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A Brave New World … increased focus by antitrust regulators on primary and secondary market activities

Introduction

In the past, competition enforcement in the financial services sector focused mainly on the areas of State aid and merger control, before the swathe of manipulation of financial benchmarks (e.g. Libor, Euribor) and collusion in bid-ask spread cases, which were investigated by both financial and antitrust regulators. This was followed by a flurry of allegations and investigations by regulators across asset classes, including credit default swaps, interest rate derivatives, FX, precious metals and bonds.

Interestingly, following a number of very recent IPO, bond offering and syndicated securities cases in the UK, Australia, US, Mexico, Spain and Japan, there now appears to be a subtle shift in the focus of new antitrust investigations in the financial services sector. There is a move towards primary market activities and the trading off the back of such activities[1] where it is considered that traders should be competing independently.

Banks, insurance companies, brokers and private equity houses - as well as entities considering a fundraising - are among those being advised to revisit their compliance programmes and practices in light of these recent developments, to ensure that they do not inadvertently fall foul of the competition rules. Especially given the frequency and importance of collaborations between competitors in the financial services sector, which makes this sector a focus for competition authorities worldwide keen to ensure that all such contacts are strictly limited to those permitted by competition law.

Recent developments

Unquestionably, the financial services sector continues to remain in the competition law spotlight. Recent investigations of particular interest include the following:

UK IPO Pricing Case

- In the first official case brought using its new competition powers, in November 2017, the Financial Conduct Authority ("**FCA**") in the UK informed four asset management firms that it believed that they had infringed competition law by disclosing to one another the price they intended to pay in relation to one or more of two IPOs and one placing, shortly before the share prices were set.[2]

[1] In some way, the authorities outside the United States almost seem to be playing catch-up with their US counterparts, who have long scrutinised the integrity of primary issues and capital markets with a number of cases involving private equity buyouts and municipal derivatives bonds.

[2] In April 2017, the FCA carried out on-site inspections at the London offices of five leading insurance brokers as part of an investigation into aviation brokerage businesses. The allegations appear to centre on concerns that competitively sensitive information was shared amongst brokers and underwriters, covering details such as the value of airline fleets and specific aircrafts. Although the brokerage process can have a very legitimate and pro-competitive purpose, by allowing firms to achieve price discovery and take out insurance accordingly, the process of brokering is not without risk. At all times competitors should be competing individually and avoiding any communication of competitively sensitive information, especially on current or future prices or strategies with customers. In a rare move, in October 2017, the European Commission ("**Commission**") took over this investigation initiated by the FCA.

The FCA noted that sharing this information allowed the firms to know their competitors' plans during the IPO or placing process when they should have been competing for shares. The firms in question have had an opportunity to respond to the FCA's case, but it is not yet known when the FCA will reach its final decision. In the meantime, one of the asset management firms has taken disciplinary action against an employee following the FCA's announcement, and there are reports that another has put "improved systems and controls" in place following the commencement of the investigation.

Australian Equity Placement Case

- In early June 2018, the Australian Competition and Consumer Commission ("**ACCC**") confirmed that criminal charges will be brought against ANZ Bank ("**ANZ**") and the joint lead underwriters of its 2015 A$2.5 billion equity placement in connection with cartel conduct in the disposal of shares in ANZ following the placement. The joint lead managers were Citigroup Global Markets Australia ("**Citi**"), Deutsche Bank ("**DB**") and JP Morgan Australia ("**JP Morgan**") plus a handful of the banks' executives. The underwriting banks were left with 25.5 million of the 80.8 million ANZ shares as a result of a poor uptake of the offer by institutional investors (though this was not disclosed to the relevant financial regulator). Whereas it is part of the process for underwriting banks to work together during a book-building process for purposes of the placement, it is more problematic where competitors collude to plan how to dispose of shares after the placement in a coordinated manner – especially if it results in the selling of stock at inflated prices when the banks should be selling down any stock independently. Some reports suggest that the ACCC will allege that a secret agreement between the banks and ANZ (as the issuer) relating to the timing and pricing of the 25.5 million share sale that took place after the placement infringes the competition rules. The charges currently appear to be laid against ANZ, DB and Citi, leading to speculation that JP Morgan may have blown the whistle on the alleged cartel, thereby escaping criminal charges under Australia's leniency program. Whilst the prohibitions on market abuse are well known, this investigation confirms that conduct that may contravene the market abuse rules may also be caught by the competition rules, and *also* attract penalties for an infringement of competition law.

US Agency Bonds Case

- It was reported at the beginning of June 2018 that the US Department of Justice ("**DoJ**") had opened a criminal investigation into whether certain traders had colluded in the selling of unsecured agency bonds. These include bonds issued by government-backed agencies Fannie Mae and Freddie Mac (to fund their purchases of mortgages), with the DoJ investigation understood to relate to alleged collusion by banks in the secondary trading of the debt, following the initial syndicated sale of the bond. Details about the investigation (which is in its early stages) are scarce, and the banks involved have not been named, but some reports suggest that the DoJ is reviewing communications between the traders at the time of the bond sales. While coordination between banks at the syndication stage is permitted under the antitrust rules, it seems that the investigation will seek to determine whether this coordination extended to their subsequent trading activities, which should be conducted independently.

Mexican Bonds Case

- In April 2018, two pension funds filed a class action complaint in the New York courts relating to alleged collusion by a number of major international banks (i.e. Banco Santander, Banco Bilbao Vizcaya Argentaria, JP Morgan Chase & Co, HSBC, Barclays, Citigroup, Bank of America and Deutsche Bank, Crédit Suisse) on the Mexican Government Bonds ("**MGB**") market. These class actions follow investigations announced by Mexico's antitrust regulator, the Comisión Federal de Competencia Económica in April 2017 and Mexico's securities regulator, the Comisión Nacional Bancaria y de Valores in August 2017. Whereas the Mexican regulators have not disclosed many facts pertaining to their investigations, it appears from the class actions launched that allegedly between January 2006 and April 2017 the banks in question, which were at one point or another "*market maker*": (i) rigged MGB auctions (i.e. on the primary market) through collusive bidding and information sharing; (ii) sold MGBs purchased at auction at artificially higher prices (i.e. on the secondary market); and (iii) agreed to fix the "bid-ask spread" artificially wider, overcharging and underpaying customers in every MGB transaction by suppressing the "bid price" at which investors offered to buy MGBs and increasing the "ask price" at which they offered to sell.

Spanish Derivatives Price Fixing Case

- The Spanish Competition and Markets Commission ("**CNMC**") in February 2018 fined four major banks (CaixaBank, Santander, BBVA and Banco Sabadell) €91 million for fixing the price of certain interest rate derivatives products ("**IRDs**") ancillary to syndicated loans.[3] The CNMC ultimately determined that these banks had colluded to offer the IRDs under conditions other than those agreed with their clients by: (i) applying hidden charges to zero-cost options; and (ii) offering clients a price for the derivative which was different from that of the market price at closing. It concluded that this conduct amounted to a serious infringement of competition law because while coordination between hedging banks to offer uniform conditions may be justified and was often a product/service offered as part of a syndicated loan arrangement, this could only be the case where such coordination led to the client obtaining the best possible market conditions, and importantly obtaining such goods/services at fair market value. It is interesting to note that the CNMC went so far as to indicate that pricing levels should be at "market value", given that this arguably goes beyond the level of intervention usually expected from competition authorities, which do not generally attempt to set pricing levels. All four banks are understood to have appealed the CNMC's decision.

Japanese Switch-Trade Case

- At the end of March 2018, the Japan Fair Trade Commission ("**JFTC**") found that Deutsche Bank and Merrill Lynch had infringed Japanese antitrust law as a result of collusion in relation to the sale of newly issued US dollar-denominated bonds (by the European Investment Bank ("**EIB**")) to a Japanese customer, Bank of Tokyo Mitsubishi UFJ ("**BTM**"). BTM asked three banks – including Deutsche Bank and Merrill Lynch – to bid for a so-called "switch trade". According to that trade $250 million worth of EIB bonds under BTM's portfolio were to be sold and $300 million of newly issued EIB bonds were to be bought. In a nutshell, the banks were supposed to compete on who could offer the highest price to buy the older $250 million EIB bonds from BTM. Apparently, the traders at Deutsche Bank and Merrill Lynch exchanged competitively sensitive information via a chatroom and disclosed to each other that the third bank was not interested in this switch trade. The three firms were supposed to compete on who could offer the lowest spread or the highest price, to buy the older EIB bonds from BTM. However, traders at Deutsche Bank and Merrill Lynch then agreed that Merrill Lynch would show a lower price to allow Deutsche Bank to win the switch trade. The JFTC found that the two firms had restricted each other's business activities, resulting in a restraint of trade contrary to Japanese competition law.

- According to a senior investigator at the JFTC, it is the first time that the JFTC has made such a finding against foreign banks for offences committed outside Japan. As the deal in question occurred in May 2012, the JFTC decided that the five-year limitation period applied and closed the investigation. However, the authority's announcement notes that, despite the application of the limitation period in this case, the *"JFTC has decided to make it public, aiming for ensuring the transparency of the application of the [Japanese competition law], and for preventing similar conduct which would be in violation of the [Japanese competition law], by other financial institutions"*. The JFTC demonstrated a clear willingness to "name and shame" the banks which participated in the alleged anticompetitive practices in question.

These cases demonstrate that although collaboration with competitors may be permitted at certain points in a transaction, competition authorities are able – and willing – to analyse different elements or stages of a deal or arrangement separately from a competition perspective, to determine whether any infringing conduct has taken place. One consequence of this approach is that legitimate engagement and/or collaborations with competitors at one level of a transaction will not automatically render *all* contacts relating to the deal permissible under the competition rules – especially at different later stages of a transaction.

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[3] Interestingly, this Spanish derivatives case comes at a time when the Commission is carrying out its EU Syndicated Loan Market Study. Although the Commission has indicated that the Study has not arisen as a result of any particular competition concerns, but rather to better understand the EU syndication loan market and ensure it is operating competitively, the Commission has nevertheless indicated that it will be closely watching developments in this Spanish case. To the extent similar conduct is identified, it appears it and other EU competition authorities will not hesitate to take enforcement action.

The developments in Spain and Australia are also notable given observations made by some industry sources that the conduct of the 'Big Four' banks in the Spanish case only reflected market practice and an international standard in these types of syndicated lending arrangements. Similarly, ANZ, DB and Citigroup in the Australian case are denying all wrongdoing and consider that their actions are entirely in line with their underwriting obligations and practices long seen as the norm in the financial industry. Interestingly, in both these cases, the regulators appear to have relied or are relying on audio / video recorded evidence; taking full advantage of their broad powers of investigation to obtain evidence to support their cases. Companies should beware!

Competition law compliance...

Individual regulators are continuing to investigate different practices in the financial sector, and finding potentially problematic conduct. This puts businesses on notice that *any* aspect of their day to day activities may be investigated, and further that an assertion that conduct is "standard industry practice" will not provide protection against allegations of infringement. Businesses should also be wary of the "domino effect" in the competition field, whereby activities investigated in one country may trigger similar investigations across the world. The UK IPO, the Spanish derivatives, the US bonds offering and Australia's equity placement cases, for example, have gained global news coverage, and other competition authorities are monitoring their development closely. Indeed, the ultimate conclusions in these cases may well have global repercussions for the industry and how business is done in these areas. The ultimate impact of all of these cases remains to be seen.

In the meantime however, and against this background, firms are advised to analyse their practices to confirm that their activities are fully competition law compliant and, if not, to consider what steps may be taken to mitigate any potential risk. Going forward, they should also ensure that compliance programmes (including training) are comprehensive, fully reflecting the obligations on firms and individuals at each stage of a transaction, and highlighting the parameters of permitted collaboration (e.g. as lead managers in an equity issue). This area is anticipated to draw continued regulatory attention following these cases, and financial and reputational consequences can be severe for entities ultimately found to have breached competition law.

Now is the time for industry players to pro-actively ensure that their day-to-day business practices are compliant with competition law and address any concerns swiftly.

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The Stephenson Harwood Competition Team has significant competition law and compliance experience advising institutions in the financial services sector. If you would like any further information, or if a brief discussion on any of the issues arising in this briefing would be helpful, please do not hesitate to get in touch.

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