

## CLIENT MEMORANDUM

# CFTC Settles Benchmark Manipulation Case Against RBS for \$85 Million

February 6, 2017

## AUTHORS

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On February 3, 2017, the Commodity Futures Trading Commission issued an Order that resolved an investigation of Royal Bank of Scotland plc (“RBS”) for attempted manipulation of the U.S. Dollar International Swaps and Derivatives Association Fix (“USD ISDAFIX”) benchmark in violation of the Commodity Exchange Act (“CEA”) and CFTC regulations. The Order requires RBS to pay an \$85,000,000 civil monetary penalty and to undertake significant remedial measures to strengthen its internal controls and procedures relating to the fixing of interest-rate swap benchmarks and related supervision of its USD interest rate swaps, options and exotics desk. RBS did not admit or deny the findings or conclusions set forth in the Order. This is yet another in a series of CFTC “benchmark” manipulation cases that the CFTC has pursued over the last few years, including settlements by the CFTC in 2016 against two major U.S. dealers on similar charges. Fines in those cases exceeded \$200 million in one case and \$100 million in the other. Aitan Goelman, the former Director of the CFTC’s Division of Enforcement, asserted in the CFTC’s press release that these cases “make clear that the [CFTC] takes very seriously its role in ensuring the integrity of any and all benchmarks used in our markets.”

The USD ISDAFIX rate was established by ISDA to provide a par swap curve derived from independently calculated reference values for cash settlement of options on interest rate swaps, or swaptions. The intent was to enhance transparency and price certainty. [ISDA Press Release \(March 25, 1998\)](#). As the derivatives market has grown, the rate has been used widely for a variety of purposes, including as a valuation tool for other over-the-counter interest rate

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products as well as a reference for listed derivatives and offerings in the debt capital markets. For example, USD ISDAFIX is used in settlement of interest rate swap futures contracts traded on the Chicago Mercantile Exchange and as a component in the calculation of various proprietary interest rate indices and structured products. During the time relevant to the Order, USD ISDAFIX was set each day via a process beginning at 11:00 AM Eastern, referred to as the “fixing,” by which banks would submit swap rates and spreads, which were averaged to create the USD ISDAFIX reference rates and spreads.

The CFTC determined that RBS attempted to manipulate USD ISDAFIX rates through its trading at the 11:00 AM fixing in order to benefit RBS’s derivatives positions in fixed income instruments, specifically cash-settled options on interest rate swaps settling or resetting against the USD ISDAFIX. All of the activity was carried out through the U.S. trading desks. The CFTC summarized the relevant conduct as follows:

As evidenced by the communications among RBS traders and between RBS traders and their brokers, as well as their actual trading conduct, RBS traders specifically intended to manipulate USD ISDAFIX by placing bids or offers or executing trades in the moments leading into 11:00 a.m. designed in a manner, including timing and pricing, to increase or decrease swap spreads and/or U.S. Treasury Rates at 11 :00 a.m., with the intent to affect levels reported on the 19901 screen and USD ISDAFIX fixings. Moreover, the evidence reflects that the traders intended such trading conduct to affect the fixings in order to benefit RBS’s trading positions against the firm’s counterparties.

In support of its Order, the Commission references a number of problematic email and instant message communications and audio tape recordings, most notably the following:

ISDAFIX is like *[expletive]*, you know, it’s job done now, you know ... we’ll have one guy working the treasuries ... I’ll be in the screens with [Swaps Broker employee (“Swaps Broker 1”)] working the ISDAFIX screen ... spreads ... if we’re sitting there hammering 12, 15s, 20s and stuff like that that’s *[expletive]* easy ... We’ll jack up all the spreads, hit the notes down, ISDAFIX prints.

According to the CFTC, “[t]his frank statement illustrates the two methods used by RBS to attempt to manipulate the ISDAFIX rate: swap spreads and U.S. Treasuries trading.” Order at 3. Notably, and similar to other benchmark cases, the Order includes a footnote that “[i]rrespective of whether the RBS traders had an interest in hedging, the traders engaged in attempted manipulation when they placed bids and offers or executed around 11:00 a.m. with the improper intent to move the USD ISDAFIX rate in RBS’s favor.” The Commission determined that RBS, through its traders, engaged in acts of attempted manipulation in violation of Sections 6(c), 6(d), and 9(a)(2) of the CEA, 7 U.S.C. §§ 9, 13b, 13(a)(2) (2006). Additionally, with respect to conduct occurring on or after August 15, 2011, the Commission held that RBS engaged in acts of attempted manipulation in violation of Section 6(c)(3), 7 U.S.C. § 9(3) (2012), and Regulation

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180.2, 17 C.F.R. § 180.2 (2015), and RBS, through its traders, used or attempted to use a manipulative device in violation of Sections 6(c)(1) and 6(c)(l)(A), 7 U.S.C. §§ 9(1), 9(1)(A) (2012), and Regulation 180.l(a), 17 C.F.R. § 180.l(a) (2015). The settlement order noted that authority to initiate the proceedings and impose sanctions had been granted as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the activity followed adopted of the Dodd-Frank Act.

The CFTC acknowledged assistance from the United Kingdom's Financial Conduct Authority and the Newark, New Jersey Field Office of the Federal Bureau of Investigation. The Order does not name any of the individual traders.

To settle the matter, RBS agreed to pay the aforementioned \$85 million civil penalty and also to submit two compliance monitoring reports to the Commission within 120 days and 365 days of the date of the Order. The compliance reports will provide updates on a number of reforms to RBS's internal controls, policies and procedures that the company already is undertaking and additional control measures imposed by the order.

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