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Spanish Cartel of Derivatives in Syndicated Loans

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Spanish Cartel of Derivatives in Syndicated Loans

Main Spanish banks sanctioned with a 91M€ fine for coordinating to fix supra-competitive prices in the contracting of financial derivatives used to hedge the interest rate risk in syndicated credits for project finance during 2006-2016

Hot Topic!

1. **Ongoing investigation by DG COMP**: EU loan syndication and its impact on competition in credit markets [(COMP 2017/008)]
   - DG COMP: the loan syndication area "exhibits close cooperation between market participants in opaque or non-transparent settings (…) which are particularly vulnerable to anticompetitive conduct”
2. LIBOR cartel
3. Bundling of financial products is common-practice

Coordination among competitors

- Banks coordinated to provide the syndicated loan, but (should have) competed for the derivatives
- This challenge arises in other contexts:
  - Joint ventures- prices in the product market
  - Credit cards-interchange fees (Rochet and Tirole, 2002)
  - Mobile calls-termination charges (Laffont, rey and Tirole, 1998)
  - Patent pools-royalties (Lerner and Tirole, 2004)
- Efficiency reasons for the coordination…but no efficiency reasons to coordinate on other decisions
  - How to define such Chinese walls
  - Relevance of compliance programs

Spanish cartel of derivatives in syndicated loans

Two conducts were investigated:

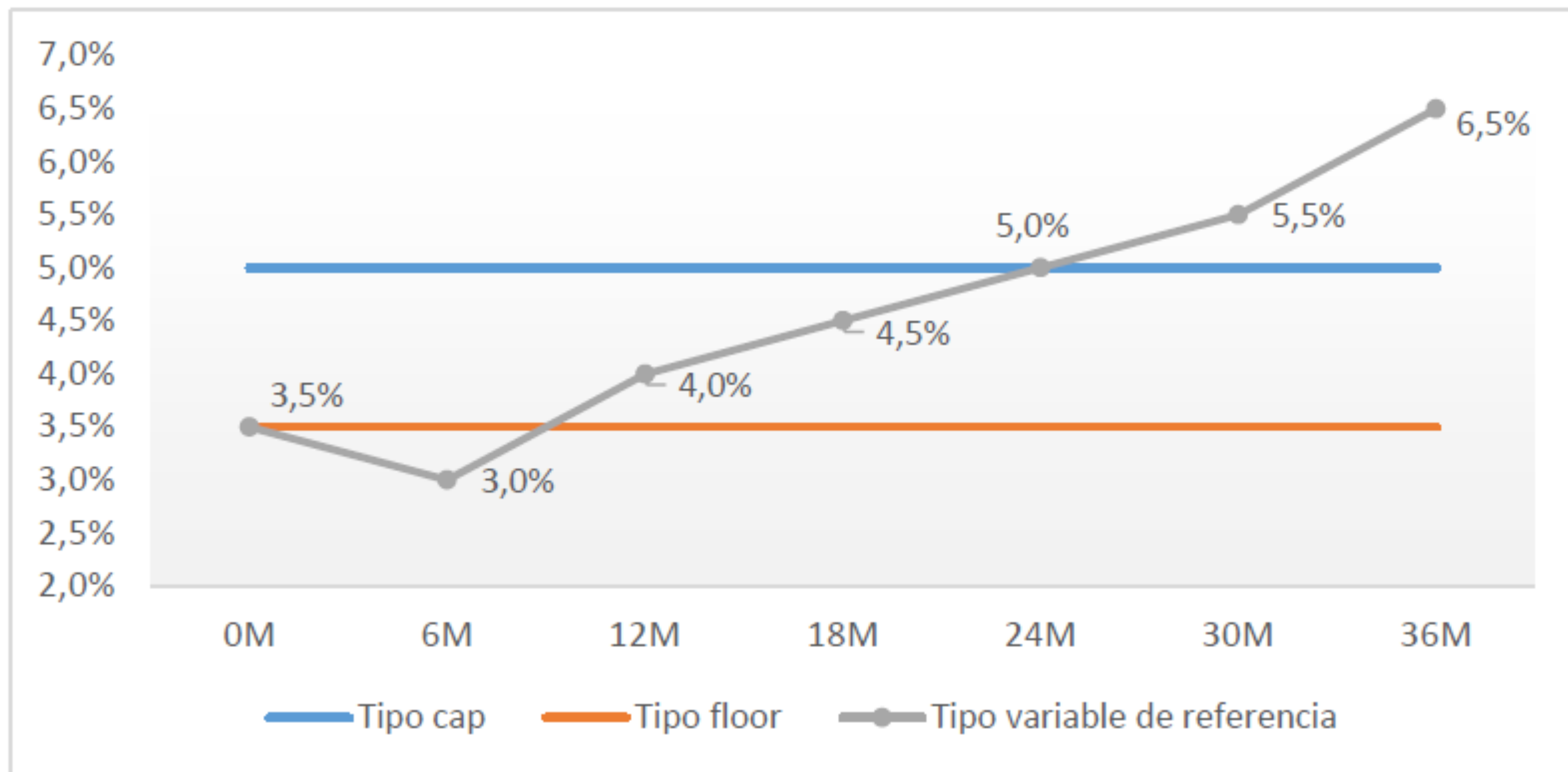
1. **Coordination** on the price of derivatives
   - Banks communicated with each other to agree on the price of derivatives

Infringement of competition <u>by object</u>

2. **Bundling** of the syndicated loan and the derivatives
   - Banks coordinated to bundle the syndicated loan and the derivatives, with pre-determined shares

Bundling facilitated price coordination

A collar



Theory of Harm

- **Perfect setting for coordination purposes!**
  - Coordination and communication needed (syndicated loan)
  - Leading bank
  - Opaque market for the borrower + non-sophisticated borrower
  - Asymmetric information for third parties
- If banks thought the cap (or swap) was needed, **why did they not offer it in the fist place through the loan**?
  - Banks face competition to provide the syndicated loan
  - They compete by offering a favourable interest rate for the loan (very salient feature), but make profits on the derivative (an "add-on")
  - They mitigate incentives to deviate from the "collusive" derivatives' price through the bundling agreement

Theory of Harm (cont.)

Bundling facilitated coordination:

- Collusion is more profitable:
  - Demand for derivatives becomes inelastic: profitable to set a high price
- Deviations are not profitable:
  - The bundling agreement pre-determined the shares of each bank over the derivative

    "*Each bank will sign its equivalent share of the hedge as a function of its share in the loan*" (p.45 of the AA decision)
  - Reducing the price would NOT allow the deviant to sell more
- Punishment would follow immediately:
  - Outcry negotiations
  - No entry by third parties: low profits would follow only after a deviation

An efficiency rationale for bundling?

Would there be bundling without coordination?

- **Adverse selection?**
  - Syndicated banks have better info about the borrower than 3rd parties
  - 3rd parties would have been either unwilling to offer the derivatives, or would have offered them at higher prices
- Bundling not needed to achieve these efficiency gains: Why bundle then?

Effects

Which is the right counter-factual?

- No agreement on the bundling and no price coordination
- What would be the price for the derivatives and the loan?

- Evidence of derivative prices at market conditions?
- Evidence of no bundling among non-colluding firms?
- Evidence of loan prices for cases with no bundling?
- Was there an invest (loan)-harvest (hedge) effect?

Effects (cont.)

- AA provides confusing (to me) evidence on the effects:
  - AA seems to focus on whether the derivatives were offered at "at zero cost"…but is the market offering "zero cost" contracts?
  - AA seems more concerned about the info provided to the borrower being "false" than about prices being "competitive"
  - In the decision, the evidence seems contradictory (p. 96):

"These figures represent overprices with respect to the market floor of [40-50]%, [40-50]%, [30-40]% y [100-150%]" (pág. 96)"

"The assessments made by the CNMC coincide with those submitted by the banks and correspond to market conditions at the date when contracts were signed"

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Muchas gracias!

questions? comments?

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