Completed acquisition by Xchanging of Agencyport Software Europe

ME/6484-14

The CMA's decision on reference under section 22(1) of the Enterprise Act 2002 given on 2 December 2014. Full text of the decision published on 13 January 2015.

Please note that [✂] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

SUMMARY

1. Xchanging plc (**Xchanging**) is active in the supply of specialist insurance software to the insurance market and, in particular, to carriers (insurers and reinsurers), brokers and Lloyd's of London (**Lloyd's**) registered managing agencies (**MAs**).

2. Agencyport Software Europe was active in the supply of software and services to the insurance market and in particular the provision of policy administration system (**PAS**) software to carriers and MAs and core software to Managing General Agents (**MGAs**).

3. Xchanging acquired certain companies of the Agencyport Software Group comprising its European operations (**Agencyport**) for £64.1 million on 4 July 2014 (the **Merger**). Xchanging has also agreed to acquire Total Objects Limited (**TOL**), which is also active in the supply of software and services to the insurance market. The Competition and Markets Authority (**CMA**) considers this to be a parallel transaction for the purposes of this assessment.

4. The CMA considers that the Parties are enterprises that as a result of the Merger have ceased to be distinct and that the share of supply test is met under section 23 of the Enterprise Act (the **Act**). The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

5. The Parties overlap in the supply of PAS software and, in particular, that for carriers with requirements for Lloyd's-specific functionality including MAs[1] (**Lloyd's Carriers**) and/or for carriers with London Companies-specific functionality (**London Companies Carriers**).

6. The Parties also overlap in the supply of business intelligence and data warehousing software and the Parties and TOL overlap in the supply of core software to MGAs. However, the CMA did not consider that the Merger gave rise to a realistic prospect of a substantial lessening of competition (**SLC**) in respect of these overlaps. The Parties and/or TOL also supply a number of other software products including broker software, binder management software and outward reinsurance software.

7. The CMA considers the narrowest plausible candidate market to be the supply of PAS software to Lloyd's Carriers in the United Kingdom (**UK**).

8. The CMA considered whether the Merger had resulted, or was likely to result, in unilateral horizontal effects in the supply of PAS for Lloyd's Carriers.

9. Third party responses to the CMA's market test suggested that insurance software products (including PAS) go through a lifecycle of up to ten years with upgrades and new products being released and legacy products being maintained for a given period. Taking account of this development cycle, the CMA assessed a range of evidence including shares of supply, bidding data and suppliers' plans for, and investment in, product development. In particular, at any given time, each supplier may be at a different point in its product lifecycles meaning that only limited weight can be placed on historical bidding data without taking account of the stage at which that supplier is in its

[1] MAs are companies providing managing agency services to Lloyd's registered syndicates and act effectively as carriers in the Lloyd's market.

product lifecycle. The CMA observed that this feature of the market may mean that the degree of competition between suppliers may vary over time.

10. The CMA considers that Xchanging and Agencyport are close competitors in this market. Agencyport currently supplies one of the leading solutions in this market, ‘Open Core Platform: Lloyd’s’ (**OpenCore**). Xchanging’s customers currently use a legacy product, Iris, that is no longer actively marketed, but Xchanging is currently marketing (and continuing to develop) a new product, branded ‘Xuber for Insurers’ and ‘Xuber for Reinsurers’ (**Xuber**), which the CMA considers is likely to be a credible alternative to OpenCore. The CMA, therefore, considers that these products are likely to compete closely going forward absent the Merger. The CMA also considers given the development cycle and the Parties’ experience in supplying specialist software to insurers in Lloyd’s that the Parties compete on product development and innovation.

11. The CMA considers that, post-Merger, the Parties would face competition from Sequel Business Solutions (**Sequel**) and NIIT. The remaining players are small in value and volume terms. The market test suggested that these suppliers were not credible alternatives to the Parties’ products and were unlikely to expand in the near future (if at all). The CMA did not consider that the Parties would be sufficiently constrained by other competitors in the market following the Merger.

12. On the evidence available to it, the CMA found that the Merger gives rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of PAS for Lloyd’s Carriers.

13. The CMA considered whether entry or expansion may mitigate the competition concerns arising from the Merger. The CMA found that barriers to entry and expansion were high in this market. The CMA considered, in particular, whether the potential entry of [✂], could mitigate the realistic prospect of an SLC arising in relation to the supply of PAS software for Lloyd’s Carriers. However, the CMA did not receive sufficient evidence to suggest that such entry would be timely or sufficient. The CMA considers that these constraints, taken together, are insufficient to exclude the realistic prospect of an SLC in the supply of PAS software as a result of the Merger.

Decision

14. The CMA therefore considers that it is or may be the case that the Merger has resulted or may be expected to result in an SLC within a market or markets in the UK and is consequently under a duty to refer the Merger for an in-depth phase 2 investigation unless Xchanging offers acceptable undertakings to address the CMA’s competition concerns in a clear-cut manner.

ASSESSMENT

Parties

15. **Xchanging Holdings Limited** and **Xchanging, Inc.** are wholly owned subsidiaries of Xchanging, which provides business processing, technology and procurement services internationally. Xchanging and its subsidiaries operate in the insurance market providing a suite of specialist insurance software to the insurance market. Xchanging generated worldwide of turnover of £685.9 million and UK turnover of £430.5 million in its financial year ended 31 December 2013.

16. **Agencyport Software Europe Limited**, **Agencyport Software Europe (Regional Hub) Limited**, **Agencyport Software Bermuda Limited** and **Agencyport Software Europe Offshore Corporation**, which comprise all of Agencyport Software Group's European operations (as per paragraph 2, together referred to as **Agencyport**). Agencyport is a supplier of software and services to the insurance market. Agencyport's turnover for the year ended 31 December 2013 was [✂].

Transaction

17. Xchanging completed its acquisition of the entire issued share capital of Agencyport on 4 July 2014 (defined in paragraph 3, the **Merger**).

Jurisdiction

18. As a result of the Merger, the enterprises of Xchanging and Agencyport have ceased to be distinct.

19. The Parties overlap in the supply of PAS software to MAs, with a combined share of supply in the UK of [30–40]% (with an increment of [10–20]%).[2] The CMA therefore considers that the share of supply test in section 23 of the Act is met in this case.

20. The CMA commenced its own investigation into this acquisition and received a satisfactory submission from the parties on 10 October 2014. The extended statutory deadline is 2 December 2014.

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[2] The Parties' share of supply was calculated by count of the MAs supplied by the Parties compared to the total number of MAs identified on Lloyd's website. The Parties supply [✂] out of 60 MAs. Agencyport supplies [✂] MAs (with [✂] customers shared with another supplier) and Xchanging supplies [✂] MAs (with [✂] customer shared with another supplier).

21. The CMA therefore believes that it is or may be the case that a relevant merger situation has been created.

Frame of reference

22. The CMA considers that market definition provides a framework for assessing the competitive effects of the Merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the Merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.[3]

Product frame of reference

23. The CMA's approach to market definition is to begin with the overlapping products of the Parties in the narrowest plausible candidate market and then to see if this can be widened on the basis of demand-side and supply-side substitution.[4]

24. The Parties overlap in the provision of specialised software to participants in the insurance industry and, in particular, to those participating in the Lloyd's and the London Companies markets, two international and specialty insurance marketplaces (or 'bureaus') based in London and collectively known as the '**London Market**'.

25. As its starting point, the CMA has considered whether there should be a separate product market for each software product supplied by the Parties and whether the supply of these specialised software products is specific to either the Lloyd's market or London Companies market.

Overlaps between the Parties

PAS software

26. The principal overlap between the Parties is the supply of PAS software for insurance carriers. The parties overlap significantly in supplying these software solutions to carriers with requirements for Lloyd's-specific functionality including MAs[5] and/or for carriers with London Companies-

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[3] See OFT 1254, *Merger Assessment Guidelines*, A joint publication of the Competition Commission and the Office of Fair Trading (***Merger Assessment Guidelines***), at paragraph 5.2.2.
[4] See *Merger Assessment Guidelines*, at paragraph 5.2.3.
[5] As set out in footnote 1, MAs are companies providing managing agency services to Lloyd's registered syndicates and act effectively as carriers in the Lloyd's market.

specific functionality (defined in paragraph 5, as **Lloyd's Carriers** and **London Companies Carriers** respectively).

27. PAS software is essentially a system of record for insurance policies that an insurance company has written. The system is used to manage various policy administration processes including around making quotations, processing contracts once agreed, managing transactions and administering policies. Most well-established PAS products for the London Market have historically been sold as 'end-to-end' software platforms. These products typically include functionality that covers an insurance policy throughout its entire lifecycle, including, in addition to policy administration, functionality for processing any claims, administering billing and purchasing reinsurance. Some recent product offerings 'split up' these processes into stand-alone 'modules' or 'components'. For PAS software, the split is typically, into separate modules for claims, billing and reinsurance.

28. Xchanging supplies two products: 'Iris', a legacy product, and a new product called 'Xuber', which it has recently started to market.[6] Agencyport supplies its PAS software, OPEN Core and 'Open Core: Commercial' products and has a number of customers using its respective legacy products (Open Box and Open Co).

29. The Parties submit that, from both a demand-side and supply-side perspective, there is no material distinction between the provision of software to Lloyd's Carriers, London Companies Carriers and general commercial insurance carriers.

30. The Parties submit this is on the basis that:

    (a) The specific requirements of Lloyd's Carriers represent around [✄]% of the functionality of the Parties' software and that the underlying software provided to all carrier customers is the same. [7] The configurations required to service Lloyd's Carriers are designed to provide relatively minor additional functionality with the key additional functionality relating to the interface with the Lloyd's bureau (which provides the central processing services in relation to all transactions within Lloyd's). In

[6] Xchanging also supplied a product called Genius. However, the CMA understands that this product was a PAS software product sold to general property and casualty commercial insurers and did not compete with an Agencyport product.

[7] The Parties submit that the specific requirements of Lloyd's Carriers include the need to interface with Lloyd's central processing services; to segregate business underwritten on behalf of several syndicates; to access and integrate Lloyd's Policy Wordings; to comply with Lloyd's regulatory reporting; and to account for business on a three-year accounting basis. In addition, the Parties submit that the requirements of Lloyd's Carriers differ to those of London Companies Carriers. These differences include that all transactions are settled centrally though the Bureau; messaging differs between Lloyd's and London Companies; there is some data that is Lloyd's specific; and Lloyd's reporting requirements differ to those of London Companies.

addition, Lloyd’s has its own reporting requirements which MAs have to produce and there is some data specific to Lloyd’s (eg, risk codes) which MAs are required to capture.[8]

(b) The same risk may be underwritten in part by one or more of insurers in Lloyd’s, in the commercial insurance markets in London and/or in markets overseas.[9]

(c) There are many carriers with operations both within and outside of Lloyd’s that use one software product for both sets of operations, for example [✄] uses Iris both for its MA business and its commercial business.

(d) The additional Lloyd’s-specific functionality (and one example of non-Lloyd’s-specific functionality) in Xchanging’s products, Xuber and Iris, can be enabled or disabled. Agencyport’s OpenCore and OPEN Core: Commercial products are built on the same underlying software foundation and are very similar solutions.[10]

(e) The Parties were not aware of any suppliers of products with Lloyd’s-specific functionality that did not supply software to non-Lloyd’s carriers.

(f) Agencyport initially developed software targeted at Lloyd’s Carriers but subsequently rolled this out to all types of commercial insurers: the Parties submit that the same approach can be applied in reverse.

(g) A report by Celent (a division of Oliver Wyman, Inc.) titled ‘Global Speciality Core Systems’ dated September 2014 (**Celent Report**) notes that ‘an increasing number of insurance enterprises are meeting broker and policyholder needs at Lloyd’s, but also in the broader London Market […]’.

(h) There are a number of examples of software providers entering and either supplying MAs or bidding to do so; in particular, (1) Guidewire has (i) won a tender to supply QBE with its ClaimCenter product, which the Parties understand means that it has successfully built a bureau message capability and now processes Lloyd’s claims messages for QBE, and (ii) produced ‘London Market Messaging’ for its ClaimCentre product, which Guidewire states is ‘aimed to deliver specialised functionality for insurers operating in [the London Market]’ and (2) Zov Solutions has

[8] The Parties’ Response of 14 November 2014 to the CMA’s issues letter of 12 November 2014 (**Issues Letter Response**), at paragraph 2.7.
[9] Issues Letter Response, at paragraph 2.6.
[10] Issues Letter Response, at paragraph 2.12.

recently announced that it has won a contract to supply an MGA established by Sciemus and Charles Taylor Insurance Services.[11]

(i) For software products with generic 'messaging capability' but without Lloyd's-specific functionality, that functionality is straightforward and can be added with 'relatively easy' modifications, in particular all the necessary requirements to interface with the Lloyd's bureau are to the global ACORD standard. The lack of the technical nature of the software is demonstrated by the fact that a significant number of MAs have developed bespoke in-house solutions.[12]

31. On the other hand, the CMA has received information from third parties that suggests that the narrowest candidate product market is plausibly narrower than the candidate market set out by the Parties.

32. The CMA has therefore considered the following plausible candidate markets:

(a) the supply of PAS for Lloyd's Carriers;

(b) the supply of PAS for London Companies Carriers; and

(c) the supply of PAS to general commercial insurance carriers.

Supply of PAS for Lloyd's Carriers

- *Demand-side substitutability*

33. The vast majority of third party responses to the market test suggested that Lloyd's Carriers have specific software requirements that limit the range of software from which they can choose and, in particular:

(a) PAS software for Lloyd's Carriers must include integration and communication with Lloyd's central market processing and comply with Lloyd's distinct regulatory and reporting requirements; and

(b) Lloyd's Carriers are only likely to consider suppliers with a strong presence in the supply of software to participants in Lloyd's given the specialist requirements for underwriting systems in Lloyd's.[13]

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[11] Issues Letter Response, at paragraph 2.17.
[12] Issues Letter Response, at paragraph 2.8(e) and 2.14.
[13] Third party responses also suggest that the London Companies market has specific software requirements and that this limits the range of software providers from which they can choose. However, a small number of third parties suggested that their product choices were not dependent on their London Companies market requirements.

34. Third parties' responses to the market test suggest that there is very limited demand-side substitutability between PAS for Lloyd's Carriers and PAS software without Lloyd's specific functionality.

35. Moreover, the CMA considers that, to the extent that it is necessary for carriers writing business within Lloyd's to use Lloyd's-specific functionality for their policy administration function – a critical business function – they are unlikely to substitute to a product lacking such functionality in response to a SSNIP.[14] This was confirmed by third party responses to the CMA's market test, which suggest that Lloyd's Carriers only consider PAS software with Lloyd's-specific functionality.

36. Based on the evidence above, the CMA considers that the product frame of reference for the supply of PAS for Lloyd's Carriers should not be widened on the basis of demand-side substitution.

37. The CMA therefore considered whether the product frame of reference should be widened on the basis of supply-side factors.

- *Supply-side substitutability*

38. The boundaries of the relevant product market are generally determined by reference to demand-side substitution alone. However, the CMA may, in principle, from a supply-side perspective, aggregate plausible candidate markets based on supply-side responses to changes in competitive conditions. There are two conditions for such aggregation. In particular:

    (a) production assets can be used by firms to supply a range of different products that are not demand-side substitutes, and the firms have the ability and incentive quickly (generally within a year) to shift capacity between these different products depending on demand for each; and

    (b) the same firms compete to supply these different products and the conditions of competition between the firms are the same for each product.[15]

39. The CMA sought to test the Parties' submission that non-Lloyd's-specific software could be easily adjusted for use by Lloyd's Carriers. Third party evidence suggested that firms do not have the ability to supply software with Lloyd's-specific functionality quickly with development and implementation

[14] SSNIP means a small but significant and non-transitory increase in price, which usually refers to a 5% increase in price. In applying the hypothetical monopolist test, the CMA will assess whether a hypothetical monopolist could profitably raise the price of at least one of the products in the candidate market by at least a small but significant amount over a non-transitory period of time (ie by a 'SSNIP').
[15] See *Merger Assessment Guidelines*, at paragraph 5.2.17.

taking several years and requiring significant financial resources.[16] There are no indications that suppliers of software products with London Companies' specific functionality routinely adjust their software specification to make it available for MAs requiring Lloyd's-specific functionality in response to increases in price or demand.[17]

40. The evidence also indicates that the conditions of competition between software with Lloyd's-specific functionality and that without differ. The sizes of the respective markets differ in value and third parties have confirmed that it is difficult and expensive for suppliers operating outside of Lloyd's to develop software for the Lloyd's market, which suggests that the cost of supplying these products is different (see further the section titled 'Barriers to entry and expansion' below). As such, the conditions of competition are likely to differ across these segments.

41. The CMA notes that there are differences among the suppliers of, on the one hand, PAS software with Lloyd's-specific functionality and, on the other hand, suppliers of PAS without Lloyd's-specific functionality with only a small group of suppliers whose software includes Lloyd's-specific functionality (although that software can also be supplied to general insurance carriers that do not require the Lloyd's-specific functionality that it includes). In particular, some third parties noted that there were a limited number of suppliers of PAS software from which Lloyd's Carriers may choose.

42. The CMA recognises that it might be possible for companies supplying London Companies Carriers to start supplying PAS software to Lloyd's Carriers. However, the conditions required to aggregate several markets on the basis of supply-side substitution are not met, and the CMA has considered this feature of the market as part of the assessment of the conditions of new entry rather than as a factor that would warrant a broader market definition.

43. The CMA therefore considers that the narrow frame of reference for the supply of PAS software for Lloyd's Carriers should not be expanded on the basis of supply-substitutability factors.

- *Asymmetric constraints*

44. In conducting its market definition exercise, the CMA may take into consideration that products in separate plausible candidate markets may impose

[16] See further detail regarding the cost and time required to enter the market in the 'Barriers to entry and expansion' section below.
[17] See further detail regarding the cost and time required to enter the market in the 'Barriers to entry and expansion' section below.

asymmetric constraints on each other[18] and, therefore, the boundaries of the product market may depend on the identity of the products in the candidate market.

45. The Parties submit that PAS software with Lloyd's-specific functionality is used outside of Lloyd's.

46. The CMA does not consider that evidence of the use of Lloyd's-specific software outside of Lloyd's (ie, by customers without Lloyd's operations) amounts to evidence that customers with requirements for Lloyd's-specific functionality would consider software lacking such functionality to be a credible substitute (rather it is evidence that there may be a degree of demand-side substitution for non-Lloyd's carriers between PAS without Lloyd's-functionality and that with Lloyd's functionality, which the CMA understands is the case because this additional functionality can simply be switched-off).

- *Conclusion on the relevant product frame of reference for the supply of PAS for MAs*

47. Based on the evidence above, the CMA concludes that, in this case, the appropriate product frame of reference for the competitive assessment is the supply of PAS for Lloyd's Carriers.

- *Supply of PAS for London Companies Carriers and general commercial insurance carriers*

48. Similarly to the supply of PAS for Lloyd's Carriers, the CMA considers that London Companies Carriers may have some specific requirements that would not be satisfied by the commercial offering of all suppliers.

49. The CMA has not reached a conclusion on the frame of reference for the supply of PAS for London Companies Carriers. The CMA's market test indicated that competition may be more intense outside of Lloyd's and that there are a number of alternative suppliers available in addition to those competing in the Lloyd's market. On this basis, the CMA focused its investigation on the Lloyd's market while considering any asymmetric constraints which may derive from outside of this frame of reference.

[18] See *Merger Assessment Guidelines*, paragraph 5.2.20. These guidelines provide the example of a hypothetical product A, which may constrain a hypothetical product B's prices, while product B may exert no competitive constraint on product A. In this case, the market for A would be one valid frame of reference.

50. On a cautious basis, the CMA therefore focuses on the Lloyd's market and does not discuss the supply of PAS to customers outside of Lloyd's further in this decision.

Business intelligence and data warehousing software

51. The Parties overlap in the supply of business intelligence and data warehousing software. Xchanging supplies its Xuber Analytics product and Agencyport supplies its Open Data Warehouse product. These products permit data analysis and reporting of a user's data.

52. The Parties submit that Agencyport does not offer a stand-alone business intelligence/data warehouse software product and sells its product only as an add-on to its PAS software. Its product is not compatible with other PAS software [✂].[19]

53. The CMA does not, therefore, consider that the Parties compete directly in the area of business intelligence and data warehousing software because these products are not sold on a stand-alone basis with competition occurring instead in relation to the PAS software to which they are tied.

54. In addition, third party responses to the CMA's market test suggest that there are several suppliers of business intelligence/data warehouse software products. Moreover, no third party raised any competition concerns regarding this overlap between the Parties.

55. The CMA will not, therefore, discuss business intelligence and data warehousing software any further in this decision given that the overlap does not lead to the realistic prospect of an SLC on any plausible basis.

Other products supplied by Xchanging, Agencyport and/or TOL

Core software for MGAs

56. Agencyport and TOL and, to a limited degree, Xchanging overlap in the supply of core software for MGAs, which is used to manage the core business processes of an MGA (including elements of functionality from PAS software and also from broker software). MGAs are insurance brokers/agents who have been delegated underwriting authority to quote, set conditions and bind insurance on behalf of insurers, as well as handle other parts of the insurance

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[19] [✂]

lifecycle, for instance claims handling and processing. MGAs in the Lloyd's market are referred to as '**coverholders**'.

57. Agencyport supplies its 'Open Core Platform: MGA' and TOL supplies its 'Global XB' and 'Global XII' products. Xchanging could also fulfil the core software needs of an MGA by supplying 'Brokasure' its broker core software and certain components of Xuber.

58. The CMA considers, on a cautious basis, that the narrowest candidate frame of reference is the supply of core software to coverholders.

59. The Parties submit that the software used by MGAs/coverholders is simpler software than the equivalent software used by brokers and carriers respectively and combines elements of the software products for each of these categories of customer (ie broker core software and PAS software for carriers respectively). The Parties submit that this indicates that it is relatively easy for providers of software to brokers and carriers to also supply software for MGAs. The Parties do not consider that segmentation by coverholders and non-Lloyd's MGAs is appropriate.

60. The CMA does not consider that it is necessary to come to a conclusion on the product frame of reference for core software for MGAs, because this overlap does not lead to a realistic prospect of an SLC on any plausible basis (as discussed in paragraphs 180 to 183 below).

Products in which the Parties do not overlap

61. In addition, one or more of the Parties and TOL supply insurance software or processing solutions in each of the following areas:

    (a) exposure modelling software for insurance carriers;

    (b) outward reinsurance software for insurance carriers;

    (c) binder management solutions;

    (d) software for brokers; and

    (e) business process outsourcing.

62. In relation to each of the products and services identified in paragraph 61 above, the CMA received evidence that indicated that Lloyd's market participants require additional functionality in software/services. They would not consider software/services without such functionality to be a substitute and that suppliers that do not currently supply software/services with Lloyd's-specific functionality do not have the ability to supply software/services with

such functionality quickly. Therefore, on a cautious basis, the CMA assessed the impact of the merger using the following narrowest plausible candidate markets for the purposes of its analysis of potential conglomerate effects set out at paragraphs 184 to 192 below:

(a) the supply of business intelligence software and data warehousing for Lloyd's Carriers;

(b) the supply of exposure modelling software for Lloyd's Carriers;

(c) the supply of outward reinsurance software for Lloyd's Carriers with requirements for "excess of loss" functionality;

(d) the supply of binder management solutions for Lloyd's market participants;

(e) the supply of insurance software for Lloyd's registered brokers; and

(f) the supply of business process outsourcing services to Lloyd's Carriers.

Geographic frame of reference

PAS software

63. The Parties submit that the relevant geographic market for the supply of PAS software for Lloyd's Carriers is worldwide, because companies from outside of the UK can, and regularly do, bid successfully for Lloyd's Carriers' business. The Parties also appear to submit that there is no need for a supplier to have a local presence although they acknowledge that local resources are generally required to undertake the direct customer engagement necessary to agree and scope the implementation requirements of individual customers.[20]

64. The Parties also submit that companies from outside of the UK have won the business of MAs in the UK such as CSC (US based) and eBaoTech (headquartered in China) and similarly software suppliers to MAs in the UK supply to customers outside of the UK.[21]

65. While third parties' responses to the market test were mixed in relation to whether they would switch away from UK suppliers to non-UK suppliers in the event of a SSNIP, a number of responses noted the importance of a local presence for suppliers to implement and service PAS software and the large majority of customers use suppliers that have a local presence in the UK.

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[20] Parties' response of 17 October 2014 to the CMA's requests for information of 10 October 2014, at paragraph 6.1.
[21] Issues Letter Response, at paragraphs 2.22 & 2.23.

There is only one example of a supplier without a local UK presence, EbaoTech, which the responses to the market test suggest is a weak competitor.

66. Based on this evidence, the CMA is minded to assess the geographic frame of reference for this Merger as being the UK. However, the CMA has not found it necessary to conclude on the precise scope of the geographic market because it does not affect its competitive assessment in any eventuality. In the competitive assessment, the CMA has considered all suppliers that are available to Lloyd’s Carriers operating in Lloyd’s irrespective of their geographic location.

Other products supplied by one or more of the Parties and TOL

67. For the purposes of its analysis of possible conglomerate effects (set out in paragraphs 184 to 192), similarly to the supply of PAS software to Lloyd’s Carriers, the CMA considered that a local presence in the UK was likely to be important for a supplier of the products/services identified in paragraph 61 above. On a cautious basis, the CMA assessed each of these products/ services by reference to their supply in the UK. However, the CMA has not found it necessary to conclude definitively on the precise scope of the geographic markets, because it does not affect its competitive assessment on any plausible basis.

Counterfactual

68. The CMA assesses a merger’s impact relative to the situation that would prevail absent the merger (that is, the counterfactual). In practice, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of a merger. However, the CMA will assess a merger against an alternative counterfactual where, based on the evidence available to it, it considers that the prospect of prevailing conditions continuing is not realistic or where there is a realistic prospect of a counterfactual that is more competitive than the prevailing conditions.[22]

69. The CMA may be required to consider a merger at a time when there is the prospect of another merger in the same market (a parallel transaction[23]). In such circumstances, the relevant question that the CMA seeks to answer is whether the transaction under review creates the realistic prospect of an SLC.

[22] See the *Merger Assessment Guidelines*, at paragraphs 4.3.5 *et seq.*
[23] See the *Merger Assessment Guidelines*, at footnote 46, which explains that a parallel transaction is considered as part of the counterfactual on the basis that it would occur whether or not the merger takes place. In this context, a parallel transaction is one which is either anticipated or which has been completed but remains subject to the possibility of being unwound as a result of intervention by the CMA under the Act.

When considering parallel transactions the CMA is likely to consider whether the statutory test would be met if the parallel transaction proceeds and also consider whether the statutory test would be met if the parallel transaction does not proceed.[24]

70. In parallel to this case, the CMA is considering the anticipated acquisition by Xchanging of TOL (**Xchanging / TOL**). TOL is active in the same market and also in adjacent markets to the Parties. The CMA considers that Xchanging / TOL is a parallel transaction for the purposes of its assessment. Therefore, the CMA considers that the Merger needs to be considered against both the pre-Merger conditions of competition (in other words, absent the anticipated acquisition by Xchanging of TOL) and, in the alternative, against the conditions of competition that would exist if Xchanging were to acquire TOL.

Competitive assessment

Horizontal unilateral effects in the supply of PAS software

71. Unilateral horizontal effects can arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm to profitably raise prices (or degrade quality) on its own and without needing to coordinate with rivals.[25]

72. As a starting point, the CMA considers the relevant shares of supply.[26] The CMA then goes on to assess the potential risk of unilateral effects through the loss of existing competition. Unilateral effects may arise, because a price increase or a deterioration of quality becomes less costly when the products of the two firms are brought under common ownership or control.[27]

73. Where there are indications that the product or the associated level of service is not perfectly homogenous unilateral effects are more likely where the Parties' products compete closely.[28] The CMA will therefore take into account in its assessment the closeness of competition of the Parties' products as well as other information.[29]

[24] See the *Merger Assessment Guidelines*, at paragraphs 4.3.25 *et seq*.
[25] See *Merger Assessment Guidelines*, section 5.4.
[26] See *Merger Assessment Guidelines,* paragraph 5.3.1 ff.
[27] See *Merger Assessment Guidelines,* paragraph 5.4.7.
[28] See *Merger Assessment Guidelines,* paragraph 5.4.6.
[29] See *Merger Assessment Guidelines,* paragraphs 5.4.9 & 5.4.10.

Shares of supply

74. The Parties provided the CMA with an estimate of the total market size for the supply of PAS software to MAs of £50 million.[30] The Parties submit that they hold a combined market share by revenue of [10–20]%. The CMA does not consider that this estimate is sufficiently robust given that the total market size is based on a high-level estimate of software spend relative to gross written premiums of 0.2%. The CMA therefore sought to calculate shares of supply by count of customer and also calculate its own estimate of shares of supply by value based on the gross written premium of Lloyd's MAs.

75. The Parties provided a table comprising an itemised list of MAs and the PAS software that they currently use, based on information available to Xchanging. In terms of the quality of this latter data set, the Parties submit that:

   (a) the table has been completed to the best of the Parties' knowledge, but that they do not have complete visibility of which product is used by each MA; and

   (b) it is not uncommon for Lloyd's Carriers to take elements of several different products. As an example of this, the Parties refer to QBE, which uses Guidewire's claims processing product alongside Xchanging's Iris.

76. Based on this information, the CMA calculated shares of supply by count of MA customers to the total number of MAs. These shares are set out in Table 1 below.

[30] The Parties calculated this figure on the basis of the volume of gross written premiums within the Lloyd's market being £25 billion, which was taken from the Lloyd's Annual Report 2013. This figure was then multiplied by the Parties' estimate as to the proportion of revenue that Lloyd's insurers spend on software (0.2%) (ie, 0.002 x £25 billion = £50 million). The Parties note that the figure of gross written premiums within the Lloyd's market does not include revenue from MGAs, brokers, coverholders or the wider London carrier market.

Table 1

Supplier	*Customers*	*Share of supply by count %*	*Share of supply by count (excl. in-house) %*
Agencyport	[✂]	[15–25][31]	[20–30]
Xchanging/Xuber	[✂]	[10–20]	[10–20]
Combined	**[✂]**	**[30–40]**	**[30–40]**
NIIT	[✂]	[20–30]	[20–30]
Sequel Business Solutions	[✂]	[10–20]	[10–20]
Northdoor	[✂]	[5–10]	[5–10]
CSC	[✂]	[0–5]	[0–5]
Eurobase	[✂]	[0–5]	[0–5]
eBaoTech	[✂]	[0–5]	[0–5]
In-house	[✂]	[10–20]	-
Unknown	[✂]	[0–5]	[0–5]

Source: Parties' internal documents. Ranged shared of supply reflect the maximum and minimum shares calculated when excluding and including 'shared' customers, respectively.[32]

77. Before seeking to draw any conclusions from the share of supply data, the CMA makes a number of general observations regarding the interpretation of market shares in the supply of PAS software for Lloyd's Carriers.

78. First, due to high switching costs faced by customers (such as migration and implementation costs, which were highlighted by a large majority of third parties in the market test), as well as the operational risk of changing core systems, they tend to remain with their chosen supplier for long periods of time.[33,34] This implies that market shares at any given point in time do not necessarily reflect the relative strength of competitors for marginal customers (ie, customers who are likely to purchase the product in the near future), but rather reflect the historical purchasing decisions of customers.

79. Secondly, insurance software is, to some extent, an 'experience good' (ie, a good whose quality is only revealed when the good is used). As such, if a supplier introduces a new product of low quality, some customers may purchase it 'in error' and subsequently refrain from switching suppliers in light of significant switching costs thereby retaining an inferior product.[35] To the extent that this occurs, it is likely that a 'tail' of small suppliers will arise, which

[31] The Parties submit that [✂]. The CMA observes [✂]. In any event, given that the CMA places only limited weight on the Parties' shares of supply in its competitive assessment, this does not impact on the CMA's conclusions.
[32] [✂] customer is shared by [✂]. Each of [✂] is assigned 0.5 customers in respect of this customer in the calculation of the shares of supply presented in this Table.
[33] No third party responses indicated that switching costs were low or that switching away was easy.
[34] The Parties' internal documents support this conclusion, in particular, an Agencyport internal document describes Lloyd's as [✂].
[35] For any given product, this imperfect information problem is likely to affect only a small number of customers as there appear to be considerable information flows between customers regarding the quality of suppliers' products once they have been installed. For example, one third party told the CMA that products stop winning competitions after a small number of unsuccessful implementations. Other third parties have noted that they evaluate products based on feedback from their peers. Moreover, Lloyd's has a small number of organised customers with established forums, and this is in any case conducive to information flows of this nature.

do not necessarily represent credible alternatives to new customers – especially if those customers were acquired a long time ago.

80. Accordingly, when considering the relative strength of competitors now, shares of supply should be interpreted with caution and the balance of evidentiary weight should favour the direct assessment of closeness of competition. This is equally true of historical bidding data given the somewhat cyclical nature of competition in this market and the long product lifecycles, which is discussed further at paragraphs 93 to 101 below. It is also the case that the long product lifecycles are likely to exacerbate the effect of the Merger, because, at any given time, only a proportion of the credible competitors may have a product in the competitive period of its product lifecycle.

81. The Parties submit that the shares of supply are based on legacy contracts and do not provide an accurate indicator of competition between the Parties in the current conditions of competition. The Parties submit that the bidding data provided by them to the CMA is a more reliable indicator (citing the OFT's decision regarding the completed acquisition by Capita Group plc of IBS OPENSystems plc,[36] in which it found that shares of installed or legacy clients were unlikely to be the best measure of competition conditions and instead looked at newly tendered contracts over a five-year period).[37] The CMA considers the Parties' submissions regarding bidding markets in paragraphs 102 to 108 below.

82. The Parties also submit that in-house (or 'self') supply is a viable alternative for Lloyd's Carriers to an 'out-of-the-box' PAS software solution and a number of Lloyd's Carriers use an in-house PAS solution. These in-house solutions are developed in-house using expert software developers/engineers that are contracted to develop the solution.[38]

83. While the data suggests that some MAs currently use in-house solutions, based on the evidence available to it, the CMA does not consider that in-house solutions pose a competitive constraint on the Parties. Some third party responses to the market test indicated that there is a growing realisation among customers that in-house supply is not a credible option given that a number of customers have made attempts that were unsuccessful; that building an in-house solution is highly complex, for example, because of the need for integration with Lloyd's standard messaging; that insurance carriers do not necessarily have the know-how to efficiently build their own system;

[36] Decision of 19 November 2008.
[37] Issues Letter Response, at paragraph 2.54.
[38] Issues Letter Response, at paragraph 2.50.

and, for these reasons, such solutions have a reputation for being expensive. Third parties indicated that they anticipate that MAs using legacy in-house systems will switch away from in-house solutions to PAS software over time. The CMA does not therefore consider that a Lloyd's Carrier using an 'out-of-the-box' software solution would be likely to switch back to an in-house solution in response to a SSNIP.

84. The data presented in Table 1 shows that, when excluding in-house solutions:

(a) the parties have a combined share of supply of [30–40]% to [30–40]%[39] by count (or [30–40]% to [30–40]% when including in-house solutions);

(b) the four largest suppliers together have a share of supply of [70–80]% to [80–90]% of MAs by count;

(c) the remaining [10–20]% to [20–30]% of supply is divided across several small suppliers, none of which has a share of supply greater than 5% of MAs other than Northdoor which has a share of supply of [5–10]%.

85. In addition, the CMA sought to verify the Parties' estimate of market size by value and also assess whether it was likely that the Parties' share of supply by value rather than volume would be greater than suggested in Table 1. In the absence of revenue data for suppliers of PAS software other than the Parties, the CMA considered a proxy value for the size of the relevant MA, in particular its gross written premium. The CMA estimates shares of supply on this basis in Table 2 below.

[39] Where two suppliers share a customer, the CMA has provided a 'ranged' market share to reflect the fact that it is not clear what proportion of each customer's business accrues to which party. The lower bound reflects the share of supply for the relevant supplier if they were responsible for supplying nothing to their shared customers, while the upper bound reflects the share of supply for the relevant supply if they were responsible for supplying all of their shared customers' needs. In probability, the true value will not lie close to either of these extremes.

Table 2

Supplier	*Product(s)*	*Share of supply to Lloyd's Carriers by gross written premium %*	*Share of supply to Lloyd's Carriers by gross written premium (excl. in-house) %*
Agencyport	Open+	[10–20]	[10–20]
Xchanging	Iris, Xuber	[10–20]	[20–30]
Agencyport/Xchanging shared customers		[0–5]	[0–5]
Combined		**[30–40]**	**[30–40]**
NIIT	Subscribe	[20–30]	[20–30]
Sequel Business Solutions*	Eclipse / SBS	[10–20]	[20–30]
Eurobase	Synergy	[5–10]	[5–10]
Northdoor	NDEX	[0–5]	[0–5]
eBaoTech	GeneralSystem	[0–5]	[0–5]
CSC	SICS	[0–5]	[0-5]
In-house	-	[10–20]	-

Source: Parties' internal documents and statistics provided by Lloyd's. Shares of supply are based on matching syndicates' gross written premium in 2013 with the supplier used by its managing agency, based on information available to Xchanging.

*[✂]% of total gross written premium relates to [✂], which in 2013 used Agencyport and Sequel. This has been added to Sequel's total for the purposes of this calculation.

86. The Parties submit that the shares of supply estimated by the CMA are incorrect. In particular, the Parties submit that where the shares of supply in Table 2 are used to gross-up their combined revenues to find a total market size figure, the CMA's estimated shares of supply in Table 2 would appear to suggest a total market size of just [✂] to [✂].[40] The Parties submit that this underestimates the size of the market; for example the Parties had [✂] customers with a spend in excess of [✂] in 2013 (which is above the average spend using this calculation).[41]

87. The CMA does not consider that the number of customers spending more than the implied average spend is a good measure of the likely accuracy of the implied total market size referred to by the Parties, especially because there may also be customers spending less than the average. The CMA notes that the average spend by Lloyd's MAs on PAS by Xchanging's Iris customers, based on data provided by the Parties, was around [✂] in 2013. Customers of Agencyport's PAS product spend, on average, around [✂] from January to September 2013, but this includes expenditure on Agencyport's Xposure product as the Parties did not provide these revenues separately. The average spend by Lloyd's MAs on PAS by the [✂] Agencyport customers purchasing only Open Licenses was around [✂] from January to September 2013.

88. While the CMA accepts that there are limitations to the data in Table 2, in particular that gross written premium is a relatively crude proxy for software

[40] The Parties used their combined 2013 revenues of [✂].
[41] Issues Letter Response, paragraph 2.47.

spend, the CMA considers that it can place some weight on the data in Table 2 suggesting that the parties have a stronger share of supply among large MAs.

89. Table 1 above suggests that there are eight known suppliers of PAS software within Lloyd's, the Parties separately submit that there are a number of additional suppliers with Lloyd's MA customers, based on the Celent Report.

90. These additional suppliers include Genasys, Unirisx, Guidewire, Sapiens, Open GI, Wildnet, Oceanwide, Fineos. Evidence available to the CMA, including the data underpinning the above market share analysis, suggest that these suppliers do not currently supply PAS software to Lloyd's Carriers. These competitors are considered further in the section titled 'Assessment of the Parties' competitors' below.

91. The shares of supply by count (excluding in-house supply) and by value indicate that the Parties would become the number one player and approximately [60–70] to [80–90]% of supply (depending on the calculation method) would be concentrated between the top three suppliers post-merger.

92. For the reasons highlighted above, the CMA's assessment of competitive conditions placed more weight on recent market events and on suppliers' future plans. The CMA has therefore considered closeness of competition between the Parties.

Closeness of competition

Preliminary observations

93. The following paragraphs set out some preliminary observations relating to the CMA's approach to assessing the closeness of competition between the Parties.

94. Third party responses to the CMA's market test suggested that insurance software products (including PAS) go through a lifecycle whereby a new product is released, builds credibility and functionality, reaches its peak sales and then begins to become obsolete because of technological developments. A new product will be released for active sales at this point and the supplier will cease to actively market its old product, which will only be maintained for existing customers (it becomes a 'legacy product'). Ultimately, a legacy product will be withdrawn. This can take many years.

95. An Xchanging internal document demonstrates this lifecycle, which shows products moving through 'build', 'invest and sell', 'sell', 'maintain' and 'support' stages before finally being withdrawn and replaced with the next generation of

product, in this case Xchanging's Iris PAS product and Agencyport's OpenCore PAS product by Xuber. Each of these stages lasts for several years at least.[42]

96. The Parties submit that software products do not follow a fixed lifecycle and suppliers will update their products and invest in the launch of new products when considered appropriate given the market demand and conditions. The Parties submit that given the high level of investment in these products, it is rational for a supplier to maintain and support existing products for as long as they remain commercially viable, this can be as long as 10 plus years from initial launch.[43]

97. One third party noted that the rankings of PAS software products in the market tend to vary over time, reflecting (i) large investments in functionality and/or (ii) significant failures by individual suppliers, typically during system implementation for new clients, which damage credibility and the perceived quality of the supplier's competitive offering (examples provided included those by [✄]).

98. Given the product development cycles and long lead times, the CMA assessed a range of evidence. This included recent wins and current offerings as well as bid data. However, it also placed significant emphasis on suppliers' plans for, and investment in, product development in order to take account of the competitive dynamics in this market. In essence, at any given time, each supplier may be at a different point in its product lifecycles meaning that only limited weight can be placed on historical bidding data without taking account of the stage at which that supplier is in its product lifecycle. In particular, the CMA observes that a supplier may be investing in product development during a period when it is not winning tenders, as was the case with Xchanging over the past five years.

99. As part of the CMA's competitive assessment, it sought to test whether the Parties were close competitors with their current product offerings, including Iris and/or Xuber for Xchanging's products, in particular by examining:

(a) the extent to which the competitive offerings of Agencyport and Xchanging are likely to be close substitutes; and

(b) the extent to which Xchanging and Agencyport update, improve or innovate in relation to their products and competitive offer.

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[42] This is supported by the internal documents of the Parties, see for example Annex 6 of the Parties' response of 3 October 2014 to the CMA's Section 109 Notice (**Section 109 Response**).
[43] Issues Letter Response, at paragraph 2.101 *et seq*.

100. The CMA examined closeness of competition between Xchanging, Agencyport and a number of other suppliers of software for Lloyd's Carriers.

101. In considering closeness of competition, the CMA examined a range of evidence, including internal documents of the parties, internal analysis of third parties, comments submitted by third parties and certain data on tenders provided by the Parties.

Parameters of competition

- *Assessment of closeness of competition in bidding markets*

102. The Parties submit that contracts to supply PAS software to Lloyd's Carriers are typically awarded on the basis of competitive tender. In this regard, the Parties cite a number of Competition Commission (**CC**) and OFT decisions, which have considered bidding markets; in particular the following:

(a) The CC's decision regarding the completed joint venture between Tradebe Environmental Services Limited and SITA UK Limited (***Tradebe/Sita***) in which the CC stated 'to win a tender process the winner must beat the next best offer. Unilateral effects will be most likely where the parties **ranked first and second in tenders merge**'.[44] [Emphasis added by the Parties.]

(b) The OFT's decision in the completed acquisition by Capita Group plc of IBS OPENSystems plc, [45] in which it focused on the extent to which the parties are the two lowest priced bidders in tenders.

(c) The CC's decision regarding the completed acquisition by Stericycle, Inc of Ecowaste Southwest Limited (***Stericycle/Ecowaste***) in which the CC acknowledged that bidding markets could result in 'competitive outcomes with **fewer** firms than might otherwise be the case'.[46] [Emphasis added by the Parties], and went on to note that under certain circumstances, 'two firms may provide enough competition to give rise to a fully competitive outcome.'[47]

103. The CMA does not agree with some of the conclusions the Parties appear to have drawn from the precedents involving tendering processes listed above.

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[44] Decision of 28 March 2014, at paragraph 6.52.
[45] Decision of 19 November 2008.
[46] Decision of 21 March 2012 at paragraph 7.102.
[47] At paragraph 7.103.

(a) In Stericycle/Ecowaste, the CC did indeed note that 'competition in markets in which prices are determined through a bidding mechanism can, **if other conditions hold**, result in competitive outcomes with fewer firms than might otherwise be the case' [Emphasis added by the CMA]. However, the CC considered that these conditions did not hold in the market under consideration in that case, healthcare risk waste,[48] and it concluded that in this context that 'any reduction in the relatively small number of potential bidders would have an adverse impact on prices and service quality available to purchasers'.

(b) Similarly, in *Capita/IBS*, the CC, following the OFT's reference decision, considered that 'the most likely way in which just two firms could be sufficient to preserve competition in the [market under consideration in that case] would be if [that market] could be characterized as a 'bidding market' as defined in the [paragraph 9.18 of that decision].'[49] However, the CC concluded that the market under consideration in that case did not present the conditions required for this framework to apply. It concluded that 'the reduction in the number of software suppliers and the resulting increase in market concentration in the [market under consideration] is likely to cause a lessening of competition for new customers going out to tender'.

(c) In *Tradebe/Sita*, also relating to the market for healthcare risk waste, the CC recognised that the merger was most likely to be harmful where the parties were likely to be the two most competitive bidders for a customer. However, the CC did not limit itself to the analysis of past tender outcomes on a market-wide basis. It considered that it was necessary to assess the relative competitiveness of the different suppliers on a forward-looking basis to capture any potential changes in the conditions of competition. To this end, it examined the suppliers' future business plans and modelled their costs for future tenders. The CC also examined how the conditions of competition varied for different customers based on their location and requirements.

104. In summary, the CC has previously examined the theoretical possibility that competition might be sustained with a smaller number of competitors in bidding markets if certain conditions are met. However, it has generally

[48] A market characterised by a high degree of homogeneity in customer requirements, little innovation in product specifications, relatively low switching costs, and large contracts relative to the capacity of the plants.
[49] In this case these conditions have been described as follows: '[a]n ideal bidding market is characterized by the following structural features: (i) competition results in the winner taking all (ie each supplier wins all or none of the order); (ii) competition is 'lumpy' (ie each contest is large relative to a supplier's total sales in a period); and (iii) competition begins afresh for each contract and for each customer (ie there are no incumbency advantages by which the outcome of one contest importantly determines another).'

concluded that the conditions required for this effect to materialise were not met. In most cases it has concluded that market concentration was a relevant parameter of competition even where customers used tenders to appoint their suppliers, and that a reduction in the number of competitors could harm customers. Even in cases where the CC has considered that anti-competitive effects would be most significant where the merging parties were likely to be the two most competitive bidders, it has performed a forward-looking assessment, taking account a variety of other factors including competitors' business plans and incorporating differences in customer requirements in its assessment. In other words, it has not limited its analysis to a review of past tender data.

105. Such a nuanced approach is even more important in assessing the supply of insurance software.

106. As noted above, in past CC decisions 'ideal bidding markets' have been described as displaying the following structural features: (i) competition results in the winner taking all (ie each supplier wins all or none of the order); (ii) competition is 'lumpy' (ie each contest is large relative to a supplier's total sales in a period); and (iii) competition begins afresh for each contract and for each customer (ie there are no incumbency advantages by which the outcome of one contest importantly determines another). In assessing the extent to which these structural features may be met in this case, the CMA found that:

(a) In this market, it is not clear whether the size of contracts relative to each supplier's total sales is large enough to expect suppliers to act as if they are 'betting their company' in each tender.

(b) In this market incumbents may have an advantage over competitors (because of switching costs and customers' emphasis on credibility and track record), indicating that competition does not 'begin afresh' for each contract. More importantly, in this market the product has a degree of differentiation (in the sense that different customers value different features of PAS), and the relative competitiveness of suppliers vary over time. So despite the fact that the Parties did not rank first and second for some customers in past tenders, it does not necessarily follow that the Parties may not rank first and second for other customers or, indeed, for the same customers in future tenders.

107. As such, the CMA considered that, while software contracts are commonly awarded through tender processes, this market is unlikely to exhibit the features of an ideal 'bidding market'.

108. The CMA cannot therefore be confident, in its first phase investigation, that the bidding data accurately reflects the full extent of competitive dynamics in this market and it therefore considered other evidence available to it in addition to the bidding data.

- *Product characteristics*

109. The CMA also considered the product characteristics that determined customer choice in the market.

110. Third party responses to the market test indicated that a range of factors are considered important by customers when choosing their software supplier. In particular:

(a) product functionality: its ability to meet business and user needs;

(b) reputation and credibility: in particular, the number of existing customers, prior proven track record, experience of delivery and reputation from past delivery, and the vendor's financial stability;

(c) long-run innovation: in particular the strategic direction or roadmap for the software;

(d) quality of service/capability, for example ability to complete software implementation successfully, agility in responding to new requirements and delivering new functionality and ongoing support capabilities;

(e) cultural fit of the supplier with the customer's business; and

(f) the structure of software sales licenses.

111. Based on the responses to the market test, the CMA considers that while customers' choice of products appears to rely on a wide range of variables, functionality and the supplier's credibility/reputation appear to be two of the most critical factors.

Closeness of competition between the Parties

112. The CMA has assessed closeness of competition as between, on the one hand, Xchanging's Iris and Xuber PAS software and, on the other hand, Agencyport's OpenCore PAS software.

113. The Parties submit that they are not close competitors for the following reasons:

(a) the bidding data provided by the Parties for the previous five years indicates that the Parties were not close competitors in bidding for contracts for MAs, in particular:

(i) Of the [✂] tenders identified by the Parties, Agencyport won [✂] and Xchanging won [✂];

(ii) Agencyport bid for [✂] tenders and faced Xchanging in [✂], of which Agencyport won [✂]; and

(iii) Xchanging has won [✂] tenders/contracts over the last five years.[50]

(b) historical market shares are an unreliable indicator of market power, and overstate the Parties' position;

(c) there are a number of strong competitors bidding for and winning contracts in relation to the supply of PAS to MAs;

(d) the Parties' products are differentiated which reduces the extent to which customers have viewed them as being close substitutes (with Xchanging's Iris product being a legacy product that is not actively marketed to customers). Xuber and Agencyport cannot be considered close substitutes, because (i) Xuber is componentised[51] while Agencyport's product is not and (ii) Xchanging's products are 'installed' while Agencyport's products are based on web-based technology;

(e) Xchanging has been most successful over recent years in the general commercial insurance market, whereas Agencyport has been most successful in relation to MAs, and Xuber's strategy is focused on the global insurance market and not just the Lloyd's market which is evidenced by the [✂] investment in Xuber that would not be justified by the total market size of PAS for Lloyd's Carriers;[52]

(f) in relation to their monitoring of competitors, the Parties submit that they do not regularly monitor each other when determining pricing strategy, business plans and software roadmaps.[53]

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[50] Issues Paper Response, at paragraph 2.36.
[51] Componentisation (or 'modularisation') refers to the 'breaking up' of software products into discrete business services or software components that can be implemented separately, without the requirement to purchase the whole suite for the functionality to work correctly and fully. A customer submitted that this would allow for the replacement of certain software incrementally, reducing the time, cost and risk of each smaller project.
[52] Issues Letter Response, at paragraph 2.38.
[53] Issues Letter Response, at paragraphs 2.26 and 2.98, and Section 109 Response, at paragraphs 27.14 and 27.15.

- *Product characteristics*

114. The CMA considered whether the Parties' submissions regarding differentiation between the Parties' products had a material impact on closeness of competition between the Parties.

115. In relation to differentiation between the Parties' product offerings (eg componentised product vs an end-to-end product offering), the CMA notes evidence from the Parties' internal documents that:

  (a) Agencyport's product has established a product development roadmap to enable componentisation;

  (b) [✄][54]

116. The CMA received a number of third party comments regarding 'componentisation' which suggest that modular products are attractive to customers because they allow for incremental change of an MA's PAS software reducing the time and risk of a replacement of an end-to-end platform. On the other hand, one third party considered that the market continues to prefer end-to-end solutions.

117. The Parties submit that 'Agencyport having an unsubstantiated and tentative long-term target to [✄] is irrelevant in this analysis'.[55]

118. The CMA considers that a product development strategy [✄] is something that may have been shared by Xchanging and Agencyport in the pre-Merger conditions of competition, rather than a characteristic that differentiates them and, even if this were not the case, it would only be a point of differentiation for some and not all customers.

119. In relation to the importance of web-based technology, the responses of third parties to the market test did not indicate that this was a strong factor of differentiation from the point of view of customers. In particular, the CMA asked customers about the product characteristics that they took into account when making their most recent product choice.[56] Only a very small minority of customers specifically referred to web-based technology as a relevant factor with one customer noting that smaller MAs may prefer a web-based technology and would not want to install and run a whole system locally and a

[54] See [Agencyport internal document]. The CMA observes that this document is effectively a sales document and has considered its probative value in that light.
[55] Issues Letter Response, at paragraph 2.89.
[56] The CMA asked, 'Please briefly describe which factors you considered when you chose your current software supplier (or decided not to switch), giving an indication of the relative importance of each factor. (If this differs across software types, please explain how).'

third party provided the CMA with a vendor assessment that included one question, of 43 questions in total, relating to web-based technology. However, some customers broadly stated that 'functional fit' was important, and it is feasible that web-based technology could be a feature these customers consider important, even without referring to it directly in their responses.

120. The CMA considers that while there is a degree of differentiation between the Parties' products, the evidence supports competition between them to supply insurers. The CMA sought to test the Parties' assertions against their internal documents and with third parties in its market test.

- *Competition between Xuber and Agencyport*

121. While the third party responses to the market test tended to confirm the Parties' submission that Iris is an outdated product, Xchanging has released a new product, Xuber. The Parties internal documents suggest the following about this new product:

(a) Xchanging had invested [✄] over two years 2013/14 in developing and marketing Xuber (including [✄]).[57]

(b) Xchanging forecasts that Xuber's market share of [✄].[58]

(c) [✄][59] The CMA considers that this may suggest that Xchanging's current share of supply may be indicative of the future competitive strength of Xuber ([✄]). This evidence may also suggest that it is likely to benefit from the customer goodwill achieved with Iris and will be able to quickly build its credibility in the market (ie by demonstrating that it has successfully implemented customers on its Xuber platform).

(d) In addition, the CMA understands from the Parties' internal documents that Xchanging intended [✄].[60] In any event, the CMA considers that Xchanging's former strategy indicates that Agencyport's product was seen by Xchanging as a competitor.

122. Moreover, the Parties tender data and third parties' responses to the market test indicate that Agencyport has a strong offering in PAS software to Lloyd's Carriers at present (although one third party did note that it did not consider that Agencyport had won significant volumes of business recently). The

[57] See [Xchanging internal document].
[58] See [Xchanging internal document].
[59] See Item 5 of the Parties submission of 11 November 2014.
[60] Parties' follow-up submission following the issues meeting dated 17 November 2014.

Parties' internal documents also support this finding. An Agencyport internal document prepared for the sale of the company states the following:

(a) under the heading 'Lloyd's', that Agencyport had a [✂];

(b) that Agencyport has a [✂];

(c) that [✂];

(d) describes Agencyport's product as [✂]; and

(e) refers to [✂].[61]

123. Third party responses to the market test suggest that the Parties compete with one another and are considered as alternatives by Lloyd's Carriers. In particular, a recent tender scorecard seen by the CMA included both Parties products, see further at paragraph 141 below.

124. The CMA notes that, in the case of the supply of insurance software, where fundamental changes to products appear to occur relatively infrequently, monitoring of competitors need not necessarily occur 'regularly' for such monitoring to constitute evidence of a supplier reacting strategically to the competitive offerings of those competitors.

125. The Xchanging board presentation regarding the transaction states that the [✂].[62]

126. In any event, an Xchanging internal document includes an analysis of Agencyport, including a side-by-side comparison of Agencyport's and Xchanging's products; descriptions of Agencyport's strategies along several different dimensions, including relating to aspects of its products' quality,[63] and commented on its credibility in the London market.[64] Fourteen competitors to Xchanging are profiled in the analysis which relates to both the Lloyd's and the wider insurance software market (including personal as well as commercial insurance) on a global basis.[65] However, only five of these competitors have a known presence in the supply of core software for insurers including PAS software with Lloyd's-specific functionality, namely Agencyport, CSC, Eurobase, NIIT and Sequel.

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[61] See [Agencyport internal document].
[62] [Xchanging internal document].
[63] In particular, Xchanging had analysed Agencyport's strategy for [✂].
[64] See [Xchanging internal document].
[65] Guidewire, Accenture, First Best, FINEOS, TOL, CSC, Agencyport, Sequel, NIIT, Eurobase, TCS, msg systems, IDIT and SSP.

127. The CMA therefore considers that Xchanging has recently developed a new product in response to the superior offerings of its competitors (which includes that of Agencyport) and was actively competing with Agencyport pre-Merger with its Xuber product. This conclusion was supported by evidence from the CMA's market test.

- *Evidence from the market test*

128. The CMA has received evidence from third parties to suggest that Xchanging's Xuber[66] product does compete with Agencyport's OpenCore product, in particular:

(a) that the Parties were strong competitors;

(b) that Xchanging is seeking to challenge Agencyport and other suppliers with Xuber through significant marketing activity (indicating an increase in competition compared to the recent past when Xchanging often did not appear in tender competitions with its Iris product); and

(c) that Xchanging has a strong reputation as a credible supplier. On the other hand, some noted that implementation of a new product is important and also supported the Parties' submission that [✄].

- *Parties' bidding data and shares of supply*

129. The CMA considers that, taken alone, the bidding data suggests that the Parties were not each other's closest competitors in the previous five years, because this was a period in which Xchanging was not successful in tenders. However, as set out in paragraphs 93 to 101, the CMA considers it to be important to assess closeness of competition not only on the basis of recent wins and current offerings, but also on the basis of competitors' plans for, and investment in, product development and improvement in their competitive offering.

130. This means that bidding data is likely to be probative in the CMA's assessment of the present conditions of competition where those data relate to the period following the launch and development of Xuber (given that Iris was an end-of-life product before this point in time and Xuber was in development), in other words 2012 at the earliest. Moreover, third party responses suggest that it takes a considerable period of time for a product to obtain credibility in the market and the internal documents of the Parties suggest that Xuber was only

[66] Third party responses to the market test supported the Parties' submission that Iris is a legacy product that is no longer actively marketed.

marketed heavily from 2013, the majority of investment in product development was planned for 2013 and 2014,[67] and has been appearing in recent tenders.

131. As noted above, the CMA has placed weight on the bidding data taking account of the product development cycle meaning that bidding data from the previous five years is only one data point in assessing competition between the Parties pre-Merger and the CMA does not consider that it is the most probative evidence when assessing closeness of competition between the Parties. The CMA therefore considers that it is important to have regard also to the other evidence from the Parties' internal documents and from the responses to its market test that are set out above, which it considers to be more probative than the bidding data in the circumstances of this case.

Conclusion on closeness of competition between the Parties

132. Based on the evidence discussed above, the CMA considers that Xchanging and Agencyport are close competitors for the purposes of its competitive assessment both in the immediate and longer term. The CMA does not consider that Xchanging and Agencyport are necessarily closest competitors but does consider that they are two of the four credible, competing competitors in the supply of PAS for Lloyd's Carriers (as discussed further in paragraphs 133 *et seq* below) and therefore do pose a significant competitive constraint on one another, which is supported by the evidence set out above.

Assessment of the Parties' competitors

133. The evidence available indicates that there are four major suppliers of PAS software for Lloyd's Carriers. These are the Parties plus NIIT and Sequel. The bidding data provided by the Parties indicates that the largest number of tenders have been won by NIIT, Sequel and Agencyport. As noted in paragraphs 93 to 101 above, the CMA also considers it important to assess competitors' plans for, and investment in, product development and improvement in the competitive offering, ie a competitor's strength.

134. The Parties provided a long list of companies that they considered to be their competitors in the provision of PAS software for Lloyd's Carriers and in particular identified the Celent Report, which identifies ten companies other than the Parties that supply to the Lloyd's market being Fineos, Genasys,

[67] [Xchanging internal document].

NIIT, Northdoor, Oceanwide, Open GI London, Sapiens, Sequel, Unirisx and Wildnet.

135. The Parties submit that several competitors are strong and credible, in particular Sequel, NIIT, Northdoor, CSC, Guidewire and Fineos. The Parties submit that each of these companies has competed in tenders in which one or more of the Parties has been involved in the previous five years:

(a) NIIT has invested heavily in its software and has recently released a new +ADVANTAGE Suite PAS software product (**AdvantageSuite**) and has recently been endorsed by [✂], an existing customer, [✂].[68]

(b) Northdoor is identified in the Celent Report as having had a 'a clear impact in the London market and wider European insurance industry' and has recently won tenders for Torus and WR Berkely; and

(c) Guidewire is [✂];

(d) eBaoTech won a contract to supply its PAS software to Argo in 2011 and has recently obtained private equity funding;

(e) Eurobase and CSC are [✂] credible competitors.[69]

136. The CMA did not consider that all of the competitors identified by the Parties were competing in the Lloyd's market, because a number of these suppliers have no Lloyd's Carrier customers for their PAS software and insufficient evidence was provided otherwise to substantiate this claim.[70] In particular, the CMA does not consider that competitors that supply only claims software to Lloyd's Carriers constrain the Parties in the supply of PAS software. The CMA understands that this is the case for Guidewire ([✂]) and Fineos. Based on the evidence available to it, the CMA understands that claims software does not perform all of the functions that can be achieved with PAS software and therefore does not compete with PAS software for this additional functionality required by customers of PAS software.

137. The CMA has therefore sought to identify the companies that compete with the Parties in the supply of PAS for Lloyd's Carriers. In this regard, the CMA

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[68] Issues Letter Response, at paragraph 2.82.
[69] Issues Letter Response, at paragraph 2.85.
[70] The Celent Report does not indicate whether a product is used by Lloyd's Carriers or other participants in the Lloyd's market and, in any event, indicates that Fineos only has a claims software product and not a PAS software product, Genasys only has a live product in relation to 'speciality directors and officers' insurance, Oceanwide only has a live product in relation to speciality 'marine' insurance, Sapiens only has a live product in relation to speciality insurance for 'contractors all risks' and Wildnet only has a live product in relation to speciality insurance for 'commercial property' and 'fine arts'. The Celent Report does not therefore support the Parties' assertion that these companies are credible suppliers of PAS software to Lloyd's Carriers writing a diverse range of business.

notes in particular the following statements in the Parties' internal documents regarding their competitors:

(a) Agencyport lists three competitors to it in Lloyd's being namely [✄] and Xuber in its competitor analysis and also in the same document these three competitors plus [✄] (which the CMA understands from the Parties refers to [✄]).[71]

(b) Xchanging lists five competitors to the parties in the London Market, namely [✄].[72]

138. The CMA notes that, in 2012, Xchanging listed 11 competitors to it in the UK, namely [✄], Agencyport, [✄] and TOL.[73] However, this list includes competitors to Xchanging across all of its business lines in the UK and is not restricted to competitors active in the supply of software with specific Lloyd's and/or London Companies market functionality, nor to competitors with products including PAS functionality.

Third party comments regarding competition in the supply of PAS software for Lloyd's Carriers

139. The CMA received mixed comments about the Merger's effect on competition from Lloyd's Carriers and the Parties' competitors. A material number of third parties considered that the Merger would result in a reduction of choice and/or competition in the market for PAS software for Lloyd's Carriers, for which there were only a limited number of specialist suppliers at present. On the other hand, a minority of responses indicated that they were not concerned by the Merger because there was sufficient choice of suppliers at present. A majority of customers responding to the market test had not tendered their PAS software in seven years or longer.

140. In particular, the balance of the third party responses (including a number that have been to market recently) suggested that there are four main or "leading" competitors in the market for PAS software for Lloyd's Carriers with the Parties competing predominantly with Sequel and NIIT. A small number of third parties also referred to a fifth, Northdoor. However, a number of third parties noted that Northdoor has a highly differentiated offering (see further paragraph 143 below). Some third parties also mentioned Guidewire, CSC and Eurobase as competitors of the Parties.

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[71] See [Agencyport internal document].
[72] [Xchanging internal document].
[73] See [Xchanging internal document].

141. The CMA received a recent competitor assessment from a third party, [✂], which submitted the results of an IT-led market review it carried out in [✂]. It ranked the top [✂] suppliers as listed in **Table 3** below. [✂]. [✂] other suppliers, [✂], were not assigned scores because they were not considered as credible suppliers for the London Market.

Table 3

Rank	*Supplier*	*Average score*
[✂]	[✂]	[✂]

142. While many third parties consider that NIIT is a leading supplier of PAS for Lloyd's Carriers, the CMA has received evidence to suggest that NIIT might not have been [✂] for new customers going to market over recent years. However, similarly to Xchanging it has recently released a new PAS software product with Lloyd's-specific functionality, AdvantageSuite, in October 2014 which it is now actively marketing to customers.

143. Third parties did not identify, as strong suppliers, a number of competitors identified by the Parties. The CMA summarises these concerns in relation to each competitor below:

(a) Northdoor: third party responses suggest that the NDEX system tends to be a bespoke system [✂] and [✂]. [✂]. This is supported by the tender data which shows [✂]. On the other hand, in response to the CMA's market test, several third parties identified Northdoor as a credible alternative to their current supplier.

(b) CSC: third party responses to the market test suggested that CSC has [✂] customers and that [✂] and [✂];

(c) Eurobase: third party responses suggest that it has [✂] and [✂]. [✂];

(d) Guidewire: the CMA has received no evidence that [✂]; and

(e) EbaoTech: has [✂] customer and third party responses suggest that it is [✂], which is supported by [✂].

144. The CMA therefore considers that the third party responses to the market test suggest that there are only four credible suppliers of PAS for Lloyd's Carriers and that the 'tail' of smaller suppliers do not offer a credible substitute to the Parties, NIIT or Sequel for a customer should it go to market now.

Conclusion on the assessment of the Parties' competition

145. On the basis of the evidence that it has received during the Phase I process, the CMA considers, on a cautious basis, that only Sequel and NIIT are credible competitors to the Parties at present. In addition, the evidence suggests that Agencyport was a strong rivalrous force in the market and therefore exercised a constraint on the behaviour of Xchanging (along with the two other credible suppliers in the market). The CMA does not consider that the evidence supports the Parties' assertion that the 'tail' of suppliers with few customers will provide a material constraint on their competitive offer post-Merger.

146. Moreover, a significant number of customers raised concerns regarding the Merger and, in particular, that it would result in a reduction of choice in the supply of PAS for Lloyd's Carriers, for which there are a limited number of specialist suppliers.

147. In addition, given that these four competitors may be at different stages in their product lifecycles, the CMA considers that post-Merger the Parties may not be constrained to a sufficient degree by the remaining competitors (particularly given that Xchanging and NIIT have recently released new products and the market will lose Agencyport's potential response to these developments). The long product lifecycles are likely to exacerbate the effect of the Merger, because, at any given time, only a proportion of the four credible competitors may have a product in the competitive period of its product lifecycle (such as Xchanging's Iris product before the introduction of Xuber and perhaps NIIT's Subscribe product before the release of AdvantageSuite).

Conclusion on horizontal unilateral effects

148. Based on the evidence set out above, the CMA found that the Merger does give rise to the realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of PAS software for Lloyd's Carriers.

149. The Parties represent two of the four large, well-established suppliers of PAS software for Lloyd's Carriers, in addition to Sequel and NIIT. While there are a number of small suppliers currently present in the market, they are not credible competitors to the Parties, Sequel and NIIT for most customers of PAS software for Lloyd's Carriers. Moreover, third party responses and the Parties' internal documents suggest that the Parties are close competitors both in the immediate- and in the longer-term with Agencyport supplying its OpenCore product and Xchanging its Xuber product and a significant number of customers have raised concerns regarding the Merger. Third parties and

the Parties' internal documents also indicated that the Parties' products have similar characteristics in many respects and their differences are in any event not material for most customers.

150. The CMA considers that the Merger represents a reduction of the number of credible competitors from four to three and the Parties are close (although not closest) competitors. The long product lifecycles are likely to exacerbate the effect of the Merger, because, at any given time, only a proportion of the four credible competitors may have a product in the competitive period of its product lifecycle. Indeed, the Parties themselves submitted that Xchanging's Iris product was not an effective competitive constraint prior to its retirement from active sales and some third party responses suggested that this may have been the case for NIIT's Subscribe product prior to the release of the AdvantageSuite product. Accordingly, if not all of the four main suppliers are competitive at any given point in time, the loss of one of these competitor is all the more problematic. The CMA does not, therefore, consider that NIIT and Sequel alone are likely to constrain the Parties to a sufficient extent post-Merger. Moreover, NIIT and Xchanging have now released new products and, absent the Merger, the CMA considers that Agencyport would have sought to respond to the product developments of its competitors.

151. Based on the evidence set out above, the CMA considers that the Merger will give the merged entity the ability to increase prices or worsen non-price aspects of the competitive offering (such as quality) and may also have a negative effect on innovation in the supply of PAS for Lloyd's Carriers. The CMA therefore believes that, subject to what is said below regarding entry, expansion and buyer power, there is a realistic prospect of an SLC in the supply of PAS software for Lloyd's Carriers.

152. The CMA therefore considers below whether entry or expansion or buyer power exist to constrain the merged entity post-Merger.

Barriers to entry and expansion

153. Entry, or expansion of existing firms, can mitigate the initial effect of the Merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient. In terms of timeliness, the CMA's guidelines indicates that the CMA will look for entry to occur within two years.[74]

[74] *Merger Assessment Guidelines*, paragraph 5.8.1 ff.

154. The Parties submit that the barriers to entering the Lloyd’s market are not high and it would be straightforward for non-Lloyd's software suppliers to add the additional functionality to their existing software to supply Lloyd’s Carriers, because, in particular, all the necessary requirements to interface with the Lloyd's bureau are to the global ACORD standard. The Parties estimate, assuming a competent functional base and a modern architecture and technology base, that the investment required to add Lloyd’s-specific functionality to an existing commercial product could be in the region of [✂] to [✂] of accounting costs or even lower because the cost is in software engineers which are likely to be employed by the supplier already. The Parties submit that this initial investment could be recouped through winning a single contract.[75] In addition, the Parties submit that they do not consider that reputation/credibility is a barrier to entry, which is evidenced by the number of smaller suppliers in the market.[76]

155. The Parties also submit that [✂] MAs have developed their own bespoke PAS software, including relevant Lloyd's-specific functionality, which suggests that it would be feasible for a specialist software company with an existing PAS system to do so.[77]

156. The Parties provide two examples of recent entry into the Lloyd’s market by suppliers from outside of the Lloyd’s market (although not for PAS software):

(a) Guidewire supplies its ClaimCentre software to QBE’s European operations, which includes bureau messaging capability and is advertising a ‘London Market Messaging’ add-on to its ClaimCentre product; and

(b) Zov Solutions recently announced that it has been selected to supply the core platform for an MGA recently established by Sciemus and Charles Taylor Insurance Services.[78]

157. The Parties submit that they face competition from large global suppliers of insurance software that could easily enter the Lloyd’s market, such as Accenture. These global suppliers may see Lloyd’s as an opportunity to win larger, global mandates for customers active in Lloyd’s that also have wider global operations.[79]

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[75] Issues Letter Response, at paragraph 2.14 & 2.15.
[76] Issues Letter Response, at paragraph 2.110(e).
[77] Issues Letter Response, at paragraphs 2.16 & 2.122 *et seq*.
[78] Issues Letter Response, at paragraph 2.17.
[79] Issues Letter Response, at paragraphs 2.119 *et seq*.

158. In addition, the Parties submit that barriers for expansion to existing suppliers of PAS software for Lloyd's Carriers are low with the marginal cost of supplying a customer with an additional unit of software being very low.[80]

159. The CMA received comments from a material number of third parties to suggest that there were significant barriers to entry into the supply of PAS to Lloyd's carriers. In particular, these comments highlighted two main barriers to entry.

160. First, a number of third parties submitted that the sunk investment cost in entering the supply of PAS software to Lloyd's carriers for an existing supplier of PAS software for non-Lloyd's carriers would be substantial and it would take two to three years to align with the specific requirements of Lloyd's customers and the Lloyd's market. Third party comments also suggested that this combined with the relatively small size of the Lloyd's market and infrequent switching of customers make entry unattractive even for large existing suppliers of PAS to commercial insurers.

161. Second, several third parties submitted that suppliers need an established reputation and experience in order to represent a credible alternative for customers and to successfully compete in the Lloyd's market. Infrequent switching means that it is particularly difficult for a supplier to gain experience, which facilitates improvement in the quality of the new entrant's competitive offering, as well as to win reference clients. Having existing customers acts as an important measure of reputation for many customers and is therefore an important means for building credibility.

162. Even in the event that a supplier overcomes a lack credibility within Lloyd's, it may not be able to win further tenders in the near term following entry until it has established a credible reputation and, accordingly, this forms a barrier to expansion. Third party comments received by the CMA suggested that such sufficiency may increase once the entrant wins enough clients, in particular if they are an important reference client (for example, a large MA) but this is likely to take a long time as implementation at the first client, once acquired, can take at least 18 months, and may take longer for a new entrant with limited experience of implementation at Lloyd's.

163. On the other hand, one third party noted that there was a recent trend over the last year for larger London Market underwriters to purchase end-to-end platforms that can service both their London Market and other business units, attracting bigger suppliers like Guidewire and CSC and that this 'probably

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[80] Issues Letter Response, at paragraph 1.8(d).

means they will have a London Market offering in the short to medium term'.[81] The CMA also received third party comments that suggested that a Lloyd's Carrier with operations outside of Lloyd's may sponsor the entry of a credible non-Lloyd's supplier; in particular, [✄].

Evidence regarding market entry

164. In relation to suppliers of PAS for Lloyd's, the Parties did not provide any examples of previous cases of sufficient entry to the supply of PAS for Lloyd's Carriers by software suppliers previously only active outside of Lloyd's. The Parties referred to Guidewire now offering a 'London Market Messaging add-on' for its claims processing product. However, in the light of the differences between claims processing products and PAS software set out above the CMA considers that this does not represent an example of entry in the supply of PAS for Lloyd's Carriers.

165. The CMA received comments from third parties to suggest that sufficient entry would be unlikely to occur on a timely basis for the reasons set out in paragraphs 160 and 161 and below.

Likelihood of entry

166. [✄] informed the CMA that [✄].

167. [✄]

168. However, [✄]. The CMA therefore considers that, on balance, entry [✄] may therefore be likely. As such, it has also considered whether any such entry would be timely and sufficient such as to mitigate or prevent the realistic prospect of an SLC in the supply for PAS for Lloyd's Carriers.

Timeliness of entry

169. [✄] submitted that there was [✄].

170. On the basis of the evidence provided by [✄], the CMA notes that there is a high degree of uncertainty regarding [✄] of the timing for its entry given the high barriers to entry in this market and, [✄]. The CMA, therefore, considers, on the basis of the evidence available, that it cannot be confident that [✄] entry would be timely for the purposes of mitigating or preventing a realistic prospect of an SLC.

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[81] It is not clear the extent to which this third party's comments are relevant separately to the Lloyd's and London Companies markets.

Sufficiency of entry

171. Even if [✂] were to enter, the CMA has received insufficient evidence to demonstrate that such entry would be of sufficient scale to constrain the Parties post-Merger. The evidence available to the CMA indicates that this is a market with high barriers to entry where, in particular, a supplier needs to build a customer base of 'reference' clients and establish a strong reputation before being considered to be a credible supplier in the marketplace.

172. The CMA concluded that while entry [✂] may be likely in the [✂], it did not have sufficient evidence to suggest that it would be either timely or sufficient to mitigate the realistic prospect of an SLC arising in the supply of PAS software to Lloyd's Carriers.

173. In relation to other potential entrants, the CMA did not receive any evidence to suggest that [✂] was likely to enter the Lloyd's market.

Expansion of existing suppliers

174. In relation to the expansion of existing suppliers, the CMA has received no evidence to suggest that existing smaller suppliers have credible plans to expand their offering of PAS for Lloyd's Carriers. In fact, the 'tail' of smaller suppliers, which do not appear to have increased their share of supply over many years, suggests that it is not easy for a small supplier to easily expand once it has gained a foothold in the market. This is supported by third party comments regarding the lack of credibility of these suppliers with a small share of supply at present.

175. In particular, [✂] submitted that [✂].

176. [✂]

177. [✂]

178. The CMA does not consider that [✂] and therefore does not consider that any expansion by [✂] is likely to be sufficient such as to mitigate the realistic prospect of an SLC arising in the supply of PAS software to Lloyd's Carriers.

Conclusion on market entry and expansion

179. Thus, the CMA is of the view that it does not have sufficient evidence to conclude that entry by suppliers from outside of Lloyd's or expansion by existing suppliers will be timely, likely or sufficient, such as to mitigate the realistic prospect of an SLC arising in the supply of PAS software to Lloyd's Carriers.

Other products supplied by Xchanging, Agencyport and/or TOL

Horizontal unilateral effects in the supply of core software for MGAs

180. The Parties submit that they have a very limited presence in the market for the supply of insurance software to MGAs in the UK. OPEN Core: MGA only has [✄] customers, only [✄] of which have the product deployed in the UK. In addition to these, Xchanging has two customer deployments outside of the UK, [✄], which use the same software solution. Moreover, TOL only has [✄] MGA customers in the UK. The Parties submit that this gives the Parties a combined market share of [0–5]% (with an increment of [0–5]%) by count of MGAs in the UK.

181. The Parties submit that there are a substantial number of competing MGA products available from other suppliers, including Sequel, SSP/Sectornet/ PURE, Northdoor, Transactor, VIPR, Acturius, Open GI, Wildnet and Salmon.

182. The CMA market tested the Parties' submission and third party responses confirmed that there were a number of competitors to the Parties in the supply of core software to MGAs and that the Parties were not strong competitors in this segment.

183. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to the supply of core software to MGAs. This is the case whether considered under the pre-Merger conditions of competition or, in the alternative, the conditions of competition that would arise should Xchanging's anticipated acquisition of TOL complete**.**

Non-horizontal effects – conglomerate effects

184. The Merger brings together Xchanging's activities in the supply of outward reinsurance software, binder management solutions, business intelligence, and business process outsourcing with Agencyport's activities in the supply of exposure modelling software and, under one counterfactual, also TOL's activities in the supply of binder management software and outward reinsurance software. The Merger therefore increases the set of credible products that can be provided by the same firm.

185. Following concerns raised by two third parties, the CMA has assessed the possibility of the Merger giving rise to conglomerate effects. The CMA considers that, in principle, if customers have a strong preference for one-stop shopping, and if competitors are unable to match the attractiveness of the bundle offered by the parties, then this strategy could ultimately lead to a

realistic prospect of an SLC in one or several markets for insurance software. One of the third parties also outlined a particular version of this theory where Xchanging would sell PAS software at a strong discount to acquire business relationships with customers with a view to selling them more lucrative business processing services at a later point.

186. This third party also raised concerns that Xchanging may increase the frequency of the updates to the central processing services (which Xchanging provides as a monopolist) that all software providers need to comply with through adaptations of their software packages in order to make these packages (especially competing PAS software) less reliable. Xchanging might also reduce the notice period given to software providers to comply with such changes [✂]. While the CMA cannot exclude at this stage that Xchanging might in fact deteriorate its competitors' offerings through this strategy, the CMA considers that the acquisition of Agencyport does not materially affect Xchanging's ability or incentive to do so. The third party itself told the CMA that 'these acquisitions do not alter Xchanging's position in this regard'.[82] As a result, the CMA has not considered this strategy any further.

187. The Parties submit that, as regards business processing outsourcing, Xchanging provides both central services and business process outsourcing services to the Lloyd's and London Companies markets through two joint venture companies. Almost all of the business processing/outsourcing services provided by Xchanging are through these joint ventures. Given the nature of these joint ventures, it is clear that Xchanging does not have the ability to take decisions unilaterally to favour its own business, nor does it have the incentive to do so given that it only has a [✂]% shareholding. Moreover, its position in this regard will not be affected by the Merger.

188. As regards bundling of other software products, the Parties submit that, pre-Merger, Xchanging offered a large suite of products, including many of the products that would be included in a hypothetical bundle. There is no evidence that Xchanging has either (i) benefited as a result of offering the suite of products, or (ii) that it resulted in the exclusion of any competitors. Similarly, pre-Merger, Agencyport also offered a range of products/services including PAS and exposure management.

189. In this case, the CMA considers that the features of this market are unlikely to support a bundling strategy. The CMA tested the complainants' concerns with customers which largely confirmed that one-stop shopping was not an

[82] This comment was provided by the third party in response to the CMA's question: 'explain whether Xchanging would be able to increase the frequency of the updates and/or reduce the notice period even in the absence of the mergers with TOL and Agencyport'.

important consideration for them. Moreover, given that customers only change supplier infrequently, it would take a very long time for a supplier to exclude competitors, and the costs incurred over this period are unlikely to outweigh the potential benefits to the supplier after competitors have been excluded.

190. The CMA considers that the Parties would not, therefore, have the ability to foreclose competitors by engaging in this strategy. Given the lack of ability, the CMA has not needed to consider the incentives of the Parties to engage in this strategy and the likely effect of any such behaviour.

191. Irrespective of whether bundling might be a profitable strategy in this market, the CMA considers that the merger effect is likely to be limited. Xchanging is already present in all of the different segments of the market except exposure modelling software and, to a certain extent, binder management software. Xchanging's Iris offering in the PAS market is currently outdated, but as explained in detail above it is developing a new product, Xuber, that the CMA considers to be a credible alternative. Therefore, if bundling is a possible strategy in this market, this risk is likely to arise in each counterfactual as well as in the Merger scenario.

192. The CMA therefore concludes that there is no realistic prospect of a SLC as a result of conglomerate effects. This is the case whether considered under the pre-merger conditions of competition or, in the alternative, the conditions of competition that would arise should Xchanging's anticipated acquisition of TOL complete.

Third party views

193. The CMA contacted customers, competitors, and received responses from Lloyd's and the Lloyd's Market Association in response to its market testing. The responses of third parties were somewhat mixed. Five customers were not concerned by a reduction of choice. However, nine customers raised concerns regarding a reduction of choice post-Merger and three further customers noted that choice would be reduced.

194. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

195. Consequently, the CMA believes that it is or may be the case that the Merger has resulted or may be expected to result in an SLC within a market or markets in the UK.

196. The CMA therefore considers that it is under a duty to refer under section 22(1) of the Act. However, the duty to refer is not exercised pursuant to section 22(3)(b) whilst the CMA is considering whether to accept undertakings under section 73 of the Act in lieu of a reference. Pursuant to section 73A(1) of the Act, Xchanging has until 9 December 2014 to offer an undertaking to the CMA that might be accepted by the CMA under section 73(2) of the Act. If no undertaking is offered or accepted within the statutory deadline or the Parties indicate before this deadline that they do not wish to offer such undertakings, then the CMA will refer the Merger pursuant to sections 22(1) and 34ZA(2) of the Act.

Sheldon Mills
Senior Director of Mergers
Competition and Markets Authority
2 December 2014