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Philadelphia Sues Banks for Bond Rate Collusion.

The city says seven big banks conspired to inflate rates on VRDO bonds so they could "continue to collect re-marketing fees for doing nothing."

The City of Philadelphia has accused seven of the largest U.S. banks of conspiring to "substantially inflate" interest rates on floating-rate municipal bonds to benefit themselves and money market funds they managed at the expense of issuers.

The harm inflicted by the banks, including JPMorgan Chase and Bank of America, "likely amounts to billions of dollars," the city said in a class-action lawsuit that focuses on the market for bonds known as "variable rate demand obligations."

VRDOs offer a built-in "put" feature that allows investors to redeem the bond at any periodic reset date, making them a low-risk and high-liquidity investment.

According to the city's antitrust complaint, the banks, which acted as "re-marketing agents" (RMAs) for VRDOs, agreed as far back as February 2008 not to compete against each other, and instead to keep VRDO rates artificially high, "to maximize the likelihood that existing holders of VRDOs would not put their bonds back" to them.

"This allowed defendants to continue to collect re-marketing fees for doing, essentially, nothing," the city said, in part because they did not have to spend time and resources to re-market tendered bonds to new investors.

RMAs typically pocket high annual fees amounting to an average of 10 basis points of the VRDO debt balance. In 2008, issuers sold more than $115 billion in VRDO paper.

Allegations of collusion among RMAs first came to light through a whistleblower who filed a complaint with the U.S. Securities and Exchange Commission in 2015. The city said its own investigation found evidence of direct communications between competing banks, with RMA staff calling each other on the phone before setting rates.

"According to former senior RMA personnel at JPMorgan, it was a 'dirty little secret' that RMAs would talk to each other about rates," the city's complaint said.

The suit alleges the banks also benefited from the artificially high rates because if an RMA "fails to find a buyer for the tendered VRDO, the RMA is obligated to repurchase the bond and assume the risk that the issuer will default on its payments."

by Matthew Heller

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