

Investigation into Allegation of collusion in the commercial banking section in Jamaica

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Outline

- Allegation
- Jurisdiction
- Relevant Sections of the FCA
- Economic evidence
- Conclusion

Allegation

- In April 2005 the Staff of the Fair Trading Commission (FTC) received two letters of complaint from the Jamaica Manufacturers Association (JMA) and the Jamaica Agricultural Society (JAS).
- **Complaint 1**
 - Lending rates offered by commercial banks are unjustifiably excessive when compared to the rates paid on deposits.
 - Collusion with respect to bank charges
 - Price gouging with respect to lending rates
- **Complaint 2**
 - Request for investigation into whether or not there is collusion and price fixing among commercial banks in the setting of interest rates and bank charges.
 - Banks operating in Jamaica are of varying sizes and must therefore have varying operating costs
 - All the banks are charging rates that are so close;
 - There is a plan among banks not to compete with each other in the granting of loans.

Jurisdiction

- The complaints address two distinct prices:
 - interest rates and bank charges. Interest rate, which is normally expressed as a percentage, is the price a borrower pays for the use of money he does not own, and the return a lender receives for deferring his own consumption, by lending to the borrower. *Interest rate is the rental price of money.* Bank charges are the fees or prices consumers pay for services rendered by banks.

- Section 2 of the FCA, provides that:
 - “price” includes any charge or fee, by whatever name called.
 - “goods” means all kinds of property other than real property, money, securities or choses in action.

- In the 2000 case of The Jamaica Stock Exchange v FTC, two of the Judges of the Court of Appeal declared, among other things, that the FCA does not have jurisdiction over the Jamaica Stock Exchange. One of the reasons given is that, “goods” is defined in Section 2 of the FCA to exclude *inter alia*, money, securities and choses in action. They found, by what they seem to have considered to be necessary implication, that the definition of “service” is limited by the definition of “goods”.

Relevant Sections of the FCA

- Collusive activities, including price fixing, fall under several sections of the FCA. The following sections deal with coordinated activities by independent firms.
 - **Section 17:** *Agreements which contain provisions that have as their purpose or effect the substantial lessening of competition.*
 - **Section 18:** *Agreement containing exclusionary provisions.*
 - **Section 34:** *Price fixing.*
 - **Section 35:** *Conspiracy.*

- Investigations carried out under Sections 17 and 35 of the FCA require a ‘rule of reason’ approach. To prove a breach of these sections the Commission is required to demonstrate that the conduct subject to the investigation has the effect of substantially or unduly lessening competition.
- Activities which fall within the ambit of Sections 18 and 34 are *per se* illegal. There is no need to demonstrate the effect of such activities on competition.

- The four sections of the FCA that are relevant to this case require the existence of an agreement among the participants of the alleged collusive activity.
- In this case evidence of direct communication was neither provided by the Informants nor obtained by the Staff.

Economic evidence

□ **Relevant Characteristics of a Collusive Market**

The feasibility of coordination depends on a number of market characteristics. Those characteristics are:

- *The number of firms in the market*—the more firms competing in a market, the more difficult it is for those firms to reach a consensus and thus coordinate their activities successfully.
- *Market concentration*—markets that have a large number of firms are still susceptible to collusive activities if only a few firms account for a large share of the market. It is possible for those few firms to act independently of the smaller firms. Whether or not this is feasible depends of the ability of fringe firms to gain market shares through price cutting.

- *The type of product*—it is generally easier for firms to agree on the appropriate coordinated price when their products are homogeneous rather than differentiated.
- *Coordinating mechanism*—the costs of forming and enforcing a collusive arrangement can be facilitated if an easy way exists for firms to meet and co-ordinate their activities. A trade association is one such mechanism.

- Number of commercial banks
 - The six commercial six banks are:
 - The Bank of Nova Scotia (BNS),
 - National Commercial Bank (NCB),
 - RBTT Bank Jamaica Limited (RBTT),
 - First Caribbean International Bank (FCIB),
 - Citibank N.A.
 - First Global Bank (FGB).

Market Shares in terms of deposits and loans and advances outstanding for the years 2003, 2004 and 2005

Commercial Banks	2003		2004		2005	
	Deposit (%)	Loan (%)	Deposit (%)	Loan (%)	Deposit (%)	Loan (%)
BNS	42.92	47.80	43.61	45.12	42.16	43.65
NCB	36.60	31.20	35.93	33.41	34.56	30.28
RBTT	8.75	11.71	8.74	11.44	9.20	12.99
FCB	7.37	6.67	6.69	7.10	6.57	9.48
FGB	0.71	0.73	1.88	2.13	3.82	2.30
Citibank	3.65	1.80	3.15	0.80	3.68	1.29
Total (JA\$ '000s)	198,774,798	95,273,701	228,425,427	110,262,425	246,264,962	129,497,596

Asset base and number of branches for the year 2005

Commercial Banks	Asset base (JA\$ '000s)	Share of asset base (%)	Number of Branches
BNS	139,148,835	37	41
NCB	135,897,797	36	47
RBTT	43,235,229	12	20
FCB	25,119,813	7	12
FGB	18,033,075	5	2
Citibank	14,423,536	4	1

Concentration of Commercial Banking Industry

		2003	2004	2005
CR(2)	Deposit	79.52	79.54	76.72
	Loans & Advances outstanding	79.00	78.53	73.93
HHI	Deposit	3326.39	3327.40	3127.80
	Loans & Advances outstanding	3443.67	3338.50	3087.77

- Companies or individuals wishing to enter the commercial banking sector must obtain the necessary licence from the BOJ pursuant to the Banking Act. The banking sector is highly specialized and is subject to strict regulation. Entry is therefore unlikely to be quick, especially in the case where the potential entrant is not already a participant in the financial sector.
- While there have been changes in ownership of existing commercial banks, there has not been any entry in the commercial banking sector, since the collapse of the financial market. At the end of 1995 there were 11 commercial banks operating in Jamaica. That number declined to nine by the end of 1998 and to six by the end of 1999. The number of banks has since been stabilized at six. In May 2006, however, the Pan Caribbean Financial Services received the necessary approval from the BOJ to convert Pan Caribbean Merchant Bank into a commercial bank.
- While financial institutions – commercial banks, merchant banks, credit unions etc. – offer similar products, there are particular restrictions for each group. For instance, the product offerings of merchant banks are limited when compared to those of commercial banks. Merchant banks cannot offer overdraft facilities and they are required to keep deposits for a minimum of 14 days.
- The amounts of loans and advances outstanding for merchant banks are substantially less than those for commercial banks. The six commercial banks are the primary source of credit in Jamaica.

- **The Jamaica Bankers Association (JBA)** is the professional industry representative body for commercial and merchant banks in Jamaica. The JBA is a not-for-profit corporation, whose activities are funded by membership fees and revenues that may result from the conduct of other activities in support of the Association's objectives.

- The stated mission of the JBA is “To ensure the strength and continuing success of our member organizations by promoting a safe, vibrant and competitive banking sector through an effective programme of advocacy and education that will also enhance the economic well being of consumers within the banking community.”
- One of the activities of the **JBA** is the training and professional development of persons employed within the financial sector. The activity is carried out by JBA’s training arm, the Jamaica Institute of Bankers (JIOB) which was set up by the central bank, the Bank of Jamaica.

The Minutes of twenty-one meetings of the Executive Council of the JBA were obtained for the period September 2003 to July 2005.

□ The following references relating to interest rates are contained in the Minutes:

- *January 21, 2005*—“BOJ Special Deposit: The President reminded the meeting that in January 2003 the Central Bank instituted a “Special Deposit” requirement for commercial banks and other institutions licensed under the Financial Institutions Act. Each institution has been requested to place cash equivalent to 5% of its Jamaica Dollars deposit liabilities with BOJ. The action was imposed as a deterrent to adverse movements in the foreign exchange market by tightening the Jamaican Dollar Liquidity. BOJ also indicated that the measure would be imposed until normalcy is restored. Based on empirical evidence the membership is of the view that the market has achieved and maintained this normalcy since May, 2003. The Secretariat was asked to draft a letter to the BOJ Governor seeking to revoke the requirements. Because of the *liquidity implications the meeting agreed to recommend a phased/gradual withdrawal of the funds. The proposal received unanimous support.*”

- March 17, 2005—“Interest/Lending Rates: Council noted that the Ministry of Finance has been voicing concerns about interest rates in the sector. Members cited articles in the Sunday Herald calling for the reduction in these rates. Council agreed that it would be ill-advised to make any formal response at this time. It was noted too that individual institutions have started to adjust their base rates and that an overall reduction would eventually take place.”

- April 21, 2005—“Interest/Lending Rates: Reference was made to an article appearing in the Business Gleaner about persons who continue to call for reductions in interest rates in the banking sector. It was thought that the issue has now become emotive and although the position of the bankers was relatively complex, Council agreed that there was a need for an industry response to this outcry. It was decided that Mr. William Clarke would draft a response on behalf of the JBA to clarify the issues in an objective way and also to use the opportunity to strengthen the lobbying exercise for the establishment of a Credit Bureau in Jamaica. Mr. Clarke will forward the draft to the Secretariat.”

- In Jamaica, the monetary policy is conducted by Bank of Jamaica (BOJ), which has been targeting price stability using open market operations and reserve requirements. The BOJ also controls money supply through the direct sales or purchases of foreign currency.
- The reserve requirements comprise liquid assets ratio and cash reserve ratio. As at January 1, 2000, the liquid asset ratio applicable to commercial banks stood at 34% with respect to local currency, while the cash reserve ratio was 16%. Between January 2000 and March 2002, BOJ consistently reduced both ratios by one percentage point each time it changed the ratios. The last reduction in the cash reserve ratio, from 10% to 9%, was on March 1, 2002. The liquid assets ratio was last changed on August 1, 2002. That change amounted to a reduction from 27% to 23%.
- In January 2003 BOJ introduced a special deposit requirement of 5%. On March 1, 2005 it reduced the special deposit requirement by 2 percentage points to 3%, stating that the reduction was being instituted in the context of continued stability in the money and foreign exchange markets. The requirement was lifted on May 1, 2006.

Open market operations

<i>Number of occasions on which rates where changed for each year</i>	<i>30-day</i>	<i>60-day</i>	<i>90-day</i>	<i>120-day</i>	<i>180-day</i>	<i>270-day</i>	<i>365-day</i>
2000: 10 times	17.50 – 16.45	18.25 – 16.60	18.40 – 16.70	18.50 – 16.80	19.00 – 17.05		
2001: 11 times	16.45 – 14.25	16.60 – 14.35	16.70 – 14.45	16.80 – 14.55	17.05 – 15.00	19.25 – 18.40	20.00 – 18.90
2002: 9 times	14.25 - 12.95	14.35 - 13.05	14.45 - 18.25	14.55 - 18.40	15.00 - 13.45	17.00 - 13.85	17.90 - 14.50

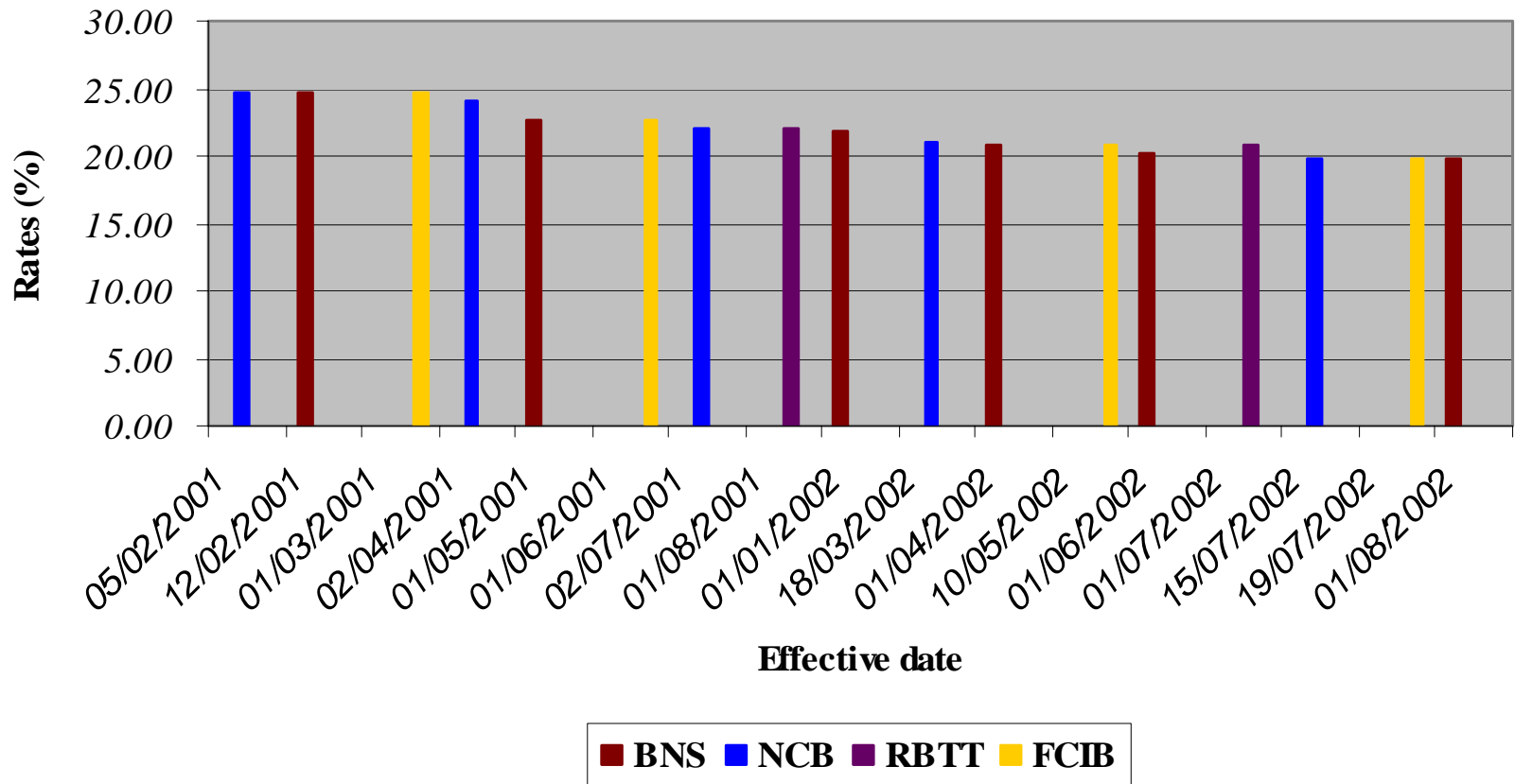
Open market operations

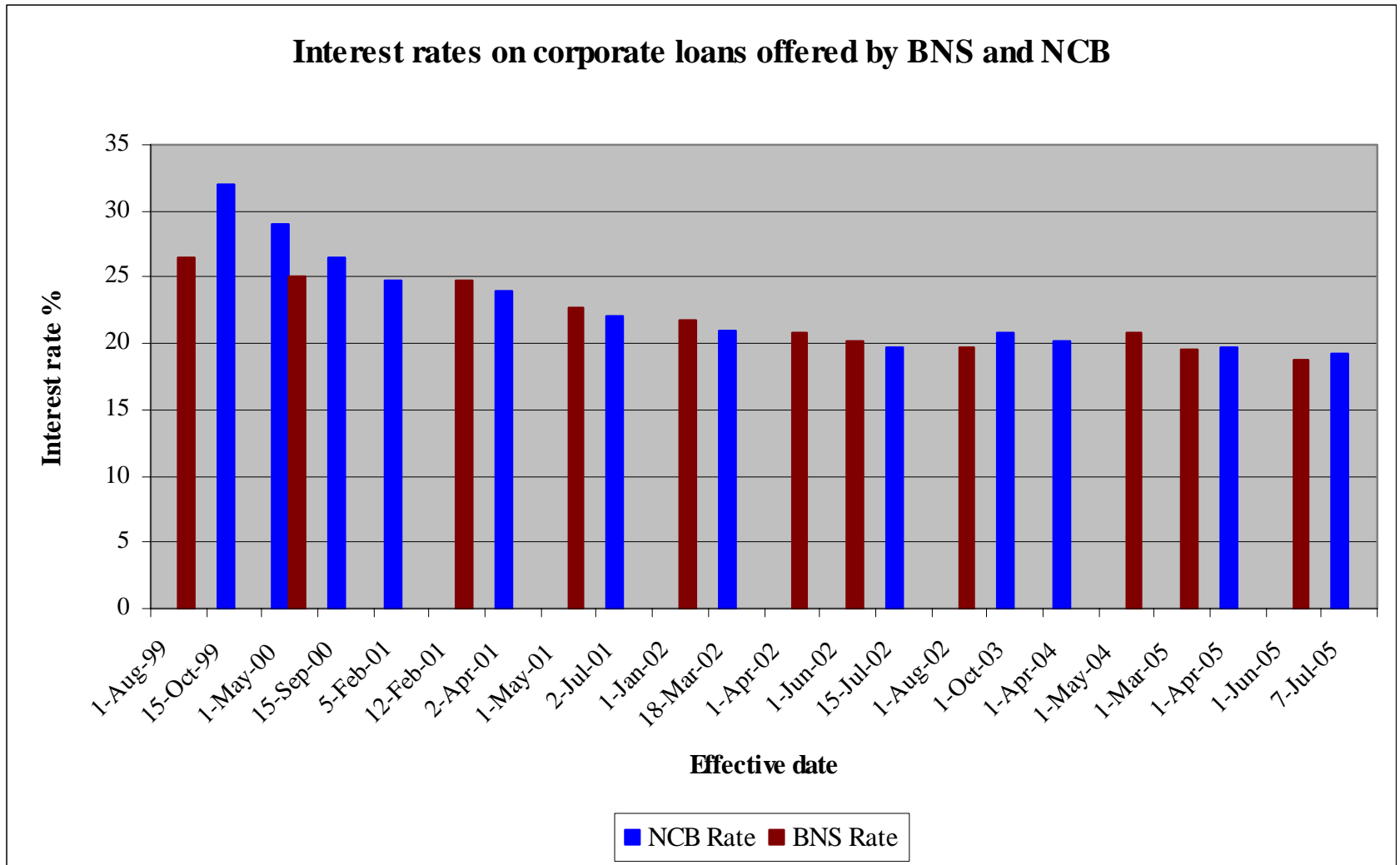
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2003: 7 times	12.95 – 15.00	13.05 – 15.30	18.25 – 20.00 – 17.00	18.40 – 24.00 – 20.00	19.65 – 33.15 – 21.00	21.50 – 34.50 – 22.00	24.00 – 35.95 – 23.00
2004: 11 times	15.00 - 13.80	15.30 - 13.95	16.00 - 14.05	18.00 - 14.15	19.50 - 14.30	21.00 - 15.00	22.00 - 15.50
2005: 3 times	13.50 - 12.60	13.65 - 12.70	13.75 - 12.75	13.85 - 12.85	14.00 - 13.00	14.50 - 13.25	15.00 - 13.60

Number of interest rate changes, January 1, 2000 – August 31, 2005

<i>Commercial banks</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>August 2005</i>
BNS	1	2	4	-	1	2
NCB	2	3	2	1	1	2
RBTT	-	1	1	-	-	1
FCIB	1	2	2	-	-	1
FGB	-	1	1	1	1	1

Loan Rates for BNS, NCB, RBTT and FCIB for the years 2001 and 2002





Period	Actions by		
	BOJ	BNS	NCB
2000	Reductions in the cash reserve ratio from 16% to 13%; and liquid assets ratio from 34% to 31%. General reduction in interest rates on all open market instruments.	One adjustment: Increase in rate by 1 percentage point.	Two adjustments: Reduction in rate by a total of 5.5 percentage points.
2001	Reductions in the cash reserve ratio from 13% to 10%; and liquid assets ratio from 31% to 28%. General reduction in interest rates on all open market instruments.	Two adjustments: Reduction in rate by 2.25 percentage points.	Three adjustments: Reduction in rate by a total of 4.5 percentage points.
2002	Reductions in the cash reserve ratio from 10% to 9%; and liquid assets ratio from 28% to 23%. General reduction in interest rates on all open market instruments up to August. Significant increase in rates on 90-day and 120-day instruments.	Four adjustments: Reduction in rate by a total of 3 percentage points.	Two adjustments: Reduction in rate by a total of 2.25 percentage points.

Period	Actions by		
	BOJ	BNS	NCB
2003	Introduction of special deposit requirement of 5%. Introduction of 150-day instrument at an interest rate of 30%. Significant increases in the rates applicable to longer term open market instruments.	No adjustment.	One adjustment: Increase in rate by 1 percentage point.
2004	General reduction in interest rates on all open market instruments.	One adjustment: Increase in rate by 1 percentage point.	One adjustment: Reduction in rate by 0.50 percentage point.
January –August 2005	Reduction in interest rates on all open market instruments. Last adjustment was on March 26, 2005. Reduction in special deposit from 5% to 4%.	Two adjustments: Reduction in rate by a total of 2 percentage points.	Two adjustments: Reduction in rate by a total of 1 percentage point.

Assessment of corporate loan rates adjustments in the year prior to receipt of complaint

- NCB changed its corporate loan prime rate twice. On April 1, 2004 it reduced its rate by 50 basis points; and exactly a year later that rate went down by another 50 basis points.
- BNS implemented two rate changes during the period. On May 1, 2004 it increased its rate by 100 basis points; and on March 1, 2005 it reduced its rate by 125 basis points.
- With the exception of Citibank, which changed its rate a number of times, there was very little movement in rates by the other commercial banks. FGB and RBTT each had only one rate change. Both banks reduced rates. FCIB did not change its rates.
- BOJ reduced, on a consistent basis, interest rates applicable to all its open market instruments. On April 2, 2004 it reduced its rates, which resulted in reductions ranging from 25 basis points on its 30-day instrument to 55 basis points on its 365-day instrument.

- BOJ reduced, on a consistent basis, interest rates applicable to all its open market instruments. On April 2, 2004 it reduced its rates, which resulted in reductions ranging from 25 basis points on its 30-day instrument to 55 basis points on its 365-day instrument.
- The 8th rate change for the period took effect on March 26, 2005, resulting in the overall reduction over the one-year period ranging from 200 basis points on the shortest term instrument to 380 basis points on the longest one. At the beginning of March 2005, the rates on all seven instruments were higher than the rates recorded in August 2002.
- BOJ also reduced the special deposit requirement from 5% to 3% on March 1, 2005.
- There were no changes in the cash reserve ratio and the liquid assets ratio, which were last reduced on March 1, 2002 and August 1, 2002 respectively.

Interest rates on personal loans

- The analysis of personal loans relates to four of the six banks - BNS, NCB, FGB and FCB.
- As with interest rates on corporate loans, there was a downward trend in interest rates on personal loans. The banks with the highest rates at January 1, 2000 were FGB with a rate of 39% and NCB with a rate of 36%. At the end of the review period FGB's rate was 21.75% and NCB's rate was 24%.
- There was a total of 28 rate changes - there were two increases implemented by NCB and BNS.

- FCIB implemented five rate changes, all reductions. Its lowest rate falls below the rates of either NCB or BNS.
- FGB implemented five rate reductions. Its last two rate changes resulted in an amount below NCB's prevailing rate.
- The years 2001 and 2002 were the most active in terms of rate changes. During those two years NCB and BNS together implemented nine rate changes. On three out of five occasions, NCB adjusted its rate to amounts below BNS's lowest rates.
- There were no changes in the cash reserve ratio and the liquid assets ratio, which were last reduced on March 1, 2002 and August 1, 2002 respectively.

Pattern of personal loans interest rates adjustments, January 1, 2000 – August 31, 2005

	2000	2001	2002	2003	2004	2005
January						
February		NCB	FGB			
March		BNS	NCB			
April		NCB			NCB	
May	NCB BNS	BNS			BNS FGB	
June	FCIB	FCIB				FCIB FGB NCB
July		NCB	NCB FCIB			
August	BNS					
September	NCB					
October		FGB	BNS	NCB	BNS	
November		BNS		FGB		
December			FCIB			

Bank charges for BNS and NCB

- BNS has three categories of loan related fees – application, annual renewal and commitment/acceptance fees.
- NCB has one type of loan related fee – commitment/renegotiation fee.
- BNS has a tier structure for application and annual renewal fees with respect to loans below one million dollars. For those loans fixed fees are charged. For loans in amounts greater than one million, a percentage of the loan is charged as the fee.
- During the review period, January 1, 2000 to August 31, 2005, BNS adjusted its fees five times – almost all the adjustments were increases. Each adjustment was implemented on November 1 of each year. NCB effected 4 rate changes. These changes took effect on December 1, 2002, January 10, 2003, November 1, 2004 and July 1, 2005. All adjustments were increases. There was only one occasion on which both banks adjusted their fees on the same date, November 1, 2004.
- On that date, NCB increased its minimum commitment fee by 100%, while BNS increased its application and commitment fees by 14.12% and 12.5% respectively

- The structural conditions of the sector favour collusion.
- There is no evidence that the observed behaviour of the commercial banks is the result of a collusive agreement.
- The observed behaviour is not inconsistent with competition.
- The observed rate changes implemented by the commercial banks are not inconsistent with independent reactions to the policies of the BOJ.
- While BOJ reduced the interest rates on all its open market instruments during the period April 2004 to the end of March 2005, there were very little changes in rates implemented by the commercial banks. There were, however, noticeable interest rates reductions implemented by the banks following the reduction in the special deposit requirement. Based on Minutes of a meeting of the JBA, it was the bankers who requested the reduction of the deposit requirement.
- While the banks agreed that the elimination of the special deposit requirement should be implemented on a phased basis, there is no evidence to indicate that they agreed on either the timetable or the amounts by which they would reduce their individual rates.

DATE	EVENT
January 21	•Bankers agreed to write to BOJ requesting reduction of the Special Deposit Requirement on a phase basis.
February 7	BOJ reduced interest rates applicable to all its open market instruments.
February 23	•Article in Gleaner: “ <i>Scotiabank to stick to core banking</i> ” Statement by Mr. Clarke, “The economic environment continues to be challenging and interest margins have contracted, due to the lower level of interest rates.”
February 28	•BNS announced that it would reduce interest rates on March 1, 2005.
March 1	•BOJ reduced special deposit requirement from 5% to 3%.
	•BNS and Citibank reduced interest rates
March 7	BOJ reduced interest rates applicable to all its open market instruments.
March 13	Articles in the Sunday Herald “ <i>Meeting fiscal target could help reduce bank spreads</i> ”; “ <i>BOJ interest rate reduction</i> ”; “ <i>Jamaican spreads way above international norm</i> ”; “ <i>Lack of competition in the sector</i> ”; and “ <i>Banking spreads still too high</i> ” Editorial: “ <i>Banks must lower lending rates faster</i> ”

DATE	EVENT
March 26	•BOJ reduced interest rates applicable to all its open market instruments.
April 1	•NCB, RBTT and Citibank reduced rates. NCB and RBTT reduced to same rate.
April 8	•JMA and JAS placed a full page ad in the Gleaner. Title of ad <i>“Interest Rates Spread Still Too High”</i>
	•Article in the Financial Gleaner: <i>“Banks go on the offensive on lending rates”</i> . The article contained quotes from President of the JMA, Mr. William Clarke of BNS and Mr. Patrick Hylton of NCB.
April 9	•Article in the Gleaner: <i>“Local Farmers demand lower interest rates”</i>
April 14	• JMA and JAS complained to the Staff of the FTC.
April 20	•Article in the Gleaner: <i>“Interest rate battle heats up – JMA, JAS ask the FTC to probe price gouging by commercial banks”</i>
April 21	JBA monthly meeting
	JMA and JAS withdraw first complaint and lodge another.
	JMA held a special luncheon as a tribute to Mr. Seaga’s public life.

DATE	EVENT
April 22	Article in the Observer: “ <i>JMA wants bank licence</i> ”
April 27	Article in Gleaner: “ <i>Brady defends banks’ interest rate policies</i> ”
April 28	Article in Gleaner: “ <i>Paulwell backs call for lower interest rates</i> ”
April 29	Article in the Financial Gleaner: “ <i>JMA and JAS respond to bankers</i> ”
	Article in the Financial Gleaner: “ <i>Bankers’ association speaks on interest rate spreads</i> ”
May 1	Article in Gleaner: “ <i>Manufacturers desperately need lower interest rates</i> ”. Contributor is Mr. Edward Seaga.
June 1	BNS and FCIB reduced rates.
June 3	FGB reduced rates.
July 1	Citibank reduced rates.
July 1	NCB reduced rates.
September 1	FCIB reduced rates.