Korea's aggressive antitrust enforcement in financial product markets

Yulchon's Sai Ree Yun, Cecil Saehoon Chung and Kyoung Yeon Kim reveal the implications of Korea's antitrust enforcement agencies on numerous sectors, observing both initial policies and recent innovations, as well as looking to the future.

Recently, antitrust enforcement agencies around the globe have started aggressively challenging suspected cartels and other perceived abuses in the financial sector, including the US and EU's LIBOR, EURIBOR, Forex, and CDS (credit default swap) investigations. This is remarkable in that, for various reasons, until recently, antitrust agencies typically had not challenged various practices in the financial sector as extensively as in other sectors. Not to be outdone, today, the Korea Fair Trade Commission (KFTC) is handling its share of financial sector competition matters. Indeed, the KFTC started challenging alleged cartels in the financial sector even before the LIBOR investigation brought the financial sector to the forefront of antitrust enforcement.

In Korea, as in other countries, the financial sector is one of the most heavily-regulated industries. However, it has never been exempted from the reach of Korea's Monopoly Regulation and Fair Trade Act.[1] Initially, the KFTC's main enforcement activity regarding the financial sector has been more consumer protection than antitrust enforcement. Specifically, because financial institutions have used various standard contracts in various consumer financing transactions, the KFTC reviewed and monitored standard contract forms in use and proposed model standard contracts under the Regulation on Standardised Contract Act. However, since the eleven insurance companies' cartel case in 1990,[2] the KFTC has steadily challenged cartels and other alleged abuses by various financial institutions.

Until 2013, the KFTC handled approximately 30 cases involving financial institutions, excluding bank mergers. Most of them were cartel matters. Insurance companies (10 cases), credit card companies (6 cases), and banks (6 cases) represented the lion's share. Over time, the KFTC has broadened its enforcement focus from explicit agreements to information exchanges.

The following two representative cases illustrate the KFTC's recent enforcement trend and key competition issues in the financial industry in Korea.

The sixteen life insurance companies cartel case

In December 2011, the KFTC imposed various corrective measures and KRW 53.8 billion in total administrative fines on 16 Korean life insurance companies. The KFTC found that from 1998 through to 2000, the life insurance companies "directly agreed" to fix the discount rate for fixed-rate individual life insurance products and the reference rate for variable-rate individual life insurance products. From 2001 to 2006, they "exchanged non-public information" on future discount rates and reference rates and then used such information to decide their own respective rates, thereby indirectly but nonetheless jointly fixing the rates. The KTFC found that these two periods constituted a single continuing conspiracy.

Most of the life insurance companies appealed to the Seoul High Court. On appeal, the court noted the markedly changed nature and type of conduct in the second period as a clear break from whatever might have happened in the earlier period, and in

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turn, dismissed the first period as falling outside the statute of limitations. Regarding the alleged indirect price-fixing via information exchanges in the second period, the Seoul High Court held that the law requires not just an exchange of price information but an agreement to fix, maintain or change prices. The Seoul High Court also noted that the life insurance companies used not just the exchanged information to determine their own rates, but also comprehensively used numerous other critically relevant factors, such as the prime rate, going rates in the marketplace, their own return on assets ratio, the level of customer recognition of each brand and their own competitive position. The Seoul High Court further observed that there was no genuine dispute as to the absence of uniformity or matching patterns in the competitors' actual discount rates. Finally, the Seoul High Court intimated that it was inherently inconsistent for the KFTC to acknowledge that the insurance companies "individually decided their own rates" after exchanging certain sensitive information with others but also to allege that they had "jointly decided" the rates. Therefore, the Seoul High Court, in separate opinions, vacated the KFTC's sanctions on those insurance companies that appealed the KFTC decision, including the administrative fines.

On further appeal, the Korean Supreme Court affirmed the Seoul High Court's decisions, finding that the exchange of future rates at issue did not amount to collusion because there was no other evidence of an actual agreement, explicit or implicit, to jointly fix the rates. In doing so, the Supreme Court clarified that: information exchange, in and of itself, does not amount to collusion (i.e., an illegal cartel agreement); and that the KFTC must show a "meeting of minds" (i.e., an agreement), which is one of the essential elements of collusion under Korean antitrust law.

The twenty securities companies small-amount bond cartel case

In November 2012, the KFTC imposed corrective measures and KRW 19.2 billion in total administrative fines on 20 securities companies. The KFTC also referred six companies to the Public Prosecutor's Office for criminal proceedings.

When people purchase a house or vehicle in Korea, they are required to buy a small-amount bond from a public institution. It is common that they immediately sell the bonds back to the nine designated banks to cash them before maturity. As of 2004, five securities companies were designated as the exclusive bond-selling agents in the bond market on behalf of the above nine designated banks that purchased small-amount bonds from individuals. The bond yields applicable to the bond sales were calculated by a mathematical means of bond yields reported from 20 securities companies that were designated as the exclusive bond buyers in the bond market. All of the bond-selling agent companies also served as the exclusive bond buyers at the same time, but not vice versa.

The KFTC found that from around March 2004 to December 2010, employees of these 20 designated bond-buying securities companies exchanged bond yields information through Internet messenger services before submission to the Korea Exchange and coordinated their reported bond yields that were either similar to or the same as one another's. Moreover, to deter deviations from the arrangement, they requested one another to submit computer screen printouts of actually reported bond yields to the designated employees of the other securities companies. The KFTC determined that these activities supported a finding of a cartel arrangement.

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The KFTC also ruled that the bond-buying securities companies tried to raise the reported bond yields, which in turn would decrease the bond prices that they would have to pay. Furthermore, to avoid the risk of getting eliminated from the exclusive bond buyers' list, the securities companies closely coordinated their own reported bond yields.

Some of the securities companies appealed the KFTC's decision to the Seoul High Court, arguing that: during a certain period of time, reported bond yields were extremely low, which they argued meant there was no cartel; the follower companies had no choice but to follow the bond yields set by the leading companies (i.e., bigger companies which were designated bond selling agents) due to their lack of business experience instead of any anticompetitive purpose; and that the coordination was inevitable due to informal guidance from the Korea Exchange that implemented a governmental policy to control the orderly functioning of the bond market. The Seoul High Court rejected these arguments because they lacked persuasiveness and also the companies failed to show clear supporting evidence.

Under the Seoul High Court's reasoning, this small-amount bond cartel case, still pending before the Supreme Court, may be different from the sixteen life insurance companies case discussed earlier. First, the Internet messenger communications tended to show explicit agreements among some members (mainly the leading companies). Thus, the frequent information

exchanges were not only circumstantial evidence but also a plus factor, supporting the existence of the implicit agreement among those follower companies. Second, the bond yield is one of the elements that determines the price of a bond, together with the maturity of bond, number of remaining days to the maturity, face revenue rate, market revenue rate and other market circumstances. However, unlike the life insurance case, the Court ruled that the reported bond yield was the major and most influential element for calculating the market price of bond. Thus, the Court decided that the agreement on bond yields amounted to an agreement on bond price.

Lessons from recent KFTC enforcement and prognosis

As discussed above, we have seen several noticeable changes in the financial industry cartel cases. At least two additional trends warrant reader attention. Firstly, private enforcement has become more active. Since class action has not yet been adopted for anti-trust cases, bringing an individual small-claim lawsuit is not an attractive or feasible option for plaintiffs who individually suffered only a small amount of damages. However, thanks to the class action system adopted in 2005 for securities law violation cases, consumer organisations, such as the Korea Finance Consumer Federation, actively began to help bring private damages claims. Similarly, when the KFTC announced its decision in the life insurance discount rate cartel case, those consumer organisations immediately started soliciting or recruiting potential individual plaintiffs for tort claims.

Secondly, very recently, the KFTC re-opened a number of financial sector investigations, at least partially responding to a strong political criticism that banks were not actively supporting the government's economic stimulus package by lowering interest rates for households and small-to-medium-sized companies. In 2009, the KFTC conducted dawn raids on nine banks suspected of colluding on the interest rates for residential mortgage-backed loans. In 2012, it also dawn-raided nine banks and ten securities companies for colluding on CD rates. Until very recently, those two separate investigations had not produced any findings of

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wrongdoings and they appeared to be on the back burner. Then, all of sudden, the KFTC conducted dawn raids on some of these banks again. Although the KFTC claimed that these dawn raids were a continuation of the CD rates investigation of 2012, the new investigation actually appears to cover the subjects of the 2009 and 2012 inquiries, as well as some others. For one thing, the KFTC dispatched the entire cartel department investigators to four major banks to examine extensive data and materials covering interest rates generally, including CD rates, COFIX (Cost of Fund Index) rates, interest rates for various types of loans, and the like. Furthermore, rumour has it that the securities companies will be the targets of the KFTC's next round of dawn raids.

It remains to be seen whether this series of the KFTC's long-running investigations will reveal anti-competitive behaviors of the banks and securities companies or provide a meaningful momentum for restructuring the complicated financial systems vulnerable to potential anti-competitive behaviors. However, it would be prudent to assume that the KFTC will stay as vigilant as ever, if not become more aggressive, in light of the recent and continuing global crackdown on various long-standing practices in the financial product markets that are now challenged as anti-competitive.

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Endnotes

1. At one point, the KFTC implicitly allowed insurance companies to adopt common premiums calculated by the Insurance Development Institute ("KIDI"), which was co-established by the insurance companies in Korea. Since they shared and adopted not only the net premium amount but also the added premium component (the loading charges), the risk of cartel-like activities among the insurance companies was quite high. Thus, the KFTC prohibited this practice in 2000 and, since then, the insurance companies could only use the net premium calculated by the KIDI and were obliged to calculate the added premium component by themselves, reflecting their own unique business conditions.
2. In this early cartel case, the KFTC found that insurance companies agreed to have common sales conditions and also agreed not to compete for one another's existing customers.