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# **REPORT FOR CONGRESS**

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# **POSSIBLE ACTIONS RELATING TO THE LIBOR SCANDAL (Part Two)**

*Brazil and Japan*

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## LAW LIBRARY OF CONGRESS

### BRAZIL

#### POSSIBLE ACTIONS RELATING TO THE LIBOR SCANDAL

##### *Executive Summary*

*Attempts to manipulate the London Interbank Offered Rate (Libor) triggered a scandal that affected several countries and companies operating in the finance market all over the world. The domestic benchmark used in Brazil is the SELIC rate, while the Libor rate is only used as a benchmark for some international transactions. Domestic law punishes violations of the economic order with fines and administrative measures, while the Public Prosecutor's Office defends the legal order by bringing public criminal and civil actions as provided by law. Brazil has apparently yet to consider the possibility of taking any measure or legal action against the entities behind the scandal for possible damages caused within the country.*

#### **I. Reactions to the Libor Scandal**

No reports have been located concerning possible actions in Brazil in relation to the Libor scandal. The institutions researched, including, *inter alia*, the Brazilian Central Bank, the Administrative Council for Economic Defense (Conselho Administrativo de Defesa Econômica, CADE), the Secretariat of Economic Monitoring (Secretaria de Acompanhamento Econômico, SEAE), the Brazilian News Agency, the Ministry of Foreign Affairs, and the Public Prosecutor's Office (Ministério Público da União),<sup>1</sup> did not provide any information in this regard.

The Libor rate is not widely used in Brazil's financial system. The domestic benchmark rate in Brazil is the SELIC rate, which is established by the Monetary Policy Committee. The Libor rate is only used in Brazil as a benchmark for some international transactions. For example, article 1(§2)(III) of Resolution No. 3,622 issued by the Brazilian Central Bank on October 9, 2008, determines that the financial burdens on loan transactions in foreign currency will be the Libor rate plus a percentage set by the Brazilian Central Bank in accordance with market conditions.<sup>2</sup>

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<sup>1</sup> The Public Prosecutor's Office (*Ministério Público*) is a permanent institution, charged with the duty of defending the legal order, the democratic regime, and inalienable social and individual interests. CONSTITUIÇÃO FEDERAL [C.F.], art. 127, [http://www.planalto.gov.br/ccivil\\_03/Constituicao/Constituicao.htm](http://www.planalto.gov.br/ccivil_03/Constituicao/Constituicao.htm). For the institutional functions of the Public Prosecutor's Office, see art. 129 of the Constitution.

<sup>2</sup> Resolução No. 3622 de 9 de Outubro de 2008, BANCO CENTRAL DO BRASIL, [http://www.bcb.gov.br/pre/normativos/res/2008/pdf/res\\_3622\\_v6\\_p.pdf](http://www.bcb.gov.br/pre/normativos/res/2008/pdf/res_3622_v6_p.pdf) (last visited July 17, 2012).

## II. Legal Framework

This report provides a brief explanation of the legal framework regarding competition and antitrust law in Brazil; the role of the various institutions involved in safeguarding competitiveness, monitoring the economy, and creating guidelines for monetary policy and short-term interest rates; and how the average rate of daily financing is established.

## III. Competition/Antitrust Law

Law No. 12,529 of November 30, 2011, organizes the Brazilian System for the Protection of Competition (Sistema Brasileiro de Defesa da Concorrência, SBDC) and provides for the prevention and repression of offenses against the economy. The Law was prepared in accordance with the constitutional principles of free enterprise, free competition, the social function of property, consumer protection, and restraint of economic power abuses.<sup>3</sup>

Under any circumstances, acts that are intended or capable of producing the following effects are considered violations of the economic order, regardless of fault and even if they are not achieved:

- I – To limit, restrain, or in any way injure open competition or free enterprise;
- II – To control a relevant market of goods or services;
- III – To arbitrarily increase profits; and
- IV – To abuse a dominant position.<sup>4</sup>

The following acts, among others, are considered offenses to the economic order as established in article 36 of Law No. 12,529:<sup>5</sup>

- I – To agree, combine, manipulate, or previously agree with a competitor, in any form, on:
  - a) the prices of goods or services offered individually;
  - b) the production or sale of a restricted or limited amount of goods or the provision of a number, volume, or frequency of services;
  - c) the division of parts or segments of an actual or potential market for goods or services by, among others, the distribution of customers, suppliers, regions, or time periods;
  - d) prices, terms, benefits, or abstention in a public bidding process;

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<sup>3</sup> Lei No. 12.529, de 30 de Novembro de 2011, art. 1, [http://www.planalto.gov.br/CCIVIL\\_03/ Ato2011-2014/2011/Lei/L12529.htm](http://www.planalto.gov.br/CCIVIL_03/ Ato2011-2014/2011/Lei/L12529.htm).

<sup>4</sup> *Id.* art. 36.

<sup>5</sup> *Id.* art. 36(§3.)

Those responsible for these offenses against the economic order are subject to fines and other administrative measures according to articles 37 to 45 of Law No. 12,529.

### A. Brazilian System for the Protection of Competition

The SBDC is comprised of the Administrative Council for Economic Defense (CADE) and the Secretariat of Economic Monitoring (SEAE) of the Ministry of Finance, with its duties set forth in Law No. 12,529.<sup>6</sup>

#### 1. Administrative Council for Economic Defense

The CADE is a federal agency (*autarquia*) subordinate to the Ministry of Justice, with its headquarters located in the Federal District. CADE exercises the powers granted to it by Law No. 12,529 throughout the country.<sup>7</sup> CADE is the entity within the executive branch responsible for guaranteeing free competition, and it is charged with the duty of investigating and providing final administrative decisions on issues dealing with competitiveness. It is also responsible for promoting and disseminating the culture of free competition. CADE has three main functions: preventive, punitive, and educational.<sup>8</sup>

#### 2. Secretariat of Economic Monitoring

The SEAE is the main organ of the executive branch responsible for monitoring the prices of and supporting decisions on adjustments and revisions to public tariffs, as well as assessing companies' mergers and repressing anticompetitive conduct.<sup>9</sup>

### B. Public Prosecutor's Office

Criminal and civil actions would most likely fall within the scope of the Public Prosecutor's Office, which, according to article 129 of the Constitution,<sup>10</sup> has the following institutional functions:

- I) to bring with exclusive jurisdiction public criminal actions (*ação penal pública*), as provided by law;
- II) to ensure effective respect by the public powers and relevant public services for the rights guaranteed in the Constitution, taking the required actions for their guarantee;
- III) to promote civil investigation (*inquérito civil*) and public civil action (*ação civil pública*) to protect public and social patrimony, the environment, and other diffuse and collective interests;

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<sup>6</sup> *Id.* art. 3.

<sup>7</sup> *O que é o CADE?*, CONSELHO ADMINISTRATIVO DE DEFESA ECONÔMICA, <http://www.cade.gov.br/Default.aspx?de5fa16eb251d376c2> (last visited July 12, 2012).

<sup>8</sup> *Id.*

<sup>9</sup> *Conheça a SEAE*, SECRETARIA DE ACOMPANHAMENTO ECONÔMICO, [http://www.seae.fazenda.gov.br/conheca\\_seae](http://www.seae.fazenda.gov.br/conheca_seae) (last visited July 12, 2012).

<sup>10</sup> C.F. art. 129.

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VIII) to request investigation and prosecution of police investigations, indicating the legal grounds for their procedural acts.

The legitimacy of the Public Office for civil actions under article 129 of the Constitution does not prevent the actions of third parties in the same cases, according to the provisions of the Constitution and the law.<sup>11</sup>

#### IV. Monetary Policy Committee

In Brazil, guidelines for monetary policy and short-term interest rates are established by the Monetary Policy Committee (Comitê de Política Monetária, COPOM), which is subordinate to the Brazilian Central Bank.<sup>12</sup> COPOM was created to enhance monetary policy transparency and to provide adequate regularity to the monetary policy decision-making process, a step similar to what was adopted by the Federal Open Market Committee of the Federal Reserve Bank of the United States and the Central Bank Council of the Central Bank of Germany. In June 1998, the Bank of England also established a Monetary Policy Committee, as did the European Central Bank, due to the creation of the single European currency in January 1999.<sup>13</sup>

In 1999, Brazil implemented a formal inflation-targeting framework for monetary policy.<sup>14</sup> Under the inflation-targeting regime, COPOM's monetary policy decisions have as their main objective the achievement of the inflation targets set by the National Monetary Council<sup>15</sup> (Conselho Monetário Nacional, CMN).<sup>16</sup> If inflation breaches the target set by the CMN, the president of the Central Bank is required to write an open letter to the Minister of Finance explaining the reasons why the target was missed, as well as the measures required to bring inflation back to the target and the time period over which these measures are expected to take effect.<sup>17</sup>

COPOM's objectives are to implement monetary policy, set the goal for the SELIC rate (the average rate for daily financing, backed by federal bonds),<sup>18</sup> determine the likely future

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<sup>11</sup> *Id.* art. 129(§1).

<sup>12</sup> *COPOM, Definição e Histórico*, BANCO CENTRAL DO BRASIL, <http://www.bcb.gov.br/?COPOMHIST> (last visited July 11, 2012).

<sup>13</sup> *Id.*

<sup>14</sup> Decreto No. 3.088, de 21 de Junho de 1999, art. 1, [http://www.planalto.gov.br/ccivil\\_03/decreto/D3088.htm](http://www.planalto.gov.br/ccivil_03/decreto/D3088.htm).

<sup>15</sup> BANCO CENTRAL DO BRASIL, *supra* note 12.

<sup>16</sup> CMN is the highest deliberative body of the National Financial System (*Sistema Financeiro Nacional*). CMN must establish the general guidelines for the monetary, exchange and credit policies; regulate the conditions of formation, operation and supervision of financial institutions and regulate instruments of monetary policy and exchange rate. CMN is composed of the Minister of Finance (Chairman), the Minister of Planning and Budget, and the President of the Brazilian Central Bank. *Conselho Monetário Nacional*, MINISTÉRIO DA FAZENDA, <http://www.fazenda.gov.br/portugues/orgaos/cmn/cmn.asp> (last visited July 11, 2012).

<sup>17</sup> BANCO CENTRAL DO BRASIL, *supra* note 12.

<sup>18</sup> *Id.* The SELIC rate is established by the Special System of Settlement and Custody (*Sistema Especial de Liquidação e Custódia – SELIC*).

trend of the SELIC, and analyze the “Inflation Report.” The interest rate established in the COPOM meeting is the target for the SELIC rate, which lasts for the entire period between regular meetings of the committee.<sup>19</sup>

COPOM is composed of the members of the Central Bank’s Board of Directors: the President of the Central Bank and the Directors of Monetary Policy, Economic Policy, Special Studies, International Affairs, Norms and Financial System Organization, Financial Supervision, and Bank Privatization and Administration. The president of the Central Bank holds the deciding vote in cases where the COPOM is evenly split on a monetary policy decision.<sup>20</sup>

## V. Special System for Settlement and Custody

The following is an explanation of the Special System for Settlement and Custody from the Brazil Central Bank website:

The Sistema Especial de Liquidação e de Custódia – Selic (Special System for Settlement and Custody) is the settlement system for most – around 96% – of central government’s domestic securities.

Selic started its operations in 1979, resulting from a joint effort of BCB and market participants represented by the National Association of Financial Market Institutions (Andima). Since then, all of the relevant government securities in Brazil were dematerialized and kept in custody in Selic.

With the restructuring of the Brazilian payments system in 2002, Selic was reformed to follow international recommendations for securities settlement systems, providing from then on immediate, simultaneous and final transfer of securities and, through a direct link with STR (Central Bank Money Transfers System), bank reserves (genuine DVP-1).

Further to outright purchases/sales and to repurchase agreements (repos), some facilities were developed in Selic to enhance liquidity in the secondary market. One such mechanism allows the association of an outright purchase to an intraday repo operation, so that the buyer can settle the former using funds provided by the latter and, later on, by means of a similar association, repurchase the bonds with the resources obtained by simultaneously selling them.

Among Selic’s extensions, the most important, from a monetary policy perspective, are the auction systems used for National Treasury’s public offerings and to BCB’s open market operations. Commercial banks, investment banks and broker houses participate in Selic, but mutual funds, pension funds and other institutional investors may also hold individual accounts. Special services have been developed in Selic to meet requirements of clearinghouses, such as special accounts where guarantees are held.<sup>21</sup>

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<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Selic – Introduction*, BANCO CENTRAL DO BRASIL, [http://www4.bcb.gov.br/pom/demab/selic/introselic\\_eng.asp?idioma=I](http://www4.bcb.gov.br/pom/demab/selic/introselic_eng.asp?idioma=I) (last visited July 11, 2012). For information on how the SELIC rate is calculated, *see*

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JAPAN

POSSIBLE ACTIONS RELATING TO THE LIBOR SCANDAL

*Executive Summary*

*Japan's Financial Services Agency has the authority, under the Financial Instruments and Exchange Act, to sanction a financial instruments business operator when its employees manipulate the Euroyen Tokyo Interbank Offered Rate (Tibor) rate calculations. Two financial instruments business operators were sanctioned and suspended from their related business for a few weeks in connection with a Tibor manipulation case in December 2011. Unless actual manipulation of the rates and damages are proved, fraud or tort provisions are not applied under Japanese law.*

**I. Administrative Actions**

In 2011, Japan's Securities and Exchange Surveillance Commission (SESC) ordered Citigroup Global Markets Japan Inc. (Citi) and UBS Securities Japan Ltd. (UBS) to submit reports concerning the involvement of their directors and employees in the Euroyen Tokyo Interbank Offered Rate (Tibor) and Yen London Interbank Offered Rate (Libor).<sup>1</sup> The SESC examined whether employees at Citi and UBS pushed banks to submit interest rates that would ensure that Tibor moved to the brokerages' advantage.

The Financial Instruments and Exchange Act (FIEA) authorizes the Prime Minister to order a financial instruments business operator to submit reports or materials that will be helpful for understanding the business or property of the operator, if necessary and appropriate for the public interest or protection of investors.<sup>2</sup> This authority is vested in the SESC through the Financial Services Agency (FSA).<sup>3</sup> The SESC is under the jurisdiction of the FSA.<sup>4</sup>

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<sup>1</sup> Press Release, SESC, Recommendation for Administrative Action Based on Findings of the Inspection of Citigroup Global Markets Japan Inc. (Dec. 9, 2011), <http://www.fsa.go.jp/sesc/english/news/reco/20111209-2.htm> (unofficial translation); Press Release, SESC, Recommendation for Administrative Action Based on Findings of the Inspection of UBS Securities Japan Ltd. (Dec. 9, 2011), <http://www.fsa.go.jp/sesc/english/news/reco/20111209-1.htm> (unofficial translation).

<sup>2</sup> Kinyū shōhin torihiki hō [Financial Instruments and Exchange Act] (FIEA), Act No. 25 of 1948, last amended by Act. No. 65 of 2008, art. 56-2, para. 1, English translation available through Japanese Law Translation, at <http://www.japaneselawtranslation.go.jp/?re=02>. Japanese Law Translation is managed by the Ministry of Justice.

<sup>3</sup> *Id.* art. 194-7.

<sup>4</sup> *History of the SESC*, in SECURITIES AND EXCHANGE SURVEILLANCE COMMISSION 2 (Sept. 2011), <http://www.fsa.go.jp/sesc/english/aboutsesc/aboutsesc01.pdf>.

### A. Tibor Case

The SESC found that a director of Citi “had continuously conducted approaches such as requesting a person in charge of submitting the TIBOR rates of Citibank Japan Ltd. . . . to change its rates since around April 2010 at the latest.”<sup>5</sup> Also, it found that a Japanese yen rates trader had, since he joined Citi in December 2009, “continuously conducted approaches such as requesting persons in charge of submitting the TIBOR rates of other banks” to report rates at different levels “for the purpose of fluctuating TIBOR so as to give advantages to the Derivatives Transactions related to yen rates” that the director and a trader were conducting.<sup>6</sup>

The SESC found that a yen rates trader at UBS “had continuously conducted approaches such as requesting a person in charge of submitting the TIBOR rates of UBS AG, Tokyo Branch . . . to change its rates since around March 2007 at the latest, and also had continuously conducted approaches such as requesting persons in charge of submitting the TIBOR rates of” UBS AG, Tokyo Branch and other banks “since around February 2007 at the latest, for the purpose of fluctuating TIBOR so as to give advantages to the Derivative Transactions related to yen rates” that the trader was conducting.<sup>7</sup>

The SESC found that the actions conducted by a director and traders of Citi and UBS were “seriously unjust and malicious, and could undermine the fairness of the markets,” and acknowledged that the actions had “a serious problem from the viewpoints of the public interest and protection of investors.”<sup>8</sup>

### B. Libor Case

Furthermore, the SESC found that Citi’s trader had “continuously conducted inappropriate approaches such as requesting to change the Yen-LIBOR rates that Citibank group submitted, since December 2009.” It found that the UBS trader “had also continuously conducted inappropriate approaches such as requesting to change the Yen-LIBOR rates that UBS group submitted, since around June 2007 at the latest.”

### C. Sanctions

When the SESC investigates a case, it can recommend that the Prime Minister and the Commissioner of the FSA take administrative action.<sup>9</sup> Under the Financial Instruments and Exchange Act, if the Prime Minister finds that a financial instruments business operator has

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<sup>5</sup> Press Release, Recommendation for Administrative Action Based on Findings of the Inspection of Citigroup Global Markets Japan Inc., *supra* note 1.

<sup>6</sup> *Id.*

<sup>7</sup> Press Release, Recommendation for Administrative Action Based on Findings of the Inspection of UBS Securities Japan Ltd., *supra* note 1.

<sup>8</sup> *Id.*; Press Release, Recommendation for Administrative Action Based on Findings of the Inspection of Citigroup Global Markets Japan Inc., *supra* note 1.

<sup>9</sup> Kinyū chō secchi hō [Act for Establishment of FSA], Act No. 130 of 1998, *last amended by* Act No. 32 of 2010, art. 20, para. 1.

conducted a wrongful act or extremely unjust act with regard to the financial instruments business and the circumstances are especially serious, he or she may rescind its registration or its authorization for certain security business, or order suspension of all or part of its business for a period not exceeding six months.<sup>10</sup> This authority of the Prime Minister is vested in the Commissioner of the Financial Services Agency.<sup>11</sup>

As mentioned above, the SESC investigated the Citi and UBS cases and found that the banks had committed extremely unjust acts. In addition, the SESC found failures of internal controls at both firms, and concluded that the circumstances were very serious. The SESC issued recommendations on December 9, 2011, that the Prime Minister and the Commissioner of the FSA take administrative actions and any other appropriate measures against Citi and UBS.<sup>12</sup>

Based on the recommendations, the FSA issued administrative sanctions against Citi and UBS.<sup>13</sup> Citi had its derivative transactions related to Tibor and Libor suspended from January 10 to January 23, 2012.<sup>14</sup> UBS's derivative transactions related to Tibor and Libor were suspended from January 10 to January 16, 2012.<sup>15</sup> The FSA also issued business improvement orders<sup>16</sup> against them. They were required to submit a written report to the FSA every three months. Their affiliated companies, Citibank Japan Ltd. and UBS AG, Japan branches, also received business improvement orders<sup>17</sup> and are required to submit a written report to the FSA every three months because they did not have effective internal control systems in place. They had received information regarding the Tibor submission from Citi and UBS employees, but did not properly report to their management teams.<sup>18</sup>

## II. Other Laws

The Anti-Monopoly Act<sup>19</sup> and the Unfair Competition Prevention Act<sup>20</sup> do not have provisions that apply to the manipulation of Libor or Tibor rates.

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<sup>10</sup> FIEA, Act No. 25 of 1948, *last amended* by Act No. 65 of 2008, art. 52, para. 1, item 9.

<sup>11</sup> *Id.* art. 194-7.

<sup>12</sup> SESC, *supra* note 1.

<sup>13</sup> FIEA art. 52, para. 1, item 9.

<sup>14</sup> *Administrative Action on Citigroup Global Markets Japan Inc.*, FSA (Dec. 16, 2011), <http://www.fsa.go.jp/en/news/2011/20111216-2.html> (provisional translation).

<sup>15</sup> *Administrative Actions Against UBS Securities Japan Ltd. and UBS AG, Japan Branches*, FSA (Dec. 16, 2011), <http://www.fsa.go.jp/en/news/2011/20111216-3.html> (provisional translation).

<sup>16</sup> FIEA art. 51.

<sup>17</sup> Ginkō hō [Banking Act], Act No. 59 of 1981, *last amended* by Act No. 53 of 2011, art. 26.

<sup>18</sup> FSA, *supra* note 15; *Administrative Actions Against Citibank Japan Ltd.*, FSA (Dec. 16, 2011), <http://www.fsa.go.jp/en/news/2011/20111216-1.html> (provisional translation).

<sup>19</sup> Shiteki dokusen no kinshi oyobi kōsei torihiki no kakuho ni kansuru hōritsu [Act on Prohibition of Private Monopolization and Maintenance of Fair Trade], Act No. 54 of 1947, *last amended* by Act No. 51 of 2009. The English translation of the Anti-Monopoly Act is available on the Fair Trade Commission website, [at http://www.jftc.go.jp/en/legislation\\_guidelines/ama/amended\\_ama09/index.html](http://www.jftc.go.jp/en/legislation_guidelines/ama/amended_ama09/index.html).

In order to prove the crime of fraud under the Penal Code,<sup>21</sup> it would need to be shown that someone obtained a profit as a result of the manipulation of the Libor and Tibor rates. In the Citi and UBS cases, the SESC did not find that the Tibor rate was actually manipulated.<sup>22</sup> It may also be difficult to apply Civil Code tort provisions to this conduct because harm must be proved.<sup>23</sup>

### III. Japanese Bankers Association's Reaction

The Japanese Bankers Association started to review the method of calculating Tibor in July 2012 to improve the transparency of Tibor calculation methods. Reporting the name of officials who submit their banks' interest rates for Tibor calculations and the basis of the calculations may be considered.<sup>24</sup>

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<sup>20</sup> Fusei kyōsō bōshi hō [Unfair Competition Prevention Act], Act No. 47 of 1993, *last amended by* Act No. 55 of 2006.

<sup>21</sup> Keihō [Penal Code], Act No. 45 of 1907, *last amended by* Act No. 156 of 2004, art. 246.

<sup>22</sup> *Kanshii, shiti kei shōken to UBS shobun kankoku happyō [SESC Released Its Recommendations to Sanction Citi and UBS]*, NIHON KEIZAI SHINBUN (Dec. 9, 2011), [http://www.nikkei.com/markets/features/12.aspx?g=DGXNASGC09017\\_09122011EE2001](http://www.nikkei.com/markets/features/12.aspx?g=DGXNASGC09017_09122011EE2001).

<sup>23</sup> Minpō [Civil Code], Act No. 89 of 1896, *last amended by* Act No. 50 of 2006, art. 709.

<sup>24</sup> *Ei bākureizu fusei: zenginkyō, Tokyo shijō ban no bōshi saku kentō [UK Barclays Manipulation: Japanese Bankers Association, Considering Prevention Measures for Tokyo Market]*, SANKEIBIZ (July 11, 2012), [http://newsbiz.yahoo.co.jp/detail?a=20120711-00000500-biz\\_san-nb](http://newsbiz.yahoo.co.jp/detail?a=20120711-00000500-biz_san-nb).