KEY POINTS

- Over the last decade, the manipulation of financial benchmarks such as LIBOR has attracted regulatory and competition law scrutiny globally, with swingeing penalties imposed by the European Commission, amongst others. The transition way from LIBOR to alternatives nevertheless suggests that competition issues are likely to be back on the regulatory agenda, requiring a careful examination.
- In addition to competition law scrutiny of "hard core cartel activity" involving price-fixing, owing to the nature of financial markets which are characterised by network effects and often large economies of scale, there is frequently a need to balance competition with co-operation and the benefits this can bring.
- Exchanging information on current or future positions, margins or quantity is likely to give rise to a presumption of anti-competitive effects.
- In loan syndication, competition law infringements may include exchanges of sensitive information, lender dual roles and agreements on pricing which are not implemented with the consent of and in the interests of an informed borrower.
- Banks will need to reinforce and refresh critical competition law safeguards in compliance training.

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LIBOR transition and managing competition law risk

In this article Professor Suzanne Rab responds to the Financial Market Law Commission's clarion call to consider key competition issues arising from a move to Risk Free Rates (RFR) or similar. She identifies challenges for the competition law regulation of banking benchmarking practices that need to be addressed.

INTRODUCTION

The London Interbank Offered Rate (LIBOR) has been the subject of regulatory and competition law scrutiny on a global scale over the last decade ever since the US Commodities and Futures Trading Commission issued a penalty notice to Barclays for manipulation of LIBOR and the Euro Interbank Offered Rate (EURIBOR) in June 2012 . Since then, many leading financial institutions have been found by regulators to have engaged in collusion to fix the rate, whether through the actions of individual traders or more senior management, and typically with effects that transcend national borders. The ongoing impetus for reform, catapulted by the Financial Stability Board in February 2013, calls for a move away from dependency of financial markets from IBOR benchmarks.

The recent publication by the Financial Markets Law Committee (FMLC) of a paper (Paper) discussing aspects of legal uncertainty arising from the transition away from LIBOR provides a focus for considering some of the residual legal issues.[1] It explores the move away from LIBOR towards a "successor rate" or risk-free rate (RFR) as a substitute. The Paper, however, acknowledges that "[a]lthough competition issues are beyond the scope of this report, it can be noted that an agreement on pricing will prima facie contravene" the EU and UK competition law prohibitions on restrictive agreements.

This article responds to the FMLC's clarion call to consider key competition issues arising from a move to RFR or similar, identifying challenges for competition law regulation of banking benchmarking practices that need to be addressed. The UK and US have been the most significant financial markets where most of LIBOR manipulation took place and where, within the EU, the European Commission (Commission), has pursued individual competition law investigations and enforcement. The focus of this article will therefore be on the issues arising under the rules on restrictive agreements contained in Art 101 of the Treaty on the Functioning of the EU (TFEU) and its EU national law equivalents which, for the purposes of the UK, are contained in s 2 of the Competition Act 1998 (Chapter I prohibition). While accepting this more limited remit, it may therefore serve as a departure point for considering the wider implications of a phenomenon which has international ramifications and where co-ordinated and consistent regulatory action should be paramount.

LIBOR REFORM

In order to set in context the discussion that follows, it is convenient to take brief stock on the developments from LIBOR through to RFR and the FMLC's current thinking as reflected in the Paper.

The FMLC sets out the uncertainties inherent in LIBOR transition and the measures that are being taken by international regulators to remain vigilant to any remaining legal and risk management issues. The FMLC concludes that if LIBOR cannot be sustained beyond 2021, the transfer of legacy contracts to the alternative rate is likely to present the most significant issues. The FMLC considers a range of solutions that could be adopted by the UK government, regulatory authorities or market participants to transition the bulk of contracts away from LIBOR. The options considered include "re-papering" (ie amendment of each existing transaction), new legislation to transition legacy contracts to a successor rate, an extension of LIBOR beyond 2021 for legacy instruments and a mandated successor rate within a specific timeframe.

The FMLC believes that preservation of screen continuity presents the best prospect for stability and risk management in financial markets. This would take the form of feeds on the Bloomberg and Reuters LIBOR01 pages displaying a successor rate under the LIBOR rubric. The aim is that this would mitigate against contractual uncertainty while the rate is established by a process set on the LIBOR01 pages. It also postulates that a "strong legal opinion" could provide a source of reassurance that the adjustments do not take the rate outside standard market definitions.

The FMLC is alert to the risks that an RFR established under these methods may not be a complete antidote to the regulatory problems that surfaced with LIBOR and that competition law issues should not be overlooked. Cautiously, it postulates that "[p]resumably, then, an arrangement to introduce a successor reference rate by means of the fallback mechanisms of reference banks and/or calculation agent – if it were possible at all – would require stringent oversight, or even active management by national authorities, to counteract the inherent conflicts of interest to which collective price-setting arrangements ordinarily give rise" (p 26).

THE KEY COMPETITION ISSUES ARISING

Relevant legal framework

Owing to the nature of financial markets which are characterised by network effects and often large economies of scale, there is frequently a need to balance competition between competitors with co-operation and the benefits this can bring.

The analysis of an agreement under EU competition law is carried out in two steps. The first step is to assess whether an agreement between independent undertakings, which is capable of affecting trade between member states, has an anti-competitive object or actual or potential restrictive effect on competition (Art 101(1) TFEU). The second step, under Art 101(3) TFEU and which only becomes relevant if an agreement is caught by Art 101(1) TFEU, is to determine any pro-competitive benefits produced by the arrangements and to assess whether those pro-competitive effects outweigh the restrictive effects on competition.

Article 101(3) provides that an agreement that would otherwise be prohibited by Art 101(1) may escape prohibition if it meets the conditions set out in a four-stage test:

- **first condition**: the agreement must improve the production or distribution of goods or promote technical or economic progress;
- **second condition**: consumers must receive a fair share of the resulting benefits;
- **third condition**: the restrictions must be indispensable (ie necessary) to achieving the agreement's benefits; and
- **fourth condition**: the parties to the agreement must not "eliminate competition" in relation to the relevant goods or services.

For convenience, this article refers to the EU competition law provision contained in Art 101 as similar considerations apply under the competition laws of the member states. From a UK perspective, it is of note that as of 1 April 2015 the UK's financial services regulator, the Financial Conduct Authority (FCA) gained competition law enforcement powers, including powers under the Competition Act 1998 in relation to the provision of financial services, which it enjoys concurrently with the Competition and Markets Authority (CMA). The general principle is that the regulator that will be responsible for a case depends on which one is better or best placed to do so.

COMPETITION LAW SCRUTINY OF BENCHMARKS AND RATE SETTING

The financial services sector has seen a number of high-profile cartel investigations under Art 101. The competition law risks associated with benchmark and index manipulation have been highlighted in the recent LIBOR and EURIBOR investigations in Europe and the US.

At EU level, the Commission has maintained its focus on manipulation of interest rate derivatives. In the *Euro Interest Rate Derivatives* case, the Commission found (after a settlement) that Barclays (who received full immunity), Deutsche Bank, RBS and Société Générale participated in a cartel for varying periods between September 2005 and May 2008. The cartel related to Euro interest rate derivatives linked to EURIBOR and/or EONIA and their attendant pricing and trading strategy.[2] The *Yen Interest Rate Derivatives* case also involved settlement discussions with most parties – UBS (who received full immunity), JP Morgan, Citigroup, Deutsche Bank, RBS and RP Martin. The Commission subsequently announced on 4 February 2015 that it fined the UK broker ICAP €14.9m for its role in allegedly facilitating cartel activity that manipulated the Yen LIBOR interest rate (ICAP did not settle with the Commission). The cartels concerned Japanese interest rate derivatives linked to the JPY LIBOR as well as the Euroyen TIBOR (in one case).[3]

UK competition law has also been applied to price fixing in the financial sector. In March 2010, The Royal Bank of Scotland agreed to pay a fine of £28.59m in respect of its infringement of the Chapter I prohibition/Art 101 TFEU by disclosing to Barclays confidential information regarding loans to professional services firms. This included a reduction of about £5m to reflect the company's co-operation with the OFT's investigation (OFT Decision CA98/01/2011).

The US Department of Justice's scrutiny of LIBOR can be seen, for example, in its 2014 LIBOR Investigation.[4]

Benchmarks and competition risk

One of the reasons why competition or "antitrust" regulators have traditionally been alert to the use of benchmarks or indices as part of a price-setting process is their potential to facilitate actual or tacit collusion amongst competitors. The terms "index" and "benchmark" are often used synonymously. A benchmark generally provides a market standard against which the performance of a security or fund manager can be measured. By contrast, an index refers to a hypothetical portfolio of stocks designed to represent the relative asset class, market or market segment. Benchmarks or indices will usually be developed by third party entities according to a prescribed methodology which may or may not be published. Three broad types of benchmark can be identified:

- submissions on a particular market view;
- submissions based on "actual" trading data; and
- observations of trading at a particular time.

If the trader has no interest in the benchmark (perhaps because they do not trade in the relevant products), competition issues should not generally arise. In such circumstances, there would be no incentive to manipulate the benchmark.

Competition issues do, however, tend to occur where the parties who have an interest in the outcome of the benchmark seek to influence it. In this instance, for competition law purposes, the precise methodology that underpins the benchmark is not particularly significant. Rather, where the party (here, a trader) regularly observes the market they will know what is good or bad for their position at a particular time, and that a particular trade of a particular amount during a particular window (whether it is a buy or sell) will have a market impact.

Even if a particular trader knows that a particular trade will have this or that impact, in the absence of market power they can determine unilaterally how to act and this should not generally be a competition law concern. They may even decide to reduce any adverse impacts on their position by netting-off the position against others in the market (eg a direct match of +100 million and -100 million will equal zero). Transactions that are motivated by parallel incentives occur frequently each day and should not generally be a competition problem provided that the parties are in fact acting independently.

Infringements by object or effect?

Greater vigilance should be exercised where the behaviour of individual competitors extends beyond netting to co-ordinated or collusive action, the object or effect of which is designed to bring about an outcome. However, even in this instance a competition authority should not rush to condemn conduct that is in the unilateral interest of each side, even if the effect is to bring about a particular market impact.

When applying EU competition law, it is useful to distinguish cases which may be restrictive by "object" and those which may be restrictive by effect. In the former category, certain types of agreement between undertakings can be regarded "by their very nature" to be so harmful to the proper functioning of normal competition in the market that there is no need to examine their effects. It is clear that a single meeting may be sufficient evidence from which an anti-competitive agreement or concerted practice may be inferred:

> "Depending on the structure of the market, the possibility cannot be ruled out that a meeting on a single occasion between competitors, such as that in question in the main proceedings, may, in principle, constitute a sufficient basis for the participating undertakings to concert their market conduct and thus successfully substitute practical co-operation between them for competition and the risks that that entails".[5]

This is an important distinction since once a practice is found to restrict competition by object it will typically be very difficult for the parties to defend their arrangements on the basis that they satisfy the conditions of Art 101(3) TFEU.

While it is not possible to prescribe in advance the practices that will raise significant competition concerns the following are likely to attract attention:

- a trader acts in a manner that is not in his best interest or that of his client;
- a trader suffers an adverse impact in the short-term in order to favour another independent market participant;
- a trader engages in a "wash trade" that is devoid of any economic purpose (ie a form of market manipulation in which an investor simultaneously sells and buys the same financial instruments to create misleading, artificial activity in the marketplace).

EVIDENTIAL MATTERS

The Commission can rely on both direct and indirect evidence for the purposes of proving an infringement of EU competition law.

- Direct evidence is of the highest probative value where it enables the Commission to find that the enterprises concluded an agreement, the object or effect of which was to prevent, restrict or distort competition. Such direct evidence may comprise so-called smoking guns such as contemporaneous documents or memoranda, gentlemen's agreements, meeting notes, minutes, diary entries or emails relating to monitoring systems. Corporate statements from the enterprises involved in allegedly infringing activity that are obtained in the course of a leniency application may also provide direct evidence of participation. Such statements need to be viewed in context, in particular taking account of the interests of the person making the statement and whether it is corroborated by other evidence and participants.
- Indirect or circumstantial evidence comprises evidence which is appropriate to corroborate the proof or existence of a cartel by way of deduction, common sense, economic analysis or logical inference from other facts which are demonstrated. Such evidence may include parallel price increases of companies suspected of participating in a cartel or economic evidence such as a situation of high market concentration and homogeneous products facilitating price co-ordination.

In the absence of evidence from a leniency applicant, in a benchmark setting there may be limited if any contemporaneous evidence of communications of intent. Even where there are, communications between traders may be equivocal and characterised by puffery and self-posturing to which limited evidential significance may be ascribed.

It can therefore be challenging to establish what are the true facts. In short, evidence that a benchmark has been manipulated (for the purposes of conduct regulation in the financial sector) may not necessarily entail that there is a violation of a relevant competition law. The US Plea Agreement of 20 May 2015 resolving the Department of Justice's LIBOR Investigation provides an indication of some of the elements that may be relevant to the analysis:

> "In furtherance of the conspiracy, the defendant and its co-conspirators engaged in communications, including near daily conversations, some of which were in code, in an exclusive electronic chat room … Participation in this electronic chat room was limited to specific … traders."[6]

The regularity of the communications, their exclusivity and covert nature (in code) are some of the relevant factors that could support the finding of collusion.

Information exchange

The issue of information exchange has been a much-vexed question for the application of EU competition law. The Commission has targeted information exchange through common platforms as a means of restricting competition in cases which focus on manipulation of interest rate derivatives. As noted above in *Euro Interest Rate Derivatives* the Commission found that Barclays, Deutsche Bank, RBS and Société Générale participated in a cartel for varying periods between September 2005 and May 2008. The cartel related to Euro interest rate derivatives linked to EURIBOR and/ or EONIA and their attendant pricing and trading strategy. Similar issues arose in the *Yen Interest Rate Derivatives* case.

Part of the challenge with information exchange in a trading environment is often the lack of specificity. Traders may exchange a generalised view of future intent ranging from "I will go late", to "I have a lot to sell" to "I am looking for a high/low". It could be maintained that this dialogue is ancillary to the trading activity and does not have as its object the restriction of competition. The more obvious category of unlawful behaviour is where information that is disclosed is commercially sensitive and not otherwise generally available to similarly situated market participants. Where the line is crossed between conduct that is merely ancillary to the main trading activity and that which violates competition law can be hard to draw.

Recognising that the circumstances of information exchange can be many and varied the Commission sets out in its *Horizontal Cooperation Guidelines* some principles which seek to demarcate the types of information exchange that are permissible and those which will require a more detailed assessment.[7] The Commission's guidance represents a departure from a box-ticking approach where the presence or absence of a particular feature of information exchange will be decisive in terms of the antitrust treatment.

The legality of any information exchange will inevitably depend not on any one factor but on the nature of the information exchange and the overall market and economic context. However, the following issues are likely to be relevant in a trading environment where benchmarks or reference rates are involved:

- did the information go beyond what was necessary for the legitimate negotiation of trades or providing market information;
- was there any prior or parallel discussion over pricing;
- was the information disseminated on a bilateral/multilateral basis or was it available only to a selective number of participants.

Despite the guidance that is available in the *Horizontal Cooperation Guidelines* fact-specific questions will arise on practical application. A far more sophisticated approach is needed towards the antitrust assessment of information exchange where no single factor is decisive.

Information exchange cases are increasingly assessed as "object" cases which increases the burden on parties to justify their arrangements. Exchanging information on current or future positions, margins or quantity is likely to give rise to a presumption of anti-competitive effects. Even the exchange of information that is in the public domain is not risk-free, particularly if it is exchanged in a form which reduces commercial uncertainty.

Loan syndication

The FMLC gives consideration to the role of market action in the transition away from LIBOR, recognising that any fallback mechanisms may only be available for bilateral transactions and derivatives. Any protocols such as those published by ISDA may not work for linked transactions (ie a loan and swap) that need to transition at the same time and in respect of asset classes that are not subject to standardised documentation. This raises at least two issues of potential competition law significance. First, FMLC conjectures at p 26 "who would pay for the cost of changing the rate?". Presumably, an adjustment payment would have to be agreed between the parties. This raises an issue as to whether this could be construed as a collective price setting arrangement (between syndicated banks and the borrower group). Second, it may be asked whether any agreements on price between reference banks in the fallbacks could be construed as collective price setting which would fall to be assessed under Art 101(1) and (3) and their national equivalents.

In order to understand the potential competition law issues, it is helpful to appreciate the interactions between the loan origination and syndication environments. Both provide liquidity where no individual institution would be willing or able to carry the risk alone. The ability of banks to carry out loan origination and loan syndication in a manner that is compliant with competition law is fundamental to the effective functioning of global financial markets.

Loan origination concerns the process before a banking group is formed, and generally involves the issuing of a request for proposal (RFP) by the borrower. At this stage in general competitor banks should not engage in discussions over rates or other commercially sensitive terms and conditions, unless the borrower has expressly approved such discussions. Loan syndication, by contrast, involves laying off the market risk where a banking group has been formed and

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after the RFP has been issued. Once the group is formed, the competition analysis changes. Syndication can be permitted provided that discussions with competitor banks are limited to laying off risks, once the group has been mandated and consistent with its mandate.

The competition law risks with loan syndication have already come under regulatory scrutiny. In 2014, for example the Loan Market Association published a notice on the application of competition law to syndicated loans and identified a number of areas where caution should be exercised, including:

- general market soundings;
- conduct during the bidding phase;
- exchanging competitively sensitive information;
- interactions regarding "flexing" of terms;
- conduct regarding refinancing/distressed arrangements.

Reflecting similar themes, in April 2019 the Commission published a report on EU loan syndication and its impact on competition. This followed regulatory interest and investigations across Europe into competition issues arising from loan syndication activities.

While these reports did not identify any specific competition law infringements, certain of the features highlighted are consistent with the observations made in this article as to potential areas of heightened competition law risk. These include exchanges of sensitive information, lender dual roles and agreements on pricing which are not implemented with the consent of and in the interests of an informed borrower. With the prospect of loan syndication coming back on the regulatory agenda in the context of LIBOR transition, an important element is the critical competition law safeguards which banks will need to reinforce and refresh in compliance training (including information barriers, non-disclosure agreements and protocols for escalation of competition issues to compliance and legal advisors at relevant stages in the loan origination and syndication cycle).

CONCLUSION

The move away from LIBOR towards a successor rate is not free from competition risk. This must allow for beneficial and market enhancing collective resolution of problems by key market agents to manage shocks, while avoiding competition concerns that arise in what can be legitimate interactions between competitors. What may amount to a violation of financial regulatory conduct rules on market manipulation may not necessarily and universally fall foul of competition law.

The challenge is how to apply competition law and complementary sector regulation in a way that will keep markets open and protect them from manipulation. In carrying out these tasks, competition and sector regulators will always be reminded not to "chill" normal market conduct. In the EU and the UK, the competition law basic rules are clear but their application in the financial services sector requires sophistication and not a blunt hammer. This is particularly so given the developments in and expansion of the category of "by object" infringements and violations through information exchange.

Whilst one chapter of antitrust and regulatory enforcement action in rate setting and manipulation may be closing, the question of successor rates may well be the next big compliance headache for the banking sector. The move towards use of RFR built around actual trading data is a step in the right direction. Experience has shown, however, that such efforts need to be co-ordinated at a global level and between both competition and financial regulators.

This article has focused on competition law scrutiny primarily in the UK and the EU. Important areas highlighted for deeper inquiry arising out of LIBOR transition include:

- the appropriate balance between application of competition law and sector regulation to market conduct in relation to alleged manipulation;
- the effectiveness of different regulatory models of intervention including, on the one hand, criminal and civil penalties and, on the other, public and private enforcement; and
- the implications for global enforcement where parties are engaged in cross-border transactions where, historically, interventions have reflected jurisdictional idiosyncrasies.

In the UK in particular, where competition law infringements were not directly pursued in relation to LIBOR-related activities it is hoped that the advent and ongoing application of the FCA's competition law powers and duties will augur for a more robust and sensitive application of competition law in any future transition scenario. ■

[1] FMLC, *LIBOR Transition: Issues of Legal Uncertainty*, October 2020.

[2] Commission press release IP/13/1208, *Antitrust: Commission fines banks €1.71bn for participating in cartels in the interest rate derivatives industry*, 4 December 2013.

[3] Commission press release IP/13/1208, *Antitrust: Commission fines banks €1.71bn for participating in cartels in the interest rate derivatives industry*, 4 December 2013.

[4] http://www.justice.gov/atr/division-update/2014/libor-investigation

[5] Case C-8/08, *T-Mobile Netherlands and others v Raad van bestuur van de Nederlanse Medeingingsautoriteit*.

[6] http://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas

[7] Communication from the Commission – Guidelines on the applicability of Art 101 of the TFEU to horizontal co-operation agreements, OJ C 11, 14.1.2011, p 1-72.

Further Reading:

- The demise of LIBOR: the value of fallbacks (2020) 9 JIBFL 589.
- LIBOR transition: ISDA Protocol first mover disadvantage and other international perspectives (2021) 1 JIBFL 5.
- LexisPSL: Banking & Finance: LIBOR developments tracker.