COMPETITION TRIBUNAL
REPUBLIC OF SOUTH AFRICA

Case No.: 65/LM/Nov03

In the larger merger between:

Rand Merchant Bank, a Division of FirstRand Bank Limited

and

Mettle Treasury (Pty) Limited

Reasons for decision

Approval

1. On 17 December 2003 we issued a Merger Clearance Certificate approving the merger between the abovementioned parties in terms of section 16(2)(a) of the Competition Act 89 of 1998, as amended. The Tribunal's reasons for its decision appear below.

The parties

2. The primary acquiring firm is Rand Merchant Bank **("RMB")**, a division of FirstRand Bank Limited ("FirstRand Bank"). FirstRand Bank is a subsidiary of FirstRand Bank Holdings Limited, which in turn is a subsidiary of FirstRand Limited. FirstRand Limited is the holding company of the FirstRand group, whose core activities are banking (conducted through FirstRand Bank), and insurance (conducted through Momentum Group Limited and its subsidiaries)[1].

3. The primary target firm is Mettle Treasury (Pty) Ltd **("Mettle Treasury")**, through its proprietary interest rate trading business and ancillary advisory business. Mettle Treasury is a subsidiary of Mettle Ltd ("Mettle"). Hosken Consolidated Investments Ltd ("Hosken") holds 60% of the shares in Mettle[2]. Mettle Treasury has no subsidiaries.

The merger transaction

<u>Structure</u>

4. This is a proposed merger in terms of which RMB will acquire the treasury business of Mettle Treasury. In summary, the transaction will involve:

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[1] FirstRand Limited controls the Momentum Group. The FirstRand group controls a number of firms, which are irrelevant for purposes of this transaction.
[2] Hosken and Mettle control a number of firms, none of which are relevant for purposes of this transaction.

- The sale and cession of all derivative contracts and bond trading positions held by Mettle Treasury to RMB;
- The employment of staff by RMB on terms substantially similar to those on which they were employed by Mettle; and
- The closure of the existing Mettle Treasury business.

5. On completion of this transaction, Mettle will still remain an independent financial institution whilst its proprietary interest rate trade and ancillary advisory business will be absorbed into RMB.

Rationale

6. The parties indicated a key factor, which attributed to the Mettle group's decision to dispose of or close its treasury business, as the lack of financial resources to continue operating a trading business successfully in the current economic climate. It is submitted, amongst other negative conditions, that corporate clients became unwilling to deal with Mettle Treasury because of a concern regarding Mettle's ability to remain in business following the demise of the A2 (small) banks.

7. The parties further claimed that should this transaction fail, the probable outcome would be that Mettle would be forced to close its treasury business with the consequence that Mettle's employees would be retrenched[3].

The relevant market

8. As mentioned earlier, the FirstRand group is a banking and insurance group, which operates through Momentum Group Ltd and FirstRand Bank. FirstRand Bank, through its RMB division, provides treasury services and specialist financial services relating to financial markets.

9. Mettle Treasury is described as a niche financial services operation focussing on the following activities:

- Speculative trading in financial instruments, particularly interest rate derivatives and listed bonds *("proprietary trading")*;
- Structuring interest rate derivatives and advising on the implementation of interest derivatives to corporate clients *("structuring")*; and
- Facilitating other business areas within the Mettle group by assisting with the placement of commercial paper, advising on hedging strategies and investing surplus cash on behalf of group companies *("group services")*.

10. Both the parties and the Commission disregarded the "group services" in analysing this transaction as these services are provided solely to internal divisions and companies of the Mettle group.

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[3] For more information, refer to page 35 and 396 of the record.

11. As a result, the Commission identified the service overlap in "treasury services" comprised of proprietary trading in interest rate derivatives, bonds and exchanges and structuring interest rate derivatives and advising on the implementation of these services to corporate clients.

- **Proprietary trading**

According to the parties, this activity comprises the speculative buying and selling of financial instruments[4] in order to make a profit. Speculative trading is made in anticipation of changes to the economic environment and market interest rates, which would enable these instruments to be disposed of at a profit. The parties indicated that Mettle trades in the following financial instruments[5]:

Interest rate derivatives

According to the Commission, a derivative instrument is a contract written on (i.e. derived from) an underlying instrument[6]. The parties described interest rate derivatives as transactions whose value depends, at least in part, upon the value of a related asset or liability. The underlying assets from which interest rate derivatives derive their value are interest rates, whilst payment obligations depend upon fluctuations in those interest rates.

Bonds

These are debt instruments issued by either the government, parastatal institutions or corporates and typically used as a mechanism to fund these organisations[7].

Repurchase agreements

These are agreements entered into by parties which own a security, usually a bond, which wish to raise finance using that security. The Commission and the parties indicated that the form of the transaction is that the owner sells the security to a purchaser and undertakes to repurchase the security at a future date[8].

- **Structuring**

[4] Financial instruments include bills of exchange, treasury bills, promissory notes, bonds, certificate of deposits, etc.
[5] Refer to page 399 of the record.
[6] It appears that the International Directory of Finance describe a derivative as a generic term for futures, options and swaps.
[7] It is submitted that bonds are traded at the Bond Exchange South Africa ("BESA").
[8] They further contend that the economic effect of the transaction is that is similar to a loan in that the repurchase price is higher than the original selling price and reflects the "interest" cost to the party who wished to raise the finance.

The structuring activities undertaken by Mettle Treasury entail advising corporate clients on interest rate hedging strategies and solutions[9]. The parties indicated that during a period when interest rates are expected to increase, Mettle would advise its clients to convert any floating rate debt (in respect of which interest payments would increase if interest rate rose) to fixed rate debt by concluding an interest rate swap. The parties explain that this strategy would protect the client from increased interest payments.

12. They further stated that revenue earned from these structuring and advisory activities is derived from fees or through the implementation of the transaction as follows[10]:

- Implementing the interest rate derivative on behalf of a client requires a bank to provide credit facilities to the client. The interest rate derivative is provided to the client directly by the bank, and Mettle is not a principal to the actual derivative concluded. In this case, Mettle would earn fees in the form of an introduction fee from the bank or an arranging fee paid by the client.
- Where Mettle is appointed as an advisor on interest rate hedging to a client, Mettle would earn fees on a retainer basis for providing advice on the implementation of hedging strategies and for reviewing the pricing of the interest rate derivatives quoted by the competing banks.
- Directly providing a client with an interest rate derivative solution. In this case, Mettle as a principal would deal an interest rate derivative with the client. Thus the transaction would be included in the speculative trading activities of Mettle's business and any profits would be dependant on future movements in interest rates.

13. Insofar as the *relevant geographic market* is concerned, the parties indicated that treasury-trading activities could be sourced nationally and globally. They stated further that advisory services are conducted principally from Johannesburg, as the majority of clients are located in the Gauteng region. After the Commission's consultative process with the customers of the merging parties, it emerged that these services can be offered to clients throughout South Africa, *irrespective of where you are located*. It is for this reason that the Commission and the parties defined this market as *"national"*.

Competitive effect of this transaction

14. According to the market share figures supplied, the merged entity's combined market shares is above 20% in speculative trading in interest rate derivatives, bonds and repurchase agreements. In respect of structuring interest rate derivatives, the parties' post-merger market shares are below 15%.

[9] The Commission's practical example is that if Anglo had been advised by RMB that it should "hedge" its interest rate risk of say, 13%, by way of the swap agreement, RMB would have been engaging in "structuring" services.
[10] Refer to page 401 of the record.

15. The Commission contends, notwithstanding the high market shares in proprietary trading, that this transaction does not raise any competitive concerns for the following reasons. *Firstly*, speculative trading is undertaken with Mettle group's funds to make a profit for the group as a result of interest rates changes. And therefore, it does not provide any goods or services to a market (i.e. clients or the community). *Secondly*, Mettle's speculative trading does not represent a fund management business, as it does not utilise third party funds. In this sense, it is not part of a contestable market. The Commission further indicated that that the post-merger market shares with regard to structuring interest rate derivatives is below 15%, which is unlikely to raise competition concerns. From the market shares provided, it appears that Mettle Treasury is in fact a small player in this market.

16. In its submissions, the Commission indicated that customers in this market are highly sophisticated. Customers interviewed by the Commission stated that they have sufficient alternative sources to go to for structuring or treasury services should the merged entity raise prices above the competitive level. It appears that most of these customers are listed companies that normally shop around to get the best deal before engaging any treasury service provider[11].

17. Although the demise of Mettle's operations, due to negative perceptions about A2 banks, might suggest that there are high barriers to entry in this market, we are persuaded by the parties' arguments that this is not the case. The parties, whilst conceding that capital is a barrier to entry, have argued that some major international banks, and even a smaller player, have entered the local market. [12].

Public interest considerations

18. The transaction will have no effect on public interest considerations as contemplated in the Competition Act. Instead it will save jobs for Mettle employees in that they will be employed at RMB.

Conclusion

19. In light of the above findings, we conclude that this merger is unlikely to substantially lessen or prevent competition in any of the relevant markets. We accordingly approve this transaction without any conditions.

_______________ 18 December 2003

N. Manoim **DATE**

Concurring: L. Reyburn, T. Orleyn

[11] Customers interviewed by the Commission include Pioneer Foods Group Ltd, Aveng Ltd, Seardel Investment Corporation Ltd, and Paarl Media (Pty) Ltd.

[12] According to the parties, recent entrants include small players such as Kagiso Hedge Trading, and international banks such as Barclays Bank and Standard Chartered.

For the merging parties:	Ms Lesley Morphet, Deneys Reitz Inc.
For the Commission:	Ms M Sebothoma assisted by Ms. K. Ramathula, Competition Commission