
Anticipated acquisition by Collins Stewart Tullett plc of Fulton Prebon Group Holdings Ltd

The OFT's decision on reference under section 33 (1) given on 7 October 2004

Please note that square brackets indicate information excised, or exact figures replaced by a range, at the parties' request.

PARTIES

1. **Collins Stewart Tullett plc.** (CST) is a global financial services group. Through its subsidiary Collins Stewart Limited, its activities comprise institutional and private client stock broking, market-making, corporate finance, fund management and the supply of online financial information. CST owns Tullett Liberty (Tullett), a fully diversified inter-dealer broker (IDB) active in the broking of cash equities, credit derivatives, energy, equities, fixed-income securities, global money and capital markets. CST carries out its wholesale pricing data sales activities through Tullett Liberty Financial Limited, a wholly owned subsidiary of Tullett. The turnover of CST in the UK for the year ended 31 December 2003 was £282.9 million.
2. **Fulton Prebon Group Holdings Ltd.** (Prebon) provides brokerage services for financial and commercial institutions worldwide in the commodities, derivatives, energy and emerging markets, fixed-income securities, foreign exchange and money markets. Prebon also carries out wholesale pricing data sales activities via Target Data Services (Bermuda) Limited. The turnover of Prebon in the UK for the year ended 31 December 2003 was £ [] million.

TRANSACTION

3. CST will acquire a 100 per cent shareholding in Prebon. The consideration will comprise a mixture of approximately £51.6 million cash and new ordinary shares in CST with an approximate value of £18 million.

4. The transaction was announced on 26 May 2004. On 25 August 2004 the parties notified the proposed acquisition to the OFT by way of a merger notice. The statutory deadline is 7 October 2004.

JURISDICTION

5. CST and Prebon will cease to be distinct as a result of these arrangements. The merger meets the turnover test in section 23 of the Enterprise Act 2002 (the Act) as Prebon's UK turnover is greater than £70 million. The notified arrangements, if carried into effect, will result in the creation of a relevant merger situation.

RELEVANT MARKET

6. The parties overlap in the broking of derivatives, energy, fixed-income securities, foreign exchange and money markets. Tullett is also active in cash equities and Prebon in commodities. Due to the absence of any overlap in these segments, cash equities and commodities are not considered further.
7. The parties also overlap in the wholesale supply of pricing data.

FINANCIAL TRADING

Products brokered by the parties

8. The parties are active in the broking of the following financial instruments:
 - Derivatives: financial instruments whose value is derived from the underlying value of another security. Derivatives include options and futures, swaps, inflation-linked derivatives, some forwards, warrants and certain mortgage-backed securities.
 - Energy: trading energy plays an important role in hedging against fluctuations in the price of products such as petroleum, crude oil, natural gas, propane, electricity, and, most recently, coal.
 - Fixed-income securities: debt securities that pay the registered owner a fixed rate of interest at specified intervals. They include gilt repos, corporate repos, US treasuries, European government bond repos and gilts¹.

¹ Repos are transactions where two parties agree that one will sell securities and commit to repurchase equivalent securities at a specified price on a specified future date or at a call.

- Foreign exchange: transactions which oblige an investor to deliver a specified quantity of one currency in return for a specified amount of another currency.
- Money markets: transactions where deposits or certificates of deposits are traded.

Product market

9. IDBs act as intermediaries or agents, bringing together two independent dealers to a transaction in a cost effective way. Dealers use IDBs to access a larger 'pool' of liquidity and pay them a commission for their service. This method of trading is known as the IDB channel and can take place either through the person of a broker, known as voice broking, or through an electronic broking system. However, dealers can also identify trading partners either directly without the use of any intermediaries (the direct channel) or via an established exchange for which they are charged a fee (the exchange channel).² Brokers can trade either on the direct channel or on the exchange channel.
10. The parties maintain that there is a considerable degree of demand side substitution between these three channels. All the major financial instruments are traded in more than one channel, and frequently in all three. In the parties' view, this interchangeability is demonstrated by shifts in the use of the various channels and the development of exchange based trading for a wide variety of instruments, which were historically traded either directly or through the IDB channel.
11. Within the IDB channel, the parties maintain that voice and electronic broking provide alternative execution mechanisms. Electronic broking is a technological evolution of voice broking and is said to place considerable competitive constraints on voice broking.
12. All third parties agree that there is some degree of substitution available between the three channels. There is general agreement with the parties on the factors influencing the choice of one channel over another for a specific transaction, namely liquidity, credit risk, product and pricing complexity, market interpretation, anonymity, price/spread and transaction costs. However, some third parties maintain that the three channels should not be considered to be completely interchangeable. The three channels are not necessarily suitable for all trades in all instruments segments. For instance, the broking of money markets is said only to be constrained by the direct channel as money markets are not exchanged instruments. There is also no exchange for trading repos.

² There are established exchanges for commodities, derivatives, energy and equity products.

Moreover, some instruments can only be traded on the direct channel (e.g. foreign exchange) while others can only be traded through the IDB channel (e.g. American Depositary Receipts).

13. Most third parties agree that voice and electronic broking are potentially substitutable and should be considered together. They maintain this view despite the fact that voice and electronic broking are generally used in different situations – voice-broking is a more effective medium for complex or unique transactions and less liquid trades, whilst electronic trading lends itself better to more liquid and commoditised trading. Not all financial instruments can therefore be traded electronically.
14. On the supply side, there is potentially some scope for brokers to move between broking different instruments. The key skill of a broker is as a salesperson and this skill can be transferred from broking one instrument to another following retraining. However, a broker moving from one instrument to another may not immediately have the necessary contacts. Third parties state that it would take considerable time to build a relationship network. Thus it appears that supply-side substitutability between instruments may be limited. Evidence as to supply side substitutability between voice and electronic broking is mixed.
15. The OFT considers that the extent of any demand side and supply side substitutability between the brokerage of different financial instruments is unclear. There seem to be different degrees of competition between the three channels depending on which of the various financial instruments is involved. On this basis, for the purposes of analysing the competition effects of this case, the OFT has considered competition at a disaggregated level for the various instruments. Accordingly the broking of each instrument where there are overlaps between the merging parties is considered separately. Voice and electronic broking are considered in combination and as separate segments. It is not necessary to reach a final view on the scope of any relevant frame of reference because, even when considered on a narrow disaggregated basis, no competition concerns arise.

Geographic market

16. The parties submit that financial trading is international in scope and encompasses at least all Member States of the enlarged EU. The parties estimate that their shares of supply will remain substantially the same regardless of whether the transaction is assessed on a global, European or UK basis. There is some confirmation of this from third party information.
17. On the basis that shares of supply figures are not sensitive to geographic scope, it is unnecessary for the OFT to conclude on geographic frame of reference.

WHOLESALE SUPPLY OF DATA

Product market

18. Both CST and Prebon are involved in the provision of real time and historical pricing information to downstream information vendors, namely Reuters, Bloomberg, Telerate Moneyline and Thompson Financial. This is known as the wholesale pricing data business.
19. Information vendors provide up-to-date news and information to end-users across the globe in the financial services, corporate and media sectors. In relation to financial services, the provision of both real-time and historical price information covers the whole spectrum of financial products. This information is used by the end-users to manage their investments and risk, to make investment decisions or as reference data. Potential end-users include central banks, government offices and agencies, financial institutions, corporations, news organisations and their wholesale data suppliers themselves. Customers register with the information vendors and pay a subscription fee to access the data. Data can be accessed in a variety of ways, including via workstations, data feeds and the Internet.
20. CST submits that in the wholesale supply of pricing data to information vendors, the parties face competition from a number of sources including exchanges (especially stock exchanges), dealers trading over-the-counter (OTC) instruments, other IDBs and clearing houses. Third parties have also confirmed that data provided by IDBs is available from other sources.
21. The relevant frame of reference appears to be the wholesale supply of pricing data.

Geographic market

22. The parties submit that the wholesale supply of data is world-wide in scope. Price information is provided electronically and accessed by end-users regardless of location. The packaged product that the information vendor offers to the end-user does not distinguish between geographical regions and all information is made available to virtually all end-users. The end-user will decide which products and pricing information they want to access. The information vendors are all global companies and compete and market their products across all geographical regions.
23. The geographic frame of reference appears to be world-wide.

HORIZONTAL ISSUES

Financial broking

24. Table one below provides the parties' shares of supply by volume in the overlapping broking of various financial instruments. The parties have the greatest presence in broking fixed-income securities ([20-30] per cent) and money markets ([35-45] per cent).

Table one: Share of supply of overall IDB by product in the EU

| | Derivatives | Energy | Fixed-income securities | Foreign exchange | Money markets |
|-----------------|----------------|----------------|-------------------------|------------------|----------------|
| ICAP | [20-30] | [5-15] | [30-40] | [05-15] | [15-25] |
| CST | [5-15] | [0-10] | [20-30] | [0-10] | [10-20] |
| Prebon | [5-15] | [5-15] | [0-10] | [10-20] | [20-30] |
| Combined | [15-25] | [10-20] | [20-30] | [15-25] | [35-45] |
| Tradition | [10-20] | [5-15] | [10-20] | [0-10] | [10-20] |
| Cantor | [5-15] | 0 | [10-20] | [0-10] | 0 |
| GFI | [5-15] | [10-20] | [0-10] | [0-10] | 0 |
| Eurobrokers | [0-10] | 0 | 0 | 0 | 0 |
| Martins | [0-10] | 0 | 0 | [0-10] | [10-20] |
| Others | [5-15] | [50-60] | [0-10] | [50-60] | [0-10] |

Source: Parties' estimates

Note: Share of supply figures based on volume of trades brokered.

25. Table two below provides share of supply data for the parties and their main competitors separately for the voice broking segments in derivatives, energy, fixed-income securities, foreign exchange and money markets. The parties have not been able to provide segmented share of supply data for the various instruments within each category. However, given the lack of third party concerns about the broking of various instruments across each category, we would not expect there to be raise any competition concerns in relation to individual instruments within these categories.

Table two: Share of supply of voice IDB by product in the EU

| | Derivatives | Energy | Fixed-income securities | Foreign exchange | Money markets |
|-----------------|----------------|----------------|-------------------------|------------------|----------------|
| ICAP | [25-35] | [5-15] | [30-40] | [10-20] | [20-30] |
| CST | [5-15] | [0-10] | [20-30] | [10-20] | [10-20] |
| Prebon | [5-15] | [5-15] | [0-10] | [10-20] | [25-35] |
| Combined | [10-20] | [10-20] | [30-40] | [20-30] | [35-45] |
| Tradition | [10-20] | [0-10] | [10-20] | [0-10] | [10-20] |
| Cantor | [5-15] | 0 | [5-15] | [0-10] | 0 |
| GFI | [5-15] | [5-15] | [0-10] | [0-10] | 0 |
| Eurobrokers | [0-10] | 0 | 0 | 0 | 0 |
| Martins | [0-10] | 0 | 0 | [0-10] | [10-20] |
| Others | [5-15] | [50-60] | [0-10] | [35-45] | [0-10] |

Source: Parties' estimates

Note: Share of supply figures based on volume of trades brokered.

26. The parties are only active in voice broking. In three segments – fixed income securities, foreign exchange and money markets – they will have a combined share of voice broking in excess of [20-30] per cent. However in the first two segments, their combined share declines if electronic broking is included within the relevant frame of reference (to [20-30] per cent and [15-25] per cent, respectively). Moreover, the direct channel is an alternative method of trading for these instruments segments. In particular, [60-70] per cent of fixed-income securities and [30-40] per cent of foreign exchange are traded through this channel.
27. Since money market trades are not brokered through an electronic channel, the parties' combined share of all money markets trades is [35-45] per cent. Nonetheless, the evidence available to the OFT shows that in respect of the broking of money markets, the share of supply figures above are not a good indicator of the parties' competitive significance. While this share is high relative to its IDB competitors and the segment appears to be concentrated, the OFT nevertheless believes there are sufficient competitive constraints to prevent the parties exercising market power:
- Firstly, in respect of money markets, third parties agree that there is cross-channel competition between the direct and the IDB channel for money markets. Indeed, the direct channel appears to be the predominant method of trading. According to the parties, [80-90] per cent of money market transactions are traded on the direct channel and the remaining [0-10] per cent is traded through IDBs.

- Secondly, dealers will typically source broking services from a number of different brokers at any one time. Third parties believe that there are several established IDBs, which provide competition within the broking of money markets: ICAP ([20-30] per cent), Tradition ([15-25] per cent), Martins ([10-20] per cent) and other small IDBs ([0-10] per cent).
- Finally, as explained below, evidence on entry and buyer power also supports the view that the merged entity will not be able to exercise market power post-merger.

Barriers to entry

28. The parties argue that barriers to entry in the IDB channel are not high. The primary barrier is relationships. The broking business is based largely on a network of contacts and relationships between brokers and dealers. Without these relationships a broking business will not be successful. Barriers for an existing IDB to enter a new financial instrument are low, since the infrastructure to support a new financial instrument desk is already in place. Provided they can establish relationships, existing voice IDBs could expand into broking other instruments.
29. Third parties agree that relationships are the key barrier to entry. Others appear to be the obtaining of Financial Services Authority (FSA) licence and clearing capital. Comments from third parties indicate that nothing prevents IDBs from moving into the brokerage of other financial products. They estimate that expansion into new instruments would only cost around £2 million for a team of 20 brokers.
30. This evidence suggests there are some barriers to entry, although they do not appear to be insurmountable.

Buyer power

31. The principal IDB customers are large, sophisticated international banks who are in a strong bargaining position when negotiating price. Banks state that they use a wide range of brokers and switch frequently. Moreover, whilst the banks value the benefits of trading through brokers they also have an option to switch to trading directly or on exchange, depending on the financial product, providing some constraint on broker's fees. The parties state that there has been no material change in brokerage fees over the past three years.
32. Third parties agree that banks are influential. Banks have actively sponsored new entry on a number of occasions. For instance, customer sponsorship was behind

the establishment of BrokerTec, the MTS Group and Eurex Bonds. Banks confirm that commission rates have fallen over recent years primarily due to greater competition and increased penetration of electronic broking.

33. It can be concluded therefore that some countervailing buyer power exists.

Wholesale supply of data

34. In relation to the wholesale supply of data by IDBs, the parties have a combined share of [20-30] per cent. As noted above, the appropriate frame of reference encompasses a range of other data sources. In this context, the parties combined share of wholesale supply of data gives rise to no concerns.
35. The parties argue that barriers to entry are low. Third parties have confirmed that entry is occurring in this evolving market. The parties also maintain that information vendors have significant buying power.
36. Given the low shares, evidence on entry, the profile of customers and lack of third party complaints, the merger does not raise concerns in the wholesale supply of data.

THIRD PARTY VIEWS

37. The majority of third parties were unconcerned about this merger.
38. One competitor raised concerns about competition in the broking of money markets. This concern has been addressed above.
39. Views were obtained from the FSA. The FSA thought that, despite the considerable consolidation in the IDB market over the last few years, the impact of the merger on competition does not raise any concerns.

ASSESSMENT

40. The parties overlap in the broking of derivatives, energy, fixed income securities, foreign exchange and money markets. These activities can be segmented between electronic broking (in which the parties are not active) and voice broking. For the purpose of analysing the competition effects of this case the brokerage of each financial instrument is considered separately at EU level.
41. Regarding financial broking, the parties have the greatest presence in voice broking of fixed-income securities ([20-30] per cent) and money markets ([35-45] per cent). The parties are not active in electronic broking. However, these figures

overstate the parties' position since other channels for trading are available to dealers. For example, within the money markets segment, [80-90] per cent of trading is carried out through the direct channel. In addition, there will remain a number of IDB competitors, of which at least three or four have a material market presence. Barriers are relatively low and there is evidence that buyers do exert a restraining influence.

42. Regarding the wholesale supply of pricing data, no third party raised concerns and the other evidence suggests the transaction does not raise any competition concerns.
43. Consequently, the OFT does not believe that it is or may be the case that the creation of this merger situation may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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