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Four Spanish banks fined EUR 91 million for fixing the price of interest rate derivatives attached to syndicated loans

On Tuesday, the Spanish Markets and Competition Commission ("**CNMC**") fined four major Spanish banks €91 million for allegedly conspiring to offer interest-rate derivatives ("**IRD**") attached to syndicated loans under conditions other than those agreed with customers. According to the CNMC, this was done by (i) applying hidden charges to zero-cost options; and (ii) offering clients a price for the IRD different from the real market price at closing.

This decision, which comes in a moment when syndicated lending is under the scrutiny of the European Commission, underscores the importance for banks to ensure transparency in their relationship with clients.

Background

IRDs (including caps, floors, collars and swaps) are attached to syndicated loans to protect group lending facilities and loan recipients, in case they are unable to meet repayments because of fluctuating interest rates.

It is usually the syndicated lenders that also act as hedging banks. Even though the loan itself is generally executed in a single document, IRDs are usually executed bilaterally between the client and each hedging bank using the ISDA Master Agreement. The same conditions are usually offered by all the hedging banks at closing.

The CNMC's investigation focused on so-called "zero-cost" or "costless" collars, which are a type of IRD established by buying a put and selling a call in a way that the premium received from the call sale offsets the premium paid to purchase the put.

The investigation

In April 2016, following a complaint by a wind farm manufacturer and operator, the Spanish antitrust enforcer began proceedings against four major Spanish banks[1] on grounds of "suspected price-fixing agreements or concerted practices, as well as alleged exchanges of commercially-sensitive information",

[1] The investigated Banks are Banco Bilbao Vizcaya Argentaria, S.A.; Banco Santander, S.A.; Banco Sabadell, S.A, and Caixabank, S.A.

in connection with the derivatives used to hedge the interest rate risk associated with syndicated loans for project finance.

During the investigation, the CNMC raised questions regarding three potentially illegal behaviours:

> **Potentially anticompetitive bundling of syndicated loans and IRDs.** Syndicated lenders usually act as hedging banks for their part of the loan. The authority investigated whether this could lead to an elimination of competition between the lenders and any potential third-party hedge providers.

> **Coordination between the hedging banks/lenders to fix the price of IRDs.** The CNMC questioned whether the fact that IRDs are executed in bilateral documents could mean that these derivatives are not syndicated and that each hedging bank should offer its own price and conditions at closing.

> **Manipulation of market prices.** The CNMC questioned whether the investigated banks colluded to offer clients a price (i) different from the "market price"; and (ii) that in many occasions also included a hidden charge.

The findings

The banks' behaviour did not amount to anticompetitive bundling

The CNMC found that there are no grounds to conclude that the behaviour of the banks amounted to anticompetitive bundling.

Syndicated project financing arrangements are highly complex and it cannot be excluded that the syndicated lenders are in a better position to also provide hedging for the interest rate risk. The CNMC also noted that the banks had provided evidence of third parties acting as hedge providers in certain cases.

The mechanism used by the banks to fix the price of IRDs is compatible with competition rules

The CNMC found that the mechanism used by the banks to fix the price of IRDs is not anticompetitive in itself.

The CNMC agreed with the banks that it may be necessary for the different hedging banks participating in a certain transaction to close IRDs under the same conditions, to the extent that all the banks share the same collateral and are bound by the same Intercreditors' Agreement. This was also supported by a report by the Bank of Spain.

The CNMC indicated that this behaviour should not amount to a breach of the competition rules, as long as clients are aware of the mechanism used to fix IRDs' conditions.

Collusion to manipulate market prices

The CNMC found that the banks' behaviour in certain instances gave rise to a breach of competition rules. The CNMC considered that, in certain cases between 2006 and 2016, the banks colluded to offer interest-rate derivatives under conditions other than those agreed with their customers by (i) applying hidden charges to zero-cost options; and (ii) offering clients a price for the derivative different from the market price at closing.

The CNMC noted that, while banks are free to apply any charges, they need to duly inform the client of such charges. According to the CNMC, in many occasions, clients were led to believe that they were purchasing a "zero-cost" option when, in fact, banks were applying a charge or margin to the IRD's market price at closing.

The CNMC also concluded that, in some instances, the banks held conversations, without the clients' knowledge, where they allegedly agreed to offer clients a price for the IRDs different from the market price at closing. To do this, the banks allegedly led the client to believe that the price at which the IRD was being traded was different from its actual market price.

The CNMC noted that, while coordination between hedging banks to offer uniform conditions may be justified, this is only the case when this coordination leads to the client obtaining the best-possible market conditions. The CNMC, quoting the ECJ's judgement in Hoffman-La Roche[2], concluded that concerted practices between competitors which concern the dissemination of misleading information constitutes a restriction of competition by object. According to the CNMC, the banks' behaviour also had an effect on the market, to the extent that the banks applied less favourable conditions to certain clients.

Fines

The CNMC concluded that the banks' behaviour amounted to a breach of Article 1 of Spanish Law 15/2007 as well as Article 101 TFEU and fined CaixaBank €31.8 million, Santander €23.9 million, BBVA €19.8 million and Sabadell €15.5 million.

Conclusion

This decision serves as a reminder of the importance of ensuring that clients are aware at all times of the extent and scope of the co-operation between the banks within the syndicate.

While the CNMC accepts that bank syndication may be justified, and uniform conditions may be offered by the syndicate even in the context of IRDs, this is only the case if this syndication allows the client to obtain the best possible conditions. Condition fixing without the borrowers' knowledge and consent, particularly if these conditions differ from market conditions, is likely to be found to infringe competition law.

[2] C-179/16 - F. Hoffmann-La Roche and Others.

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