EUROPEAN COMMISSION

MEMO

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Antitrust: Commission fines banks € 1.71 billion for participating in cartels in the interest rate derivatives industry - frequently asked questions

See IP/13/1208.

A) The products and benchmarks concerned

What are financial derivatives?

Financial derivatives are financial agreements (i.e. contracts) between two counterparties that derive their value from the level of an underlying asset, index, benchmark interest rate, etc.

What role do derivatives play in the European economy?

Derivatives are contracts traded on financial markets that are used to transfer risk. They are of key importance for the European economy. This is because they serve as insurance against price movements and reduce the volatility of companies' cash flows, which in turn results in more reliable forecasting, lower capital requirements, and higher capital productivity. Derivatives have in recent years developed into a main pillar of the international financial system and are an indispensable tool for risk management and investment purposes. Derivatives contribute to improve the operational, information, and allocation efficiency, thereby increasing the efficiency of financial markets. They help lower the cost of capital and enable firms to effectively invest and channel their resources.

What is the interest rate derivatives market? What is the importance of this market?

The most common basic interest rate derivatives are: forward rate agreements, interest rate swaps, interest rate options and interest rate futures. Interest rate derivatives may be traded over the counter ("OTC") or, in the case of interest rate futures, exchange traded.

According to the Bank for International Settlements' statistics on OTC derivatives, interest rate derivatives constitute the largest segment of all OTC derivative products. In other words, of all financial derivatives, interest rate derivatives represent the largest asset class.

Interest rate derivatives products are used by corporations, financial institutions, hedge funds, and other undertakings to, among others, hedge their exposure to interest rates fluctuations.

What are Euro interest rate derivatives ('EIRD')?

EIRD products are interest rate derivatives denominated in Euro. The main benchmark interest rates to which EIRD products are linked to are the EURIBOR rates. Another important benchmark interest rate to which EIRD products are linked to is the EONIA rate.

What are Yen interest rate derivatives ('YIRD')?

YIRD products are interest rate derivatives denominated in Japanese Yen. The main benchmark interest rates to which YIRD products are linked to are the Japanese Yen LIBOR rates. Other benchmark interest rates to which YIRD products are linked to include the Euroyen TIBOR rates.

What are EURIBOR and EONIA? How are they set?

The **EURIBOR** is a benchmark interest rate intended to reflect the cost of interbank lending in Euros which is widely used in the international money markets. The EURIBOR is defined as an index of the rate at which Euro interbank term deposits are offered by one prime bank to another prime bank within the euro zone and it is based on the panel banks' individual quotes of the rates at which each of them believes that a hypothetical prime bank would lend funds to another prime bank. Indeed, according to the European Banking Federation's Euribor Code of Conduct, panel banks provide daily quotes of the rate that each panel bank believes one prime bank is quoting to another prime bank for interbank term deposits within the euro zone.

The EURIBOR is calculated on the basis of the submissions of panel banks (44 banks at the relevant time) sent on every trading day between 10.45 am and 11.00 am Brussels time to Thomson Reuters, which serves as the calculation agent to the European Banking Federation ("EBF"). The highest and lowest 15% of all the panel bank submissions collected are eliminated. Each panel bank has submitters which are responsible for proposing the quote submissions on behalf of the given panel bank. Submitters operate normally within the treasury department of the given panel bank. The EURIBOR is determined and published at 11.00 am each business day Brussels time (10.00 am London time). Each panel bank provides a contribution for each of the 15 different EURIBOR interest rates (one for each maturity ranging from one week to twelve months – referred to as "tenors").

The EURIBOR does not have an overnight tenor. This role is taken by the **EONIA** which is an overnight interest rate computed with the help of the European Central Bank as a weighted average of all overnight unsecured lending transactions of certain banks in the interbank market. The banks contributing to EONIA are the same as the panel banks contributing to EURIBOR.

What are the Japanese Yen LIBOR and the Euroyen TIBOR? How are they set?

The JPY LIBOR is set by the British Bankers Association (BBA) and the Euroyen TIBOR is set by the Japanese Bankers Association (JBA). The rates are set daily for different maturities on the basis of submissions from banks that are members of the JPY LIBOR and Euroyen TIBOR panels. These banks are asked to submit each business day, before a certain time, estimates of interest rates at which they believe they could borrow unsecured funds in a reasonable market size on the London interbank money market (in the case of JPY LIBOR) or estimates of what they believe to be prevailing market rates for transactions between prime banks on the Japan offshore market (in the case of Euroyen TIBOR) for various maturities. The BBA and JBA then calculate, on the basis of an average of these submissions, while excluding – at the relevant time – the 4 (in the BBA's case) and 2 (in the JBA's case) highest and lowest submissions, the daily JPY LIBOR and Euroyen TIBOR rates for each maturity. The resulting rates are immediately published and available to the public each business day.

B) The cartels and the Commission's investigation

What is the scope of the two cartel cases?

The conduct established by the two decisions relates to anti-competitive conduct of traders in financial derivatives products tied to the respective benchmark interest rates.

Are banks liable for the behaviour of their traders under EU competition law?

Banks, like any other undertaking, are liable for the behaviour of their employees under EU competition law. The EU's competition rules concern the conduct of undertakings and not that of individuals and on this basis, no express instructions by the banks' management are necessary for an undertaking to be liable for the conduct of its employees.

What is leniency? What are the benefits of the Commission's leniency programme?

The Commission's leniency programme is its main and most effective tool to detect illegal cartels. All major competition agencies have a leniency programme and its optimal functioning is considered to be paramount to the success in the authorities' fight against cartels. Because most cartels are operated in secret, detecting cartels is a major challenge.

Leniency programmes allow authorities to grant full immunity or a reduction in the penalties that would otherwise have been imposed on a participant in a cartel, in exchange for freely volunteered disclosure of information on the cartel and continuous cooperation in the authority's investigation.

As cartels are extremely harmful to the economy and consumers, already their termination can significantly contribute to consumer welfare and a more competitive economy, even though a company that is the first to report a secret cartel to the Commission escapes fines. Moreover a company that receives immunity from fines is not exempted from compensating cartel victims for the damages caused by its participation in the cartel.

Leniency is a successful and powerful tool to detect and terminate cartels. By creating incentives to provide information to competition authorities, well-functioning leniency programmes can also destabilise existing cartels and prevent the creation of new cartels. The operation of a leniency programme by the European Commission since 1996 has significantly improved the Commission's track record in its fight against cartels. Since that time the Commission has sanctioned more than 500 undertakings and imposed more than 16 billion euros in cartel fines.

Why is the Commission acting in a field where financial regulators have also been active?

The Commission has the responsibility to enforce the EU antitrust rules, in particular Article 101 of the TFEU and Article 53 of the EEA Agreement which prohibit cartels, in all economic sectors, including the financial sector.

In contrast to the actions undertaken by regulatory agencies, the Commission focuses solely on breaches of competition rules – in this case collusion between competitors in derivatives markets.

This means that the Commission has looked at the conduct of the relevant bank in respect of financial benchmarks from a different angle. Financial regulatory agencies tackling the possible manipulation of benchmarks may for instance focus on the conduct of single banks rather than a number of banks. By contrast, the Commission has detected and sanctioned cartels.

Participation in a cartel is a very serious infringement of EU competition law for which the Commission, as the EU's antitrust authority, must impose a fine sufficiently deterrent to ensure that other undertakings refrain from engaging in such conduct.

The Commission understands that benchmark manipulation is also being investigated by other authorities or that such authorities may have already imposed fines on some of the undertakings involved in these cases, but none of these cases concerns the enforcement of competition rules in the European Economic Area (EEA). Investigations of other regulators do not relieve the Commission from its responsibility to also ensure that the rules of fair competition are respected in the banking sector.

What is the Commission doing to enforce competition rules in the financial sector?

In the field of interest rate derivatives, the Commission also has an on-going cartel investigation in relation to products denominated in Swiss Franc.

The Commission is also investigating other financial products and sectors, such as Credit Default Swaps (see IP/13/630) and the foreign exchange markets.

The Commission has carried out inspections concerning possible collusion to manipulate benchmarks in the field of oil and biofuels (MEMO/13/435).