Article

Anti-trust Litigation: An Increasing Threat for Banks?

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Article

After the financial crisis, there was a widespread view among regulators that banks had become concentrated and abused their dominant position to control the CDS market and rig interbank rates. This article describes the recent antitrust enforcement developments, some of the possible underlying reasons for increased antitrust scrutiny, and whether banking and financial institutions can protect themselves from future investigations.

What the Problem was?

In 2011, the European Commission had opened two antitrust investigations concerning the Credit Default Swaps market on whether 16 investment banks have colluded to control the financial information on CDS. The 16 CDS bank dealers are: JP Morgan, Bank of America Merrill Lynch, Barclays, BNP Paribas, Citigroup, Commerzbank, Crédit Suisse First Boston, Deutsche Bank, Goldman Sachs, HSBC, Morgan Stanley, Royal Bank of Scotland, UBS, Wells Fargo Bank/Wachovia, Crédit Agricole and Société Générale. The European inquiry focused on bank's activities from 2006 to 2009 when two exchanges, the Deutsche Börse and the Chicago Mercantile Exchange, were trying to enter the credit derivatives business but complained that they were prevented by the banks from accessing information necessary for trading in CDS. Further they were refused licenses and even some banks tried to prevent them from entering the market by choosing another clearing house.

What was the aim of the EU Commission's investigations?

In the first investigation, the European Commission said that it would focus on finding what financial information is necessary for trading in CDS. The Commission stated that it "has indications that the 16 banks that act as dealers in the CDS market give most of the pricing, indices and other essential daily data only to Markit," [9] which may potentially have harmed any of Markit's competitors. The second investigation focused on a series of agreements between the banks and ICE Clear Europe which, according to the European Commission, "contain a number of clauses such as preferential fees and profit sharing agreements which might have created an incentive for the banks to use only ICE as a clearing house" and prevent other competitors from entering the market.[10]

Preliminary Findings from the EU Commission and what it means for the banks

On July 1 2013, the antitrust division of the European Commission announced that its investigators had come to a "preliminary conclusion" and that the banks and two entities controlled by them had infringed European antitrust rules. These entities colluded "to prevent exchanges from entering the credit derivatives business between 2006 and 2009." [11] Both exchanges, Deutsche Börse and the Chicago Mercantile Exchange, had applied for licenses and data from ISDA and Markit to begin trading futures contracts based on CDS, but the banks that control ISDA and Markit refused to provide licenses for exchange trading, and several banks tried to shut out the exchanges by choosing another

clearing house for trades, ICE Clear Europe, which they owned. If there is enough evidence of antitrust infringements by any of the entities, the commission can impose a fine of up to 10 percent of a bank's revenue.

Concurrent Investigations by the US Department of Justice

Back in 2009, the SEC and CFTC began investigations when it was reported that in 2008 the LIBOR rate showed lower borrowing costs for banks than other market measures. The aim of the investigation was to find out whether the banks had provided incorrect information on their borrowing costs to intentionally hide their true financial condition.

The US Department of Justice Anti-trust Division also started investigations against banks on indications that the market had become concentrated. In the United States, price-fixing is prosecuted under Section 1 of the Sherman Act, which requires a "contract, combination or conspiracy" that restrains trade. To establish a violation of the Sherman Act the Anti-trust Department has to prove that two or more banks jointly agreed to fix the Libor rate.

In 2011, the US Department of Justice, Antitrust Division issued grand jury subpoenas to some of the world's largest banks as part of its investigation into collusion on Libor. The point in issue was whether the big financial institutions had worked to keep transactions in these insurance-like instruments closed to competitors and more profitable for themselves. However the investigations have not been completed yet and hence no charges have been filed. The issue of grand jury subpoenas can however help the investigators uncover vital information and present a strong case against the banks.

On February 6, 2013, the Antitrust Division announced that it had entered into a Deferred Prosecution Agreement (DPA) with the Royal Bank of Scotland PLC ("RBS") for its role in an alleged price-fixing conspiracy to manipulate Yen LIBOR and Swiss Franc LIBOR. The DOJ's Criminal Division was also party to the DPA. [5] The DOJ alleged that RBS derivatives traders requested favorable Yen LIBOR and Swiss Franc submissions from the RBS employees responsible for making submissions. By adjusting RBS's submissions, the traders allegedly increased the profitability of their derivatives transactions that were tied to Yen LIBOR and Swiss Franc. Additionally, the DOJ alleged that RBS traders conspired to manipulate the submissions of other banks that made Yen LIBOR submissions. In the DPA, RBS agreed to pay a $100 million fine beyond the $50 million fine imposed upon RBS Securities Japan. As a condition, RBS Securities Japan Limited also agreed to plead guilty to a single count of wire fraud and to pay a $50 million fine. [8]

Among other investigations, the DOJ has pushed investigation into the municipal bond market towards the end of 2013. Former CDR Financial Products executives Zevi Wolmark and Evan Zarefsky were sentenced in April for their role in rigging the competitive bidding process for municipal bonds. Wolmark was sentenced to 18 months in prison, two years of supervised release, and a $500,000 criminal fine. Zarefsky was sentenced to 8 months in prison, 2 years of

supervised release, and a $17,500 criminal fine. The founder of CDR Financial Products, David Rubin, pleaded guilty in December 2011, and is currently scheduled to be sentenced in October.[6]

So far, DOJ has filed criminal charges against one financial services corporation and 20 former executives of such in the municipal bonds investigation. 19 of the 20 executives and the corporation have pleaded guilty or been convicted; one former executive is currently awaiting trial. Sentencing dates for 7 individuals who have pleaded guilty have been pushed back to the second half of 2013. [7]

Private Lawsuits in the US

Simultaneously private lawsuits have been filed in US courts against possible anti-competitive behavior by banks. Some of the prominent ones are:

1. Sheet Metal Workers Local No. 33 Cleveland District Pension Plan, based in Parma, Ohio, sought damages for "substantial injuries" that "buy side" entities like itself sustained in buying or selling CDS contracts to the "sell side" dealer-defendants between 2008 and 2011. [1]

2. Danish pension funds, namely Unipension Fondsmaeglerselskab, Arkitekternes Pensionskasse, MP Pension-Pensionskassen for Magistre & Psykologer, and Pensionskassen for Jordbrugsakademikere & Dyrlaeger, filed a lawsuit in U.S. District Court for the Northern District of Illinois, alleging antitrust violations by banks and claiming that the banks "unreasonably restrained competition" in the CDS market. The funds have asked the court for injunctive relief in addition to monetary damages.[2]

3. MF Global Capital LLC sued 12 large banks, accusing them of restricting competition in the credit default swap market. The case was filed on Monday in the U.S. District Court in the Northern District of Illinois.[3]

4. Value Recovery Fund, has filed a similar lawsuit against a number of banks in the Southern District of New York.[4]

What this means for banks going forward

There are several factors that seem to have caused such an increased antitrust scrutiny of the banking and financial industries by the Antitrust Division, and other enforcement agencies around the world:

- complaints by affected parties about rising levels of concentration in the industry leaving fewer and larger banks
- changes in top level officers in enforcement agencies around the world
- the growing academic and industry expertise is now within the reach of enforcers regarding the functioning of CDS markets

- it is possible that one or more banks may have taken advantage of the Antitrust Division's Corporate Leniency Policy and agreed to aid in the investigations to reduce their own penalties

The simultaneous announcements of the investigations around the globe also suggest that the enforcers are cooperating with each other. Over the next several years, banks and other financial institutions can expect increased antitrust scrutiny on all aspects of their business and more follow-on class action suits. It must be remembered that antitrust investigations are always lengthy, time consuming and very expensive. On the other hand, it is also possible that the Antitrust Division may come to the opinion that prosecuting the major financial institutions can have severe unwanted consequences to the financial industry and therefore the Division may choose not to take severe steps.

Notes:

1. Sheet Metal Workers Local No. 33 Cleveland District Pension Plan v. Bank of America Corp., 13-cv-03357, U.S. District Court, Northern District of Illinois (Chicago).
2. http://www.koreintillery.com/files/Pensions_Sue_Banks_Over_Credit-Default_Swaps.pdf
3. http://online.wsj.com/article/SB10001424127887323854904578637793536043624.html
4. Value Recovery Fund LLC v. JPMorgan Chase & Co., Citi Group, Inc., The Goldman Sachs Group, Inc., HSBC Holdings plc, HSBC Bank USA, N.A., Bank Of America Corporation and Markit Group, Ltd., Case Number 1:2013cv04928, New York Southern District Court, 2013
5. http://www.justice.gov/atr/public/press_releases/2013/292421.htm; Deferred Prosecution Agreement, United States v. The Royal Bank of Scotland plc, No. 3:13-cr-00074-MPS (D. Conn. Apr. 12, 2013), ECF No. 5, (http://www.justice.gov/iso/opa/resources/28201326133127414481.pdf)
6. United States v. Rubin/Chambers, Dunhill Ins. Servs. Inc., No. 09-cr-01058 (S.D.N.Y. Apr. 23, 2013), ECF Nos. 412, 413.; Docket Entry, United States v. Rubin/Chambers, Dunhill Ins. Servs. Inc., No. 09-cr-01058 (S.D.N.Y. Apr. 23, 2013), ECF No. 414.
7. http://www.justice.gov/atr/public/press_releases/2013/290872.htm
8. Plea Agreement, United States v. RBS Securities Japan Limited, No. 3:13-cr-0073-MPS (D. Conn. Apr. 12, 2013).
9. http://europa.eu/rapid/press-release_IP-11-509_en.htm;
10. Articles 101 and 102 of the TFEU prohibit anticompetitive agreements and the abuse of dominant positions;
11. http://europa.eu/rapid/press-release_IP-13-630_en.htm