Anticipated acquisition by ION Investment Group Limited of Fidessa group plc

Decision on relevant merger situation and substantial lessening of competition

ME/6745/18

The CMA's decision on reference under section 33](1) of the Enterprise Act 2002 given on 3 August 2018. Full text of the decision published on 22 August 2018.

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. ION Investment Group Limited (**ION**), through its subsidiary ION Capital UK Limited, has agreed to acquire Fidessa group plc (**Fidessa**) (the **Merger**). ION and Fidessa are together referred to as the **Parties**.

2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of ION and Fidessa is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the turnover test is met. Accordingly, arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

3. The Parties supply sell-side[1] front office [2]capital markets software, world-wide. Ion supplies sell-side front office trading software for fixed income financial products (**fixed income**) and exchange traded derivatives

[1] Sell-side institutions, such as banks and brokers, facilitate trading in capital assets. By contrast buy-side institutions, such as pension funds, manage investments in capital assets.
[2] The front office in sell-side institutions deal directly with those institutions' customers and so cover the first parts of the trade process, eg trade execution. In contrast, the back office covers supporting functions, such as cash and risk management.

(**derivatives**). Fidessa supplies sell-side front office trading software for equities and derivatives.

4. The CMA assessed the possibility that the merger would give rise to horizontal unilateral effects in the supply of sell-side front office trading software for derivatives, where both Parties supply products. However, the CMA found that the Parties' are not close competitors and face extensive competition from alternative suppliers.

5. The CMA also considered conglomerate effects in the supply of sell-side front office trading software for equities and the supply of sell-side front office trading software for fixed income. The CMA assessed whether the Parties might tie their products together, raising customers' switching costs. However, the CMA believes that the Parties would not have the incentive to pursue this strategy, given that this would increase the risk that they would lose customers to competitors.

6. Accordingly, the CMA believes that the Merger does not give rise to a realistic prospect of a substantial lessening of competition (**SLC**).

7. The Merger will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

ASSESSMENT

Parties

8. ION is a software provider headquartered in Ireland. It offers trading and workflow automation products to financial institutions. The turnover of ION in 2017 was £[✄] million in the UK. Within derivatives, ION supplies front, middle and back office solutions to the sell-side and is not active for buy-side solutions.

9. Fidessa is a software provider based in London. It also offers trading and workflow automation products to financial institutions. The turnover of Fidessa in 2017 was £122 million in the UK. Within derivatives, Fidessa supplies front office, but not middle or back office, solutions to the sell-side and supplies the buy-side.

Transaction

10. As part of a public takeover being conducted in accordance with the takeover code, ION would acquire the entire issued share capital of Fidessa.

Jurisdiction

11. Each of ION and Fidessa is an enterprise. As a result of the Merger, these enterprises will cease to be distinct.

12. The UK turnover of Fidessa exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied.

13. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

14. The initial period for consideration of the Merger under section 34ZA(3) of the Act started on 19 June 2018 and the statutory 40 working day deadline for a decision is therefore 13 August 2018.

Counterfactual

15. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, it believes that, in the absence of the merger, the prospect of these conditions continuing is not realistic, or there is a realistic prospect of a counterfactual that is more competitive than these conditions.[3]

16. The CMA will consider whether the counterfactual situation should include the entry by one of the merger firms into the market of the other firm.[4]

17. In this case, the CMA found evidence in Fidessa's internal documents that it had in the past tried to enter the supply of [✂]. However, the CMA did not receive evidence to indicate that such entry would have been a realistic prospect, absent the Merger. After several years of attempted entry, Fidessa's internal documents show that it concluded that [✂]. Accordingly, it ultimately decided to close its fixed income initiative in [✂].[5] This was not motivated by contemplation of the Merger, as at the time Fidessa did not

[3] *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

[4] *Merger Assessment Guidelines*, paragraph 4.3.19.

[5] Response to request for information 1, Annex 3.

intend to merge with ION (as proven by the fact that in March 2018 Fidessa agreed to a separate merger with Temenos).

18. Therefore, the CMA believes the prevailing conditions of competition to be the relevant counterfactual.

Frame of reference

19. Market definition provides a framework for assessing the competitive effects of a 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. The CMA will take these factors into account in its competitive assessment.[6]

20. The Parties supply sell-side front office trading capital markets software, world-wide. Ion supplies sell-side front office trading software for fixed income and derivatives. Fidessa supplies sell-side front office trading software for equities and derivatives.

Product scope

21. The CMA considered whether it was appropriate to segment the supply of sell-side capital markets software in the following ways:

    (a) By asset class;

    (b) By trading stage; and

    (c) By type of customer.

Segmentation by asset class

22. The Parties submitted that technology solutions within each asset class differ significantly, as trading each asset class requires different features. The relevant broad asset classes were fixed income (where Ion supplies software), derivatives (where both Parties supply software) and equities (where Fidessa supplies software).

[6] *Merger Assessment Guidelines*, paragraph 5.2.2.

23. In assessing the scope for demand-side substitution, the CMA found that the Parties' internal documents supported the Parties' submissions that the features required for trading each asset class differ substantially. Third parties also told the CMA that different features need to be provided within each asset class to support different workflows and algorithms, and to meet different regulatory needs.

24. The CMA therefore considered that there was no scope for demand-side substitution between products supporting different asset classes.

25. In assessing the scope for supply-side substitution, the CMA found that the Parties' internal documents assessed competition within each asset class separately. Indeed, Fidessa's 2014 annual report stated that *"[l]ong-term commitments are required for each asset class in order to build functionally rich offerings that are effective in all regions."*[7]

26. Although some third parties said that in principle they try to leverage existing technology in one asset class when providing another asset class, the CMA found evidence from both third parties and the Parties' internal documents that the cost of supporting an additional asset class can be very high, and can require substantial development time.

27. The CMA therefore considered that there was little scope for supply-side substitution between products supporting different asset classes.

28. Accordingly, the CMA defined separate frames of reference for fixed income, derivatives and equities.

Segmentation by trading stage

29. The Parties submitted that the transaction cycle can be divided into four stages: (i) research and analytics; (ii) front office execution; (iii) middle office trade clearing and reconciliation; and (iv) back office risk and compliance management. The front office in sell-side institutions deal directly with those institutions' customers and so cover the first parts of the trade process, eg trade execution. In contrast, the back office covers supporting functions, such as cash and risk management. The Parties submitted that customers' software needs at each stage of the trading cycle are very different (albeit with some blurring of middle and back office for some customers, and for some asset classes).

[7] Merger Notice, Annex 1.3L.

30. Third parties told the CMA that the provision of middle and back office trading software is a very different proposition to the provision of sell-side front office trading software, and that each is typically provided by a different set of companies (or, if both are provided by one company, they are produced by different sets of staff). Third parties told the CMA that middle and back office software is frequently handled in-house, while front office software is typically purchased externally (for example, from the Parties).

31. On the basis of the above evidence, the CMA found that there was little scope for demand- or supply-side substitution between front office software and software designed for other trading stages. Accordingly, on a conservative basis (given that Fidessa does not have middle or back office activities), the CMA separated front office software from software designed for other trading stages. However, the CMA has not found it necessary to conclude on whether the frame of reference should be segmented by reference to the trading stage as no concerns arise on this conservative basis.

Segmentation by type of customer

32. The Parties submitted that buy-side customers and sell-side customers should be considered separately, as they have different requirements. Buy-side institutions, such as pension funds, manage investments in capital assets. Sell-side institutions, such as banks and brokers, facilitate trading in capital assets.

33. The Parties' internal documents considered the supply of buy-side and sell-side customers separately, and supported the Parties submission. In particular, the CMA believes that buy-side customers require execution management systems which are different to the tools required by sell-side customers.

34. Third parties' views were mixed on whether these products should be segmented. Some third parties said that both buy-side and sell-side customers typically purchase the same product but use it differently.

35. The CMA has therefore, on a conservative basis (given that Ion does not have buy-side activities) separated the supply of trading software by customer type (ie to buy-side and sell-side customers). However, the CMA has not found it necessary to conclude on whether buy-side and sell-side should be separated as no concerns arise on this conservative basis.

Geographic scope

36. The Parties submitted that the relevant geographic market is global, as the Parties and their competitors supply software across the world.

37. The Parties' competitors told the CMA that they operate globally. The Parties' customers which responded to the CMA's questionnaire did not consider a supplier's location to be important.

Conclusion on frame of reference

38. For the reasons set out above, the CMA has considered the impact of the Merger in the following frames of reference:

    - The supply of sell-side front office trading software for derivatives, world-wide;
    - The supply of sell-side front office trading software for fixed income, world-wide; and
    - The supply of sell-side front office trading software for equities, world-wide.

Competitive assessment

39. The CMA considered two theories of harm. The first involved horizontal unilateral effects arising from both Parties' supply of sell-side front office trading software for derivatives. The second involved conglomerate effects arising from Ion's activities in the supply of sell-side front office trading software for fixed income and Fidessa's for equities.

Horizontal unilateral effects in the supply of sell-side front office trading software for derivatives

40. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or to degrade quality on its own and without needing to coordinate with its rivals.[8] Horizontal unilateral effects are more likely when the merging parties are close competitors. The CMA assessed whether it is or may be the case that the Merger has resulted, or may be expected to result, in an SLC in relation to horizontal unilateral effects in the supply of sell-side front office trading software for derivatives, world-wide.

[8] *Merger Assessment Guidelines*, from paragraph 5.4.1.

Shares of supply

41. The Parties submitted market share estimates for the supply of front office derivatives solutions, world-wide, by revenue, drawn from public information and from historical mergers and acquisitions processes.

Table 1: Shares of supply of sell-side front office trading derivatives solutions, world-wide, by revenue

Supplier	% *Share of supply*
Fidessa	[10-20]
ION	[0-5]
Parties	**[10-20]**
Trading Technologies	[10-20]
Itiviti (Orc) & Ullink	[10-20]
Bloomberg / RTS	[10-20]
ICE Connect / IDC Futuresource / eSignal	[5-10]
CQG	[5-10]
FIS / SunGard / GL Trade (Valdi)	[5-10]
Flextrade	[5-10]
Vela / Options City / Object Trading	[0-5]
Stellar Trading Systems	[0-5]
Horizon	[0-5]
Thomson Reuters / Redi	[0-5]
Ninja Trader	[0-5]
Others (including eSunny, Sharp Point, Neon (EasyScreen) / Marex, QST, CME)	Unknown

Source: The Parties

42. The CMA was unable to fully verify these shares of supply with third parties, although they broadly align with the CMA's wider market testing and almost all these suppliers were mentioned by customers in their responses to the CMA's questionnaire. As described below, third parties confirmed the Parties' view that the supply of sell-side front office trading software for derivatives is highly fragmented, with a wide range of credible alternative suppliers to the Parties.

Closeness of competition

43. The Parties submitted that they are differentiated by functionality. Some complex orders need significant sell-side involvement (for example, they may need to be executed over a longer period rather than instantaneously); an order management system can enable this. Fidessa offers an order management system, while ION offers execution screens (work-station-based products) that are more typically used for simpler trades.

44. Evidence from third parties suggested that the Parties are differentiated. Less than half the customers that responded to the CMA's market testing considered the Parties to be alternatives. Customers identifying the Parties as alternatives also identified a number of other suppliers.

45. On the basis of the above evidence, the CMA considers that the Parties are not particularly close competitors.

Competitive constraints

46. The Parties submitted that they face a range of well-funded competitors such as Bloomberg, FIS/SunGard, CME and Intercontinental Exchange; as well as smaller entrants such as Options City (recently acquired by Vela) and Ninja Trader.

47. The Parties' customers named a wide range of competitors to the Parties in the supply of sell-side front office trading software for derivatives, naming 10 current suppliers and 11 additional suitable alternatives. The following competitors were most frequently referred to as alternatives to the Parties by customers that responded to the CMA's questionnaire and the Parties' internal documents also provided evidence of constraint:

   (a) Trading Technology was referred to by the large majority of customers and [✄].[9]

   (b) CQG was referred to by a large number of customers, one of which emphasised its "high suitability". They were also [✄].[10]

   (c) Ullink was referred to by many customers, which noted its "good coverage" and "high" suitability. In addition, they were [✄].[11]

   (d) Stellar Trading was referred to by many customers, one of which described it as a "direct competitor" to ION and Fidessa.

48. Some of the Parties' customers named few alternatives. However, these customers did not see the Parties as close competitors, and did not raise concerns about the merger's impact on competition.

49. On the basis of the above evidence, the CMA believes that the Parties face extensive competition from a diverse set of competitors in a fragmented market.

Conclusion on horizontal unilateral effects

50. For the reasons set out above, the CMA believes that the Parties are not particularly close competitors, and that they face extensive competition which will continue to constrain the Parties post-merger. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result

[9] For example, [✄]
[10] [✄]
[11] [✄]

of horizontal unilateral effects in the supply of sell-side front office trading software for derivatives.

Conglomerate effects in the supply of sell-side front office trading software for equities and the supply of sell-side front office trading software for fixed income

51. Conglomerate effects may arise in mergers of firms that are active in the supply of goods or services that do not form part of the same markets but which are nevertheless related in some way. Usually, this is because their products are complements (so that a fall in the price of one good increases the customer's demand for another) or because there are economies of scale in purchasing them (so that customers buy them together).[12]

52. Most non-horizontal mergers are considered to be benign or even efficiency-enhancing (when they involve complementary products) and do not raise competition concerns. However, in certain circumstances, a conglomerate merger can result in the merged entity foreclosing rivals, including through a tying or bundling strategy.

53. The evidence available to the CMA does not indicate that ION's fixed income products and Fidessa's equity products were complements or that customers wished to buy them together due to purchasing economies.[13]

54. However, some competitors expressed concern about customers losing bargaining power if the Parties contractually or technically linked their fixed income and equities products. A small number of respondents submitted that, post-Merger, customers who are currently supplied by both parties would incur higher switching costs in future as they would have to switch both products (because they would be contractually or technically linked), making it less attractive for them to switch to other suppliers.

55. The CMA acknowledges that in these circumstances customers may experience costs in switching away from the Parties' products to other suppliers. The CMA received some evidence from the Parties' internal documents and from third parties that ION has a strong position in the supply of sell-side front office trading software for fixed income, with only one close competitor (with a much smaller share of supply), Broadway Technology. The CMA received some evidence from third parties to suggest that Fidessa may have a strong position in the supply of front-office trading solutions for equities but also that a number of other competitors are also present. The CMA also

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[12] *Merger Assessment Guidelines*, paragraph 5.6.2.
[13] Some customers did however refer to possible benefits from integrating the Parties' products.

received evidence that some customers of ION were also customers of Fidessa.

56. However, the CMA considers that tying the Parties' products in this way could only increase the Parties' bargaining power if it disproportionately increased customers' switching costs relative to the Parties' loss of margin from customers switching to other suppliers. The CMA has not received evidence that this would be the case. Therefore, given also that linking the products would likely incur some costs for the Parties, the CMA believes that the Parties would not have the incentive to pursue this strategy.

57. Accordingly, the CMA found that the Merger does not give rise to a realistic prospect of an SLC as a result of conglomerate effects in relation to the supply of sell-side front office trading software for equities and the supply of sell-side front office trading software for fixed income.

Barriers to entry and expansion

58. Entry, or expansion of existing firms, can mitigate the initial effect of a 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.[14]

59. However, the CMA has not had to conclude on barriers to entry or expansion as the Merger does not give rise to competition concerns on any basis.

Third party views

60. The CMA contacted customers and competitors of the Parties.

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

Decision

62. Consequently, the CMA does not believe that it is or may be the case that the Merger may be expected to result in an SLC within a market or markets in the United Kingdom.

63. The Merger will therefore **not be referred** under section 33(1) of the Act.

[14] *Merger Assessment Guidelines*, from paragraph 5.8.1.

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