

Anticipated acquisition by London Stock Exchange plc of the transaction reporting system business of the Financial Services Authority

ME/5142/11

The OFT's decision on reference under section 33 given on 18 October 2011. Full text of decision published 15 November 2011.

Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

PARTIES

1. **London Stock Exchange plc** (LSE) is a wholly owned subsidiary of London Stock Exchange Group plc. LSE is predominantly an exchange on which equities, bonds and some derivatives are traded. LSE provides transaction reporting services through UnaVista. LSE is also active in a range of other activities which are unaffected by this merger. For the year ended 31 March 2011 LSE's UK turnover was £306 million of which UnaVista's revenue was £[] million.
2. **Transaction Reporting System** (TRS) is a business unit within the Financial Services Authority (the FSA, the UK's financial services regulator) and it provides transaction reporting services to around [] customers. For the year ending March 2011 TRS' UK turnover was £[] million.

TRANSACTION

3. On 1 August 2011 the parties entered into a Business Sale Agreement which was announced on 2 August. LSE proposes to acquire TRS from the FSA for £15 million.

4. The parties filed the proposed acquisition with the Office of Fair Trading (OFT) on 12 August 2011. The OFT's administrative deadline in this case is 10 October 2011.

JURISDICTION

5. As a result of this transaction LSE and TRS will cease to be distinct. The proposed acquisition includes intellectual property rights, software, the TRS contract with [] and []. The OFT considers that TRS constitutes an enterprise within the meaning of section 129 of the Enterprise Act 2002 (the Act) and therefore as a result of the merger, enterprises will cease to be distinct.
6. The parties overlap in transaction reporting to the FSA where together they account for more than a 25 per cent share. Therefore, the share of supply test in section 23 of the Act is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

THE COUNTERFACTUAL

7. In assessing the merger the OFT needs to consider whether it raises a realistic prospect of a substantial lessening of competition when measured against the competitive situation that would preside without the merger. The competitive situation absent the merger is known as the counterfactual. The OFT generally adopts the prevailing conditions of competition (or the pre-merger situation) as the relevant counterfactual.¹ However, it may be the case that some developments are foreseeable and have sufficient certainty for the OFT to adopt an alternative counterfactual. For example, the imminent exit of one of the merger parties or a competitor.
8. In this case the OFT considers that the counterfactual should be that, absent the merger, the FSA would have sold TRS to another buyer. Without knowing the identity and strategy of the alternative buyer, it is hard to assess how this purchase would have changed TRS' competitive

¹ OFT and Competition Commission (CC), 'Merger Assessment Guidelines', OFT1254, September 2010, paragraph 4.3.5.

strength in the market. However, the OFT expects that TRS would have retained the competitive strength that it had immediately prior to the merger.

MARKET DEFINITION

Product scope

9. Under the Markets in Financial Instruments Directive (MiFID)² transactions carried out involving financial instruments admitted to trading on a regulated market (that is, the trading of equities and bonds) must be reported to the relevant national market supervisor (in the case of the UK, the FSA).³ The reporting of such transactions must be undertaken by an Approved Reporting Mechanism (ARM), approved by the relevant regulator.
10. The transaction reporting services involve the collation of reports of securities transactions from customers, validation of these data to the standards required by the relevant regulator and the transmission of those data to the regulator (the FSA). The reports must contain key details including the product traded, the firm that executed the transaction, the underlying client, whether it was a buy or sell order, the price and quantity, and the time and date of the transaction.
11. The parties both operate ARMs which is their only area of overlap.
12. The parties submitted that the appropriate product frame of reference in this case is the supply of transaction reporting services irrespective of whether a firm reports its own transactions only and of the financial instrument type traded.⁴ These possible segmentations are discussed below.

Self-reporting

13. Most customers told the OFT that they would not consider applying for ARM status if all transaction reporting fees increased by five per cent.

² EC Directive 2004/39/EC which came into effect in November 2007.

³ Before MiFID the transaction reporting regime dated back to 1989. However, MiFID expanded the number of categories of financial instruments for which transaction reporting is required.

⁴ Credit Suisse and Getco currently handle their own transaction reporting obligations.

However, some (over a third of respondents) did say that they would consider it. The OFT has therefore examined whether the ability of firms to self-report (irrespective of whether they actually do) constrains the pricing of transaction reporting services.

14. LSE submitted that one of its customers, [], had told it in March 2011 that it had decided to apply to become an ARM in order to reduce its transaction reporting costs. LSE considered this to be a credible threat and [].⁵ The FSA confirmed to the OFT that [] had applied for approval to become an ARM. However, despite telling the OFT that it would consider becoming an ARM in the event of a five per cent price rise in transaction reporting services, [] itself said that it was its understanding that the same rates are offered to other firms who require a similar service from UnaVista.
15. Another third party told the OFT that it did not get any more favourable terms from its ARM when it said that it was considering to self-report.
16. The parties submitted that in some European countries firms of all types and sizes self-report, showing that a similar diversity of firms could self-report in the UK.
17. Overall, however, the OFT did not receive adequate evidence that self-reporting constrained transaction reporting services to such an extent that it should be considered to be in the product market. However, in examining this merger the OFT has taken account in its competitive assessment of self-reporting where appropriate.⁶

Financial instrument and trading type

18. In terms of differentiating by financial instrument, only a minority of customers (that is, three) who the OFT contacted selected different ARMs. Two of these did so according to the type of financial instrument being traded and the other for reasons of redundancy (that is, if a fault occurs which makes an ARM temporarily unavailable). No customers said that they selected an ARM according to the type of trade (for example, whether it

⁵ The parties submitted that [] typically paid between £[]-[] for []. [].

⁶ OFT and CC guidance says that the boundaries of the market do not determine the outcome of the analysis of the competitive effects of a merger in a mechanistic way, and that the OFT may take into account constraints outside the relevant market ('Merger Assessment Guidelines', OFT1254, September 2010, paragraph 5.2.2).

was on-exchange or over-the-counter). From the demand-side, therefore, the evidence indicates that the product market should not be segmented by financial instrument or trade type.

19. On the supply-side, the OFT notes that all ARMs are authorised to report all instrument types. In addition, all except CREST are authorised to report transactions of all types.⁷ Therefore, on the supply-side evidence indicates that the product market should not be segmented by financial instrument or trade type. Moreover, the OFT notes that trading in equities accounts for over 90 per cent of UK reportable transactions. The OFT believes, therefore, that it is not necessary for the OFT to conclude on the point of different financial instruments for the purpose of assessing this merger.⁸
20. The OFT has examined this case on the basis of the provision of transaction reporting to the FSA on behalf of third parties irrespective of the financial instrument being traded.

Geographic scope

21. The parties submitted that the geographic market was EEA-wide. The parties submitted that this is because of two reasons.
22. First, reportable transactions executed outside the UK by a UK branch of an EEA firm may be submitted either to the FSA or to the 'home' competent authority. Transactions in reportable instruments executed in the UK, whether by a UK firm or a UK branch of an EEA firm, are required to be reported to the FSA.
23. Second, subject to obtaining local authorisation, which involves a process of systems testing, an ARM can provide the same transaction reporting system across the EEA.
24. With regards to the first point, the OFT has not seen any evidence on the proportion of transactions which are executed outside the UK by a UK branch of an EEA firm that might suggest this could be material enough to constrain prices charged for those firms trading only within the UK.

⁷ CREST is not authorised to report over-the-counter trades.

⁸ This is non-derivatives trading in equities.

25. With regards to the second point, the bulk of third parties procured transaction reporting services for the FSA separately from other transaction reporting services that they may require across the EEA. However, two customers told the OFT that they used TRS for their entire EEA requirements. Three others used UnaVista for all of their EEA transactions.
26. Without prejudice to the precise geographic market in this case, the OFT has adopted a cautious approach and examined this merger on a UK only basis.

HORIZONTAL ISSUES

27. The FSA submitted to the OFT share of supply figures (table 1). Given its product market frame of reference (discussed above), the OFT has excluded self-reporting by both firms who currently self-report (Credit Suisse and Getco). Further, Xtrakter and CREST's figures are combined since they are under the same ownership group (Euroclear).⁹

Table 1 Share of transaction reporting to FSA, excluding self-reporting, 2008–2011 (by number of transactions, per cent)¹⁰

	2008	2009	2010	2011
LSE	[0–5]	[0–10]	[0–10]	[10–20]
TRS	[35–45]	[30–40]	[25–35]	[20–30]
LSE + TRS	[40–50]	[35–45]	[30–40]	[30–40]
Xtrakter	[25–35]	[30–40]	[40–50]	[40–50]
CREST	[15–25]	[10–20]	[10–20]	[10–20]
Xtrakter + CREST	[45–55]	[50–60]	[50–60]	[50–60]
Omgeo	[0–5]	[0–10]	[0–10]	[0–10]
VIRT-X	[0–5]	[0–10]	N/A	N/A

Note: Periods are calendar years apart from 2011 which is for 1 January to 31 July 2011. Xtrakter and CREST came within the same ownership group in 2008. Before 2010 LSE's transaction reporting business was ERS. The OFT understands that VIRT-X exited in 2009. Source: FSA.

⁹ The parties submitted that Xtrakter and CREST are operated separately and compete against each other. However, the OFT considers it appropriate to view them as a single competitor since any decision to operate them separately can be changed by their parent company, Euroclear.

¹⁰ The figures do not include LIFFE (London International Financial Futures and Options Exchange). The parties submitted that in November 2011 certain derivatives trading which to date has been excluded from FSA reporting requirements will be obliged to be reported to the FSA. Such derivatives trading takes place on LIFFE and so the parties submitted that LIFFE is expected to increase its share of supply of transaction reporting in the short term.

28. Table 1 shows that the merged entity, together with Xtrakter/CREST, would account for around [80–100] per cent of transaction reporting services for third parties. The merged entity would have a share of supply of 30–40 per cent with an increment of at least 10 per cent. The FSA submitted to the OFT that [].¹¹ [].
29. One customer told the OFT that the reduction in the number of ARMs from the marketplace is such that customers may not be able to negotiate as good a deal as they currently do. Two other customers told the OFT that there are some switching costs involved in changing providers (that is, the costs of reconfiguring the IT systems). The OFT has investigated these concerns in order to ascertain whether unilateral or coordinated effects could realistically be expected to arise as a result of the merger.

Unilateral effects

Closeness of competition

30. In general, unilateral effects are more likely to arise as a result of a merger if the merger parties are close competitors (although in considering this the OFT will also supplement its analysis in this regard with other information).¹²
31. In this case, most customers told the OFT that the merger parties are close competitors. However, some said that there are significant differences in the TRS and UnaVista offerings in terms of product sophistication, notably that UnaVista offers a higher level of sophistication and value-added service than does TRS (making UnaVista closer to Xtrakter in product placement terms).
32. Given the concentration in the marketplace it can be reasonably expected that the diversion ratio between the parties is significant. Indeed, a LSE internal document notes the pre-merger competition between the two parties, saying [].¹³

¹¹ [].

¹² 'Merger Assessment Guidelines', September 2010, OFT1254, paragraphs 5.4.9 and 5.4.10.

¹³[].

33. The OFT has investigated whether the merger would substantially lessen choice and competition in the market, especially for smaller customers who, the OFT was told by some third parties, faced material switching costs. One aspect of the OFT's assessment in this regard was to examine switching evidence.
34. The evidence available to the OFT shows that customers of all sizes (by transaction volumes) do switch ARMs. LSE explained that when replacing its previous transaction reporting service, ERS, with UnaVista, of the [] []. OFT questioning of customers found that two-thirds (10 out of 15) had switched ARMs in the past.¹⁴ These instances of switching included examples of tier 1, 2 and 3 customers.^{15,16} A further three gave no indication of switching and only two customers indicated that they had not switched ARM.
35. In terms of what the switching evidence shows in regard to how closely the merger parties have competed, evidence of recent switching shows that [] of the [] customers who have moved to UnaVista over the past year have come from []. Few of UnaVista's []. Of the [] switch from another provider, [] previously used [] exclusively, [] used [] exclusively and [] used [] previously. UnaVista has won [] customers over the past year. [] switched from TRS. However, one of these customers told the OFT that [].
36. TRS switching data show that of the [] customers that it has recently lost, [] went to UnaVista (discussed above).
37. Indeed, table 1 shows that TRS' share of transaction reporting (by volume) has decreased by [10–20] percentage points, from [35–45] per cent in 2008 to [20–30] per cent in 2011. Whilst UnaVista has increased its share by [five–10] percentage points over the period, in aggregate share terms it appears that the bulk of TRS' transaction reports that have switched have switched to Xtrakter. Taking the recent loss of [] into account would further reduce TRS' share to around [15–25] per cent (and a corresponding rise in UnaVista's share). The FSA told the OFT that it has not been

¹⁴ Most had switched their entire transaction reporting requirements whereas some used multiple ARMs.

¹⁵ The parties have used a definition of tier 1 customers being those who pay transaction reporting fees of at least £[] per year, tier 2 customers pay £[]–£[] per year, and tier 3 pay less than £[] per year.

investing in TRS and does not employ staff to proactively market the business to potential customers.¹⁷ The evidence suggests that TRS has become a weaker competitor to UnaVista and Xtrakter over time.

38. In addition, internal documents submitted by LSE show its concern that TRS customers would switch to competitors ([]). One LSE document submitted [] says '[]'. The same document goes on to say [].¹⁸
39. In considering whether the parties are close competitors, the OFT has investigated LSE's product development, UnaVista Lite. UnaVista Lite (which is not yet available) will offer a lower level of functionality than the standard UnaVista service (but the parties submitted that it would nevertheless have a higher level of functionality than the existing TRS service). For example, relative to UnaVista, it will be available to the client on archive for a shorter period of time and will not include features such as full transaction reconciliations, comprehensive reports, the UnaVista 'dashboard' interface or monthly reports. However, it will meet the regulatory requirements for transaction reporting. The parties submitted to the OFT that UnaVista Lite will appeal to those customers seeking a lower functionality and lower cost alternative to UnaVista (perhaps smaller customers) and, as such, it will be closer to the current TRS offering.
40. Therefore, absent the merger, and assuming the introduction to UnaVista Lite, the parties may become closer competitors than they are currently. In that case, the merger might be said to remove potential competition (for customers seeking a low functionality, low cost ARM).
41. The parties submitted that UnaVista Lite is being developed in reaction to customer demand. This is broadly consistent with the results of the OFT's market testing which found a number of ARMs are considering ways in which to develop their offerings so that they can undertake a higher value-added service incorporating greater data analysis for those customers who want such a service whilst still offering a lower functionality service for those customers who only require compliance with transaction reporting

¹⁶ The OFT has been unable to ascertain in which tier all of these customers are placed.

¹⁷ Note that the OFT's counterfactual, that the TRS business would have been sold to another firm, assumes that going forward the TRS business would be developed and actively marketed to customers.

¹⁸ [].

under MiFID. The OFT considers that it would be easy for an entrant to offer a lower functionality service (such as UnaVista Lite).

Self-reporting

42. The parties argue that the threat of self-reporting is sufficient to keep prices low. In the past, financial institutions carried out all of their own transaction reporting and, the parties submitted, could do so again.
43. Currently, the FSA has authorised two market participants as ARMs and they report their own transactions (whether proprietary trading or trading on behalf of their own clients). These are Credit Suisse and Getco (accounting for around [] per cent of all UK reportable transactions).
44. The parties have supplied one example of a customer who was able to achieve a lower price per transaction reported as a result of a threat to self-report (paragraph 14). Another example (involving another ARM) was given to the OFT by a third party of a customer receiving a lower transaction reporting fee following a threat to self-report.
45. OFT questioning of third parties revealed that over a third would at least consider self-reporting if transaction costs were to rise by around five per cent. Respondents who said that they would consider it included firms in tier 1, 2 and 3. Moreover, the FSA submitted evidence to the OFT that [].
46. The evidence of those who have to date undertaken self-reporting and [], strongly indicates that it is likely to be those firms undertaking large volumes of transactions (and who hence can quickly recoup the costs getting authorisation and the infrastructure in place). One third party told the OFT that although large financial institutions may very well move to self-reporting, mid-size firms are unlikely to do so.
47. The OFT considers that the evidence on self-reporting shows that it is a credible option for at least some customers, and therefore it should be taken into account in the OFT's competitive assessment.¹⁹ Tier 1 customers are most likely to move into self-reporting. Whilst there is some

¹⁹ The evidence on self-reporting does not persuade the OFT that it is a credible alternative for a large enough number of customers to constrain transaction reporting prices for everyone, hence the OFT's conclusion that it is not in the same product market as ARM services on behalf of third parties.

evidence that larger customers are able to leverage the threat of self-reporting into lower fees to ARMs, the OFT does not consider it likely that such a threat offers much protection to the bulk of customers.

Countervailing buyer power

48. The parties submitted some examples of customers negotiating considerable discounts as evidence of them possessing countervailing buyer power. [] negotiated []. The OFT was told that [] (the OFT understands that typical per transactions fees are around [] pence and TRS' lowest published tariff is 0.85 pence for 20 million or more transactions per year).
49. The OFT market testing exercise has shown that some customers (albeit a minority of customers) consider that they have some buyer power sufficient to prevent an increase in their prices.
50. In terms of smaller customers, the parties submitted that some small firms submit their transactions for reporting to agents. These agents, or aggregators, collect information on behalf of a number of small firms so that the aggregators themselves grow to a size where they possess buyer power. Similarly, the parties submitted that major banks and brokers can act as gateway firms in that they report the transactions of their clients. This is a second avenue via which smaller firms may benefit from buyer power.
51. The FSA submitted that TRS transaction reporting on behalf of aggregators such as Pershing comprised [] firms and around [] per cent of TRS' reporting volumes (and around [] per cent of its revenue).
52. However, the evidence submitted on firms acting as aggregators and gateway firms is not compelling to the standard that it shows buyer power on behalf of smaller firms. But the evidence does indicate that the largest customers do possess some countervailing buyer power.

Coordinated effects

53. The OFT has investigated whether the merger raises a realistic prospect of strengthening or creating coordination in the market. It notes that:

- the market is concentrated
 - there may be some transparency in pricing through the process of negotiation with individual customers. One third party told the OFT that it undertakes some price monitoring to the best of its ability, while another third party told the OFT that it sometimes receives feedback from actual and potential clients, and
 - providers in the market experience repeated interactions with customers. Indeed, [].
54. On the first point, the market is concentrated. However, the increment arising from the merger is modest and it is against a declining share of the market held by TRS.
55. While there may be some price transparency, the transaction reporting services offered differ substantially in functionality. This would make coordinating on price difficult since a higher functionality offering would attract a higher price.
56. Further, the parties submitted that pricing is not transparent which would encourage ARMs to deviate from the coordinated outcome in order to win market share. Indeed, different ARMs have different pricing models (and evidence submitted to the OFT shows that the same ARM may have different pricing models for different customers). Moreover, volumes of transactions are not transparent. Even as a stock exchange LSE does not have a better insight into transaction volumes relative to other ARMs given the significant volume of off-exchange, over-the-counter trading that takes place.
57. The LSE further submitted that one of its strategic objectives in gaining ARM customers is [].
58. Finally, the parties submitted that barriers to entry are low.
59. The OFT has not found that this merger raises a realistic prospect of coordination.

Barriers to entry and expansion

60. Some third parties told the OFT that the main barrier to entry was having reliable software systems in place, getting FSA approval and winning customers in the presence of some switching costs.

61. In order to enter, an entrant would need:

- Reliable software systems providing a robust interface between the client and the FSA. The OFT's investigation has found that some parties are able to develop the software themselves, but if they cannot a number of third party software developers are available to them (for example, Logica, Sungard and Fidessa), and
- FSA approval (which involves a payment of a £100,000 fee and robustness checking of the software over a period of some weeks). The FSA submitted that the entire approval process takes less than six months.

62. Information submitted by [a third party] shows that [] entry is likely. [].

63. The evidence from [another third party from paragraph 62] strongly suggests that entry can be timely and likely.²⁰ The OFT also considers that entry could be sufficient to prevent a substantial lessening of competition from arising. This is because:

- any entry would need to replace the loss of TRS but TRS has become a weaker competitor over time
- information from the FSA and some other ARMs indicates that the market is a growing one. Growing markets with low entry barriers tend to induce further entry. Third parties, and the parties in this case, consider the market to be growing because of the introduction of derivatives (Aii coded²¹) into transaction reporting requirements. The

²⁰ OFT guidance says that the OFT will assess entry and expansion against a criteria of timely, likely and sufficient. See section 5.8 of 'Merger Assessment Guidelines', September 2010, OFT1254.

²¹ Alternative Instrument Indicator. All financial instruments traded are given a code which can be read by transaction reporting software. Generally these are 'ISIN' codes but ISIN codes do not cover over-the-counter derivative trades or derivative trades undertaken on some platforms (such as LIFFE).

FSA has estimated that transaction reporting in the UK will grow by 15–30 per cent as a result of this. Moreover, the FSA submitted that the introduction of transaction reporting in commodity markets will greatly expand the transaction reporting market, offering opportunities to existing and new ARMs,²² and

- the OFT understands that ARMs do not suffer from significant capacity constraints.
64. In addition, OFT questioning of [] revealed that [] would be willing to supply transaction reporting services if margins were to increase ([]).
65. The OFT considers that the evidence in this case shows that actual and potential entry in the event of a price rise as a result of the merger will be timely, likely and sufficient to offset any substantial lessening of competition, especially for pure transaction reporting services.

THIRD PARTY VIEWS

66. Almost all third parties were unconcerned about the merger. One third party raised concerns which the OFT does not consider to be competition related or merger-specific. Two others did raise concerns with the OFT about the reduction in choice and the costs of switching providers. These have been discussed above.

ASSESSMENT

67. The parties operate ARMs providing transaction reporting services to third parties. The OFT has examined this merger on the basis of transaction reporting services in the UK for third parties for the purpose of complying with MiFID.
68. The merger will give the merged entity a share of around [30–40] per cent of reportable transactions, with Euroclear (comprising of Xtrakter and CREST) accounting for [50–60] per cent.

²² The FSA submitted that EU Regulation on Energy Market Integrity and Transparency will require transaction reporting for trading in commodities very similar to that which exists for financial instruments and therefore will provide opportunities for financial instrument ARMs.

69. The OFT's investigation has found that the parties' offerings are not closely positioned. TRS offers a basic reporting function designed for regulatory compliance whereas UnaVista offers a greater range of functions which place it closer to Xtrakter than to TRS.
70. Market testing by the OFT has found that a significant degree of switching takes place (by customers of all sizes). The switching data available to the OFT shows that UnaVista competes with Xtrakter more closely than it does with TRS. More limited switching data from TRS shows that it has lost customers to UnaVista although it has lost more customers to Xtrakter.
71. However, more robust transaction reporting data shows that TRS has become a weaker competitor generally over the past four years (during which time its share of supply has almost halved).
72. The OFT has also investigated whether the merger would lead to a substantial loss of potential competition in that LSE plans to introduce UnaVista Lite – a product offering closer to that which TRS offers (and possibly of greater interest to smaller customers). However, the OFT considers that any loss of potential competition would not be substantial given the low barriers to offer a 'lite' service.
73. Further, the evidence in this case strongly suggests that some customers – large customers in particular – could switch to self-reporting if ARM fees were to increase. There is some evidence to indicate that the threat of switching to self-reporting is sufficient to constrain prices for some customers.
74. The OFT has also seen evidence that shows large customer possess buyer power sufficient to resist price rises for transaction reporting services. The parties submitted that even smaller customers could possess buyer power by using 'aggregators'. However, the OFT did not find that the evidence on this was compelling.
75. The OFT has found that entry barriers are low and that entry could be expected to be timely, likely and sufficient to offset any substantial lessening of competition (either for self-reporting or for ARM services on behalf of third parties). Indeed, the OFT has compelling evidence that entry []. Moreover, the OFT has identified one existing ARM []. The OFT

considers that the expansion of the market (through incorporating derivatives reporting) will induce entry and expansion of ARMs.

76. In terms of the merger creating or strengthening coordination in the marketplace, the OFT is satisfied that any coordination would not be easily monitored since neither prices nor volumes are transparent, would not be internal sustainable since the lack of transparency would encourage deviation from the coordinated outcome and would not be externally sustainable since entry and expansion barriers are low.
77. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

78. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.