Competition law and wholesale markets

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1. Why does awareness of competition law matter?

1.1 The ability of market participants to trade at competitive prices and engage in merit-based competition are two essential characteristics of fair and effective markets. However, attempted collusion to manipulate market prices has featured in many of the most prominent recent FICC market misconduct cases. Based on the consultation responses and its own analysis and outreach, the Review has concluded that there needs to be much greater awareness and understanding among market participants of the existing UK and EU competition law framework as it applies to wholesale FICC markets.

1.2 This annex, written in conjunction with the Competition and Markets Authority (CMA), provides a high-level summary of the competition law framework and the means by which it is enforced. It aims to highlight unacceptable practices and related sanctions, as well as reminding market participants of the leniency programmes provided by UK and EU competition authorities.[1] It also sets out some illustrative case studies of historical enforcement cases relating to financial markets. The examples of scenarios or conduct which could result in breaches of competition law given here are illustrative only and not exhaustive [2]

1.3 The main messages are:

- The UK and EU competition law (or 'antitrust') framework covers all firms and individuals including those operating in the financial markets. No distinction is made between wholesale and retail markets, or between FICC and non-FICC markets. The framework also applies to financial markets, including spot FX, which may currently fall outside of the direct scope of financial market regulation.
- Breaches of competition law can have serious consequences for individuals as well as firms — including possible fines, director disqualification, criminal sanctions, damages claims by third parties, and reputational damage.
- Businesses and individuals that come forward to report their own involvement in a cartel may have their penalties reduced, avoid a penalty altogether and/or be granted immunity from prosecution under the 'leniency' programme.

1 The information provided in this section is for general information and educational purposes only. The information may not be applicable in all situations and may not, after the date of this final Report, even reflect the most current authority. It is not intended and should not be construed to constitute legal advice and should not be relied or acted upon without the benefit of independent competition law advice.

2 For further information on competition law, see 'Competition Law Risk: A Short Guide' produced by the Institute of Risk Management and Competition and Markets Authority, available at www.gov.uk/government/uploads/system/uploads/attachment_data/file/372555/CMA_Risk_Guide.pdf — and the wide range of CMA guidance publications available on www.gov.uk/cma.

2.
What are the penalties for breaching competition law?

2.1 Breaches of competition law can have serious consequences for both firms and individuals participating in FICC markets, including[3]:

- Significant financial penalties for firms: firms found to have breached competition law can be fined up to 10% of their annual group global turnover and ordered to change their behaviour.
- Criminal penalties and fines for individuals: individuals in firms who engage in certain types of cartel activity (for example, agreements between competitors on pricing, sharing or dividing up customers or markets, or engaging in bid-rigging in auctions or tenders) may face criminal prosecution for an offence under the Enterprise Act 2002, which carries a maximum sentence of five years imprisonment, or be made to pay a fine.
- Liability in civil litigation: companies or individuals that have suffered as a result of practices that breach competition law may sue the firm(s) involved and, if successful, may obtain an injunction to stop the breach and/or damages to compensate for the loss.
- Director disqualification: company directors can be disqualified from directorships in any UK company for up to fifteen years.
- Reputational damage: this can be significant and long lasting.

3 For more information on fines and penalties see OFT423 *OFT's guidance as to the appropriate amount of a penalty* (now adopted by the CMA); CMA9 *Cartel offence prosecution guidance*; and OFT510 *Director disqualification orders in competition cases* (now adopted by the CMA). The CMA has also produced a 60-second summary guide for Directors on avoiding cartel infringements which can be accessed on www.gov.uk/cma.

3.
What types of behaviour could breach competition law?

3.1 There are three broad types of anti-competitive behaviour, discussed in further detail below:

i. Cartels;

ii. Other anti-competitive agreements or concerted practices; and

iii. Abuse of dominant market position.

Cartels

3.2 Cartels are a serious form of anti-competitive behaviour and involve two or more competitor firms agreeing, whether formally or informally, to limit or cease competition between them. The operation of a cartel may involve price-fixing, market sharing, bid-rigging, limiting the supply or production of goods or services, or information exchange. The agreement or arrangement between competitors could be formed in many ways — including a written contract, a conversation over the phone or at a social event, a meeting or chat room, or via emails.

3.3 Cartel behaviour can have the most detrimental impact on competition, which is why engaging in cartel activity may lead to criminal prosecution of individuals (under the cartel offence in the Enterprise Act 2002), as well as fines imposed on firms (under UK/EU legislation on anti-competitive agreements and arrangements).[4]

3.4 In FICC markets, potential examples of behaviour which may be indicative of cartel behaviour include:

- Price-fixing: agreeing with one or more competitors (directly or indirectly) the prices at which to supply products or services to clients (such prices could include commissions, fees, interest rates, benchmark submissions, discounts or rebates). Case Study 1 gives an example from the interest rate derivatives markets.

- Market sharing: agreeing with one or more competitors to share customers or markets. Examples include where firms: agree among themselves not to compete in providing certain financial instruments or services; agree not to compete with one another in certain territories; or agree not to compete with one another for certain classes of customer.

- Agreeing to limit production or sales: Case Study 2 gives an example from the zinc market.

4 However, not all cartel arrangements will give rise to criminal liability under the cartel offence. This is because the criminal cartel offence is framed more narrowly than the law on anti-competitive agreements in the civil regime. The offence only applies to price-fixing, market or customer sharing, agreements to restrict production or supply, or bid-rigging and it applies only to reciprocal arrangements between competitors. For more information on the cartel offence in the UK see CMA9 *Cartel offence prosecution guidance* on www.gov.uk/cma.

- Engaging in bid-rigging: where a group of firms agree to collaborate over their response to a competitive auction or tender; for example by agreeing not to undercut each other on price or to 'take turns' and rotate the order among them.

- Other anti-competitive agreements or concerted practices

3.5 A cartel is only one form of prohibited anti-competitive agreement. Other anti-competitive agreements or arrangements can be either 'horizontal' (between competitors) or 'vertical' (between suppliers and their clients).[5] Like cartels, these can arise formally (for example, via a contract) or informally (for example, via a conversation). Examples of such agreements, formal or informal, which could arise in FICC markets and which may raise concerns include:

- Direct or indirect communication of non-public commercially sensitive information such as future pricing intentions between competitors. Case Study 3 gives an example involving the pricing of loans.

- Agreements between a firm and its client which restrict the price and/or terms on which that client can resell a product, service, instrument or data. For example, a firm may require a client not to sell products below a certain price or impose a condition that the client cannot resell a financial instrument to the firm's competitors.

- Where a group of firms (or individuals within such firms) work together to prevent other competitors from entering the market, thus protecting their position in the market. For example, by imposing criteria or fees for participating in a market that discriminate against smaller players or new entrants in a way that is not objectively justifiable.

- Where a group of firms (or individuals within such firms) agree to work together to prohibit the development or introduction of new technologies which could reduce their influence in the market and/or reduce their profits.

- Where a group of firms agree to work primarily or exclusively with another firm(s) in a related (upstream or downstream) market, and in exchange get beneficial terms placing them at a competitive advantage to their rivals. For example where a group of asset management firms enter into an agreement with an investment bank in return for beneficial treatment.

3.6 Not all such agreements will breach the law. An agreement or arrangement will be 'exempt' from the UK or EU law on anti-competitive agreements and arrangements if (broadly speaking) it brings economic or technical benefits which are passed on to consumers and is restrictive of competition only to the extent absolutely necessary (ie is 'indispensable') to achieving those benefits. For example, some exclusivity agreements will be exempt if they bring a new product to market, provided that the exclusivity lasts only for a limited period necessary to achieve that.

5 For more information about how competition law may apply to agreements see OFT401 (now adopted by the CMA) *Agreements and concerted practices* available on www.gov.uk/cma. For more information on agreements between competitors see the European Commission *Guidelines on the applicability of Article 101 of the Treaty for the Functioning of the European Union (TFEU) to horizontal co-operation agreements*. For more information on how competition law provisions may apply to agreements between businesses at different levels of the distribution chain, see the European Commission *Guidelines on vertical restraints*.

Abuse of dominant market position

3.7 Both UK and EU competition law prohibits any firm with a 'dominant' market position from behaviour that may constitute an abuse of its dominant position.[6] A dominant position equates essentially to market power: a business is only likely to hold a dominant position if it is able to behave independently of the normal constraints imposed by competitors, suppliers and consumers. Having a dominant position does not in itself breach competition law; it is the actual abuse of such a position which is prohibited. Competition law requires that dominant businesses compete on the merits of the products or services they provide rather than by trying to exploit clients and/or exclude their competitors from the market by anti-competitive means.

3.8 A dominant firm can employ different strategies to exclude competitors, and/or exploit customers. Examples of behaviour in FICC markets which could potentially amount to an abuse of dominance by a firm are considered in the non-exhaustive list below:

- Refusing to supply an existing or new client, or refusing to provide access to an essential facility, service or data (or providing such access only on terms which are unreasonable) without an objective justification.

- Offering different prices or terms to similar clients without an objective justification. For examples of both (i) and (ii). See Case Study 5.

- 'Bundling' or 'tying' two products. This is where a firm stipulates that a client wishing to purchase one product must also purchase another different one. In some circumstances bundling can be efficient and lead to lower prices for clients; however competition concerns arise when the dominant firm uses its dominance in one product market to push out competitors in another market by bundling the two products together.

- Stipulating that a firm will do business with a client only on the condition that the client gives all of its business to the firm. For example, where a large broker takes on a client for prime brokerage services on the condition that the client agrees to conduct all of its trading activity through the broker (even though services such as execution-only trading are separable and may be cheaper elsewhere).

- Charging prices so low that they do not cover the cost of the products or services being sold. For example, where a firm offers a service at below-cost with the aim of driving out competitors and then increasing prices again.

3.9 The practices described above are not always evidence of an infringement of competition law. The specific facts and circumstances of each case would be taken into account, including whether there was an objective reason for the dominant firm undertaking such behaviour.

6 One measure of market power is market share. As a rough rule of thumb a dominant position is unlikely to arise with a market share of below 40%. However, market shares are not the only factor to consider when assessing dominance. For more information see OFT402 *Abuse of a dominant position* (now adopted by the CMA) available on www.gov.uk/cma.

4. Who is responsible for competition law in the United Kingdom and Europe?

4.1 Anti-competitive behaviour which may affect trade within the United Kingdom is prohibited by UK legislation (under the Competition Act 1998 and the Enterprise Act 2002). The Competition and Markets Authority (CMA) and Financial Conduct Authority (FCA) share enforcement powers in relation to the provision of financial services in the United Kingdom (although only the CMA is responsible for the UK cartel offence). The FCA's competition functions are not limited merely to FCA-regulated activates and firms, but extend to financial services as a whole, including parts of the FICC markets which currently fall outside of the United Kingdom's financial services regulatory perimeter.

4.2 Where the effect of anti-competitive behaviour extends beyond the United Kingdom to other EU Member States, EU legislation (Articles 101 and 102 of the Treaty on the Functioning of the European Union) is applicable. The European Commission (through its Directorate General for Competition) is tasked with enforcement of EU-wide competition rules. The CMA and FCA also have powers to enforce Articles 101 and 102 in the United Kingdom.

5.
Reporting knowledge or suspicions of breaches of competition law, and the leniency programmes

5.1 Under leniency programmes operated by the CMA and the European Commission, firms and individuals that come forward to report their own involvement in a cartel to a competition authority may benefit from a reduction or annulment of the fines that would otherwise be imposed on them.[7] To qualify for leniency, applicants must admit their involvement, co-operate fully with the authority's investigation and immediately stop their involvement in the cartel (unless the CMA directs otherwise, which it will do only rarely).

5.2 Provided they co-operate, the directors of applicant firms may also avoid disqualification and employees and officers may be granted immunity from prosecution under the cartel offence if the application is made to the CMA.

5.3 The CMA is prepared to offer financial rewards for information about cartel activity (informant rewards). Additionally, individuals who come forward with information about their involvement in a cartel may be granted immunity from criminal prosecution (called a 'no-action' letter).

5.4 The FCA expects that leniency applications will normally be made directly to the CMA, in particular since the FCA cannot grant immunity from criminal prosecution in relation to the cartel offence. However, if a firm were to apply to the FCA directly for leniency and it satisfied the relevant criteria, the FCA would have regard to the CMA's Penalty Guidance and apply the CMA's leniency policy in relation to its competition enforcement[8].

5.5 Individuals or firms who suspect a colleague, competitor, supplier, customer or any other business may be infringing competition law, should call the CMA Cartels Hotline on 020 3738 6888; or email cartelshotline@cma.gsi.gov.uk. For information about leniency and to apply call 020 3738 6833.

5.6 Individuals who are concerned about other instances of potentially anti-competitive behaviour by their firm, a rival firm, or other firm(s) can raise concerns, formally (through a complaint) or informally, with the CMA or FCA. Firms regulated by the FCA can also raise their concerns with their supervisors.

5.7 Regulated firms may also be obliged to bring their own contraventions to the FCA's attention under Principle 11 of the Principles for Businesses.[9]

7 For more information on the CMA leniency programme and no-action letters, see OFT1495 *Applications for leniency and no-action in cartel cases* (now adopted by the CMA); OFT14951 *Quick Guide to Cartels and Leniency for Individuals* (now adopted by the CMA); OFT1495b *Quick Guide to Cartels and Leniency for Businesses* (now adopted by the CMA Board); CMA9 *Cartel offence prosecution guidance* – All available on www.gov.uk/cma.

8 See the FCA policy statement on '*PS15/18: FCA Competition Concurrency Guidance and Handbook amendments*', July 2015.

9 www.handbook.fca.org.uk/handbook/PRIN/2/1.html

Case study 1
Illegal cartels in the interest rate derivatives markets[10]

In December 2013, the European Commission announced that it had fined eight international financial institutions a total of €1.7 billion for participating in illegal cartels in markets for financial derivatives covering the European Economic Area. The Commission found that:

- Barclays, Deutsche Bank, Société Générale and RBS had participated in a cartel relating to euro-denominated interest rate derivatives linked to Euribor and/or EONIA. Traders in those banks discussed their bank's submissions for the calculation of Euribor as well as their trading and pricing strategies. The Commission imposed fines totalling €1 billion (Barclays received full immunity for revealing the existence of the cartel). The Commission has also opened proceedings against Crédit Agricole, HSBC and JPMorgan, which remain ongoing.
- RBS, UBS, Deutsche Bank, JPMorgan, and Citigroup had participated in one or more bilateral cartels relating to interest rate derivatives denominated in Japanese yen. The broker RP Martin facilitated one of the infringements by using its contacts with a number of Japanese Yen Libor panel banks that did not participate in the infringement, with the aim of influencing their Japanese Yen Libor submissions. The Commission imposed fines totalling €0.7 billion (UBS received full immunity for revealing the existence of the cartels). In addition the broker ICAP was found to have facilitated six of the infringements, resulting in a €14.9 million fine from the Commission in February 2015. (ICAP announced it would be challenging this decision).

Case study 2
Zinc Producer Group[11]

In 1984 the European Commission found that the world's major zinc producers had formed a cartel by agreeing to limit their production to collectively agreed quotas and not to build any new zinc production facilities without approval from the cartel. The arrangements also included market sharing — and the cartel agreed to introduce a common price in their supply contracts, substituting this for the price set by the London Metal Exchange (LME), while also agreeing not to sell on the LME. The cartel was dismantled after the infringement came to light

10 http://europa.eu/rapid/press-release_IP-13-1208_en.htm.
11 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31984D0405&from=EN.

Case study 3
Unilateral disclosure of confidential and commercially sensitive information[12]

In January 2011, the Office of Fair Trading (OFT), the predecessor of the Competition and Markets Authority, concluded that individuals at RBS had disclosed confidential and commercially sensitive future pricing information to their counterparts at Barclays with the aim of co-ordinating the price of loans supplied to large professional services firms, although there was no explicit agreement on those prices.

Individuals at RBS shared generic information about the market between October 2007 and February or March 2008. For example in an email titled 'Enemy Intelligence — RBS', Barclays' Head of Team disclosed that he had 'been verbally approached by [the RBS Head of Team] to come to an agreement over raising our pricing as margins are too low they say they are suffering'. RBS also shared specific pricing information: for example, a Barclays Regional Director said that RBS had informed him that they would be pricing their loan facility at a basis point margin 'somewhere in the 70s'.

The disclosures by RBS staff took place through telephone conversations and a number of informal contacts, such as a bowling event organised by an accountancy firm, an industry dinner for managing partners, and a seminar at a law firm.

The case demonstrated that an infringement of the law on anti-competitive agreements does not require the sharing of commercially sensitive information to be reciprocal: the unilateral disclosure of such information is sufficient.

This case came to light because Barclays approached the OFT seeking leniency. RBS was fined £28.59 million (which included a 15% reduction in the fine to take into account the early resolution of the case, involving RBS admitting the breach and co-operating with the OFT). By contrast, Barclays benefited from total immunity under the OFT leniency policy.

12 http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/ca-and-cartels/CE8950_08_dec.pdf.

Case study 4
European Commission investigations into Credit Default Swaps[13]

The European Commission has two separate ongoing investigations into (a) the activities of sixteen investment banks, as well as the International Swaps and Derivatives Association (ISDA) and the market information provider, Markit, in relation to the Credit Default Swaps (CDS) information market, and (b) the activities of nine investment banks, as well as a clearing house provider, ICE Clear Europe, in relation to the CDS clearing market.

In the CDS information market, the European Commission's preliminary statements of objections stated that thirteen of the sixteen investment banks, together with ISDA and Markit, infringed EU competition law by colluding to prevent exchanges from entering the credit derivatives business. Between 2006 and 2009, Deutsche Börse and the Chicago Mercantile Exchange tried to enter the credit derivatives business. The exchanges turned to ISDA and Markit to obtain necessary licenses for data and index benchmarks, but, according to the preliminary findings of the Commission, the banks controlling these bodies instructed them to license only for 'over-the-counter' (OTC) trading purposes and not for exchange trading. Several of the investment banks were also found to have sought to shut out exchanges in other ways, for example by co-ordinating the choice of their preferred clearing house.

In the Commission's preliminary view the banks acted collectively to shut out exchanges from the market because they feared that exchange trading would have reduced their revenues from acting as intermediaries in the OTC market. The Commission's investigations are ongoing and its statement of objections does not prejudice the final outcome of the investigation.

13 http://europa.eu/rapid/press-release_IP-13-630_en.htm.

Case Study 5
Clearstream (Clearing and Settlement)[14]

In 2004, Clearstream Banking AG, a provider of primary clearing and settlement services for securities issued under German law, was found by the European Commission to have abused its dominant position in the market by:

- Refusing to supply primary clearing and settlement services to Euroclear Bank, one of its customers, for more than two years after it requested those services. This contrasted with a usual delay of a maximum four months within which other comparable customers were supplied those services.
- Discriminatory behaviour towards Euroclear Bank by charging an unjustified higher per transaction price to Euroclear Bank for clearing and settlement services than to other similar customers outside Germany.

The above infringements came to an end before the conclusion of the investigation and Clearstream agreed to refrain from repeating the infringements in the future.

14 http://europa.eu/rapid/press-release_IP-04-705_en.htm?locale=en

Financial Conduct Authority

25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk