LIBOR matter requested by Chairman Neugebauer of the U.S. House of Representatives, Committee on Financial Services, sub-committee on Oversight and Investigation. The New York Fed said it also released additional materials that document efforts in 2008 to highlight problems with LIBOR and press for reform. :theflyonthewall.com

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July 12, 2012

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07:15 EDT	BCS	theflyonthewall.com:World bank investors push for Libor settlement, Sky News reports Major world bank investors are pushing for a deal to settle the

			Libor-fixing scandal on concerns that there could be a "Barclays (BCS)-style purge" of top executives, Sky News has learned. Reference Link :theflyonthewall.com
06:48 EDT	BCS	theflyonthewall.com:	Spanish prime minister proposes more austerity measures, NY Times reports Subscribe for More Information :theflyonthewall.com
06:18 EDT	BCS	theflyonthewall.com:	ECB's zero rate cuts banks' overnight deposits, Reuters reports The European Central Bank's new zero deposit rate had an immediate impact as it went into effect, as banks more than halved the amount of cash parked there overnight, reports Reuters. One ECB policymaker says he expected the move to increase banks' lending. Reference Link :theflyonthewall.com
July 11, 2012			
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07:27 EDT	BCS	theflyonthewall.com:Moody's changes outlook on Barclays' standalone rating to negative from stable Subscribe for More Information :theflyonthewall.com
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05:33 EDT	BCS	theflyonthewall.com:Barclays announces resignation of CEO Bob Diamond Barclays announced the resignation of Bob Diamond as Chief Executive and a Director of Barclays with immediate effect. Marcus Agius will become full-time Chairman and will lead the search for a new Chief Executive. Marcus will chair the Barclays Executive Committee pending the appointment of a new Chief Executive and he will be supported in discharging these responsibilities by Sir Michael Rake, Deputy Chairman. The search for a new Chief Executive will commence immediately and will consider both internal and external candidates. The businesses will continue to be managed by the existing leadership teams. Diamond said, "I am deeply disappointed that the impression created by the events announced last week about what Barclays and its people stand for could not be further from the truth." :theflyonthewall.com
05:19 EDT	Δ BCS	theflyonthewall.com:Barclays volatility elevated into resignation of CEO Diamond Barclays overall option implied volatility of 52 is above its 26-week average of 47 according to Track Data, suggesting large price movement into CEO Diamond resigning. :theflyonthewall.com
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06:50 EDT	BCS	theflyonthewall.com:	Barclays traders investigated by FBI following Libor scandal, Daily Mail reports Fourteen Barclays (BCS) traders are being investigated by the FBI following the Libor-fixing scandal, reports The Daily Mail. According to the chairman of the Treasury Select Committee, criminal charges could also be brought against individuals in Britain. Reference Link :theflyonthewall.com
05:38 EDT	BCS	theflyonthewall.com:	Barclays announces resignation of Chairman Marcus Agius Barclays announced the resignation of its Chairman, Marcus Agius. The search for a successor both from within the existing Board members and from outside will be led by Sir John Sunderland and will commence today. Agius will remain in post until an orderly succession is assured and Sir Michael Rake has been appointed Deputy Chairman. The Board also agreed to launch an audit of its business practices. The audit will be led by an independent third party reporting to Sir Michael Rake and a panel of Non-Executive Directors. Marcus Agius said, "But last week's events - evidencing as they do unacceptable standards of behaviour within the bank - have dealt a devastating blow to Barclays reputation. As Chairman, I am the ultimate guardian of the bank's reputation. Accordingly, the buck stops with me and I must acknowledge responsibility by standing aside." :theflyonthewall.com
July 1, 2012			
15:09 EDT	BCS	theflyonthewall.com:	Chairman of Barclays set to exit, FT says Subscribe for More Information :theflyonthewall.com
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			victims for four years, reports The Telegraph. Barclays (BCS) alone could face billions of pounds in claims. [Reference Link] :theflyonthewall.com
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Morgan Stanley: bank Libor costs could top $22 billion

Rates scandal may cost banks $22bn
News24 2012-07-13
Morgan Stanley: what $22bn Libor hit could mean for UK banks
Citywire 2012-07-13
Barclays business feels pain of rate fixing scandal
Reuters 2012-07-13
Barclays takes rate fixing scandal hit
Independent online (SA) 2012-07-13
HSBC Reveals Problems With Internal Controls
Jakarta Globe 2012-07-13
Wells Fargo, Libor Defense, Tax Legislation: Compliance
Bloomberg 2012-07-13
Libor Scandal Could Turn 'Ugly' As U.S. Cities Begin To Sue
Huffington Post 2012-07-11
UBS says gave no guidance on possible Libor fine

[Reuters]2012-07-13

Here Come The Libor Liability Estimates

Submitted by Tyler Durden on 07/12/2012 12:13 -0400

Just as we noted here, the analyst estimates for the potential impact of Libor (litigation and regulatory) liabilities have begun. **Morgan Stanley sees up to a 17% hit to 2012 EPS (from $420 to $847 million per bank) in a worst case from just regulatory costs**, and a further **6.8% potential hit to 2013 EPS if the top-down $400 million average per banks losses from litigation** are taken on one year (considerably more if the bottom-up numbers of more than $1 billion are included). They see LIBOR risk in three parts: regulatory fines (we est median 7-12% hit to ‘12 EPS; litigation risk (7% EPS hit over 2 yrs); and less certainty on forward earnings. There are a plethora of assumptions - as one would expect - but the ranges of potential regulatory fine and litigation risk are very large though the MS analysts make the greater point that the LIBOR 'fixing' broadens investor support for more transparency in fixed income trading in addition to fixed income clearing leaving the **threat of thinner margins as another investor concern**.

We estimate LIBOR regulatory fines off of Barclays settlement. Our bull case: a 2-9% hit to 2012e EPS as banks settle with regulators for the same amount as Barclays. Our base case: a 4-13% hit to 2012e EPS as, apart from UBS, banks do not receive the discount that Barclays got for being early and cooperative. Our bear case, 5-17% hit to 2012e EPS: a 30% premium to base case fines to reflect the possibility that the UK Serious Fraud Office layers on new fines once its LIBOR investigation (started July 6) is completed.

Exhibit 3

Sizing Potential Regulatory Settlement by Bank

(millions, local currency)

		Bull	Base	Bear
		In-Line with BARC Penalty	Implied BARC Penalty with No Discount	30% Premium to Base
BAC	USD	456	651	847
C	USD	456	651	847
JPM	USD	456	651	847
CS	SFr	446	636	827
UBS	SFr	446	636	827
DBK	EUR	371	530	689
SG	EUR	371	530	689
RBS	GBP	294	420	546
HSBC	USD	456	651	847
LLOY	GBP	294	420	546

Source: Company Data, Morgan Stanley Research

Exhibit 5

% Impact to 2012 EPS

	Bull	Base	Bear
	In-Line with BARC Penalty	Implied BARC Penalty with No Discount	30% Premium to Base
BAC	4.5%	6.4%	8.4%
C	2.5%	3.6%	4.7%
JPM	1.8%	2.4%	3.3%
CS	9.4%	13.4%	17.4%
UBS	8.1%	11.5%	15.0%
DBK	5.0%	7.2%	9.4%
SG	10.0%	14.3%	18.6%
RBS	9.8%	14.0%	18.1%
HSBC	2.2%	3.1%	4.1%
LLOY	17.7%	25.3%	32.9%
Median	*6.6%*	*9.4%*	*12.2%*

Source: Company Data, Morgan Stanley Research

LIBOR litigation risk is harder to quantify, but we take a stab. We assume every 1bp of LIBOR understatement every day for 4 years represents a $6 billion hit to the LIBOR panel of banks. If the 16 banks listed in the class action lawsuits shared equally, we estimate this would be a ~$400 million hit per bank. Top-down:

Exhibit 10

Estimate Potential Cost Per Bank Based on Size of Rate Derivative Book, 35 bp of LIBOR Suppression Over 4 Years and 1% Probability of Payout

	Rate Derivative Notional (USD trillions)	% Dealer-to-Client or Corporate	% Adversely impacted from supression of LIBOR	Notional amount adversely impacted (USD trillions)	Amount LIBOR understated (bp annualized cost)	probablity of sucessful claim	loss est per 1 bp LIBOR understated ($ millions)
BAC	56.5	24%	50%	6.9	35 bp	1%	994
C	39.9	24%	50%	4.9	35 bp	1%	702
JPM	55.4	24%	50%	6.8	35 bp	1%	975
CS	42.2	24%	50%	5.2	35 bp	1%	742
UBS	33.3	24%	50%	4.1	35 bp	1%	585
DBK	59.1	24%	50%	7.2	35 bp	1%	1,041
SG	18.7	24%	50%	2.3	35 bp	1%	329
RBS	60.0	24%	50%	7.3	35 bp	1%	1,057
HSBC	19.8	24%	50%	2.4	35 bp	1%	348
LLOY	3.3	24%	50%	0.4	35 bp	1%	59
BARC	55.1	24%	50%	6.7	35 bp	1%	970
Total	*443.2*			*54.2*			*7,802*

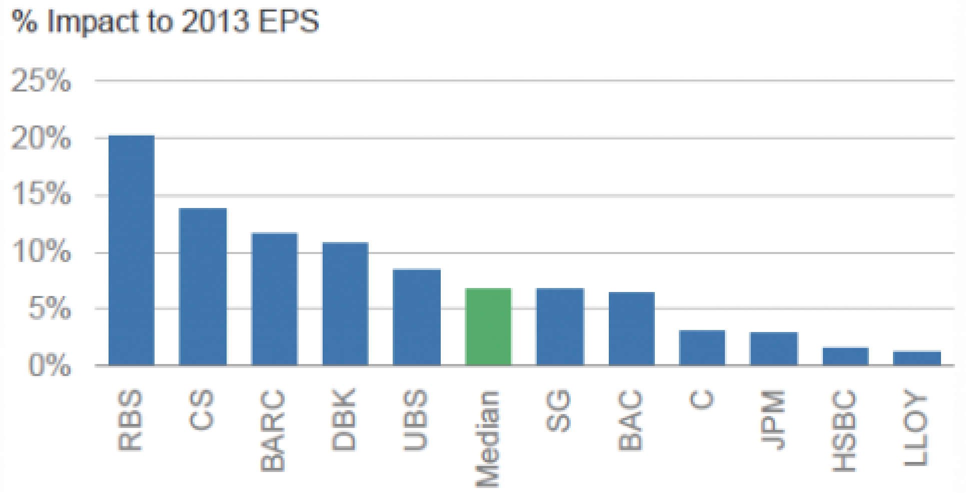
Source: Company Data, Morgan Stanley Research estimate

We use a bottoms-up approach to assess impact on our EPS estimates that is proportional to each bank’s derivative book; we estimate the hit would range from $60 million to $1.1 billion. See page 4 inside for our long list of assumptions in arriving at this estimate. We run both estimated LIBOR fines and litigation charges through our US LC Bank EPS estimates.

Bottom-Up (1 Year EPS Impact):

Exhibit 11

Median 6.8% Potential Hit to 2013 EPS If Fully Taken in 1-Year



Source: Morgan Stanley Research estimate

Bottom-Up (2 Year Total Litigation expectations):

Exhibit 13

If We Assume Settlement Hit Over 2 Years, 2013-14

($ millions)

	Est Total Litigation Settlement	% Impact to 2013 EPS	% Impact to 2014 EPS	% BVPS Impact : 2013	% BVPS Impact : 2014
BAC	994	3%	2%	0.1%	0.1%
C	702	2%	1%	0.1%	0.1%
JPM	975	2%	1%	0.2%	0.2%
CS	742	6%	6%	0.6%	0.5%
UBS	585	4%	4%	0.4%	0.4%
DBK	1,041	5%	5%	0.5%	0.4%
SG	329	3%	3%	0.2%	0.2%
RBS	1,057	10%	7%	0.4%	0.4%
HSBC	348	1%	1%	0.1%	0.1%
LLOY	59	1%	0%	0.0%	0.0%
BARC	970	6%	5%	0.4%	0.4%
Median		*3.4%*	*2.9%*	*0.2%*	*0.2%*

Source: Company Data, Morgan Stanley Research

LIBOR setting changes, debate over industry structure and investor demands for more trade transparency all reduce certainty on forward estimates. Changing LIBOR could shift market share or drive one-off valuation adjustments. Renewed debate in the UK on Vickers/banking separation could resonate elsewhere. More trade transparency could thin margins and shift share further to efficient participants.

Additionally, the LIBOR fixing broadens investor support for more transparency in fixed income trading in addition to fixed income clearing. The threat of thinner margins is another investor concern. **Counterparties with the most transparent trading and clearing platforms ultimately win, speaks to a need for strong electronic trading backbone in FICC, as well as size/scale.** So the big get bigger once again... *Source: Morgan Stanley*