ANTICIPATED ACQUISITION BY LONDON STOCK EXCHANGE GROUP PLC OF QUANTILE GROUP LIMITED

Summary of the CMA’s decision on relevant merger situation and substantial lessening of competition

ME/6973/21

Introduction

1. On 6 December 2021 London Stock Exchange Group plc (**LSEG**) entered into a share purchase agreement to buy the entire and to be issued capital of Quantile Group Limited (**Quantile**) (the **Merger**). LSEG and Quantile are together referred to as the **Parties**, and, for statements referring to the future, as the **Merged Entity**.

2. The Competition and Markets Authority (**CMA**) believes that it is or may be the case that each of LSEG and Quantile is an enterprise; that these enterprises will cease to be distinct as a result of the Merger; and that the share of supply 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.

Competition assessment

3. LSEG mainly offers centralised risk management. It operates a business, LCH, that acts as a clearing house for various types of trades. Trades are first agreed and then are ‘cleared’ (so that each party can be sure the trade will go ahead – removing the risk that the other party to the trade might fail (ie the counterparty risk)).

4. LCH’s business states that it operates on an ‘open access’ model, which means that ‘market participants should be able to clear all eligible trades, regardless of the venue traded on’. The practical implication is that LCH will clear transactions on any exchange, including those owned by LSEG’s competitors.

5. Both Parties are active in the provision of post trade services, ie services that are offered to parties using the clearing house and that are performed after a trade is executed. The key stages of a trade after execution may include (1) trade matching/affirmation; (2) clearing; (3) settlement; (4) custody and asset servicing; and (5) related activities such as collateralisation. Other post trade services reduce

risk or capital requirements (such as portfolio compression and margin optimisation) or provide the transparency required by regulation (such as reporting).

6. Quantile provides (1) portfolio compression services for cleared trades; and (2) margin optimisation services for cleared and uncleared trades.

7. The CMA's investigation focused on whether the Merged Entity might be able to use its control of certain inputs to harm Quantile's rivals in relation to two products: multilateral compression and margin optimisation.

Input foreclosure in multilateral compression of over-the-counter interest rate derivatives (OTC IRDs)

8. Multilateral compression is a risk-reduction technique by which a group of market participants contract with a multilateral compression provider to identify and replace multiple offsetting derivative contracts with fewer deals of the same net risk to reduce the notional value of their portfolio. By reducing the notional value of the portfolio, a customer reduces the capital that needs to be held, lowering the cost of engaging in those trades.

9. Multilateral compression providers for OTC IRDs rely on cooperation by LSEG's clearing house, LCH, to implement their multilateral compression proposals for trades cleared at LCH. As Quantile's multilateral compression services at LCH relate to cleared OTC IRDs only, the CMA investigated whether the Merged Entity could foreclose current and future multilateral compression providers for OTC IRDs that compete with Quantile. If the Merged Entity foreclosed competitors to Quantile, those rivals would be less effective competitors.

10. A multilateral compression provider that wants to offer compression of LCH cleared OTC IRDs must be approved by LCH as an Approved Compression Service Provider (**ACSP**). There are only two ACSPs for LCH in relation to OTC IRDs: Quantile and TriOptima.

11. The CMA considered whether the Merged Entity could harm Quantile's rivals by (1) ceasing to approve rival providers as ACSPs (total foreclosure), and/or (2) engaging in strategies that worsen the ACSP terms or otherwise harming Quantile's competitors (an example of this type of strategy would be LCH changing the order of compression files so that Quantile files are always processed first (partial foreclosure)).

12. In relation to the Merged Entity's ability to engage in foreclosure:

(a) the CMA found that LCH has significant market power in the provision of clearing services for OTC IRDs with a stable share of supply of around 90% (by notional cleared) between 2018-2021.

(b) Feedback from clearing house customers confirmed that switching from one clearing house to another is difficult. Around 75% of OTC IRDs are cleared and the CMA considers that LCH has significant market power in the provision of clearing services for OTC IRDs.

(c) The CMA, therefore, believes that multilateral compression providers who wish to offer their services in relation to OTC IRDs need the ability to offer to compress trades cleared at LCH.

(d) Based on third-party feedback, the CMA found that LCH retains a margin of discretion in granting the ACSP status to a multilateral compression provider and that LCH could engage in other mechanisms of foreclosure strategies such as those described in paragraph 11.

(e) Finally, the CMA found there is no legal impediment for LCH to deviate from its current (open access) governance model. That model enables trades from any trading venue to be cleared at LCH. It is not clear that the open access principle would fully secure the protection that the Parties claimed it would in relation to competition between multilateral compression providers as the CMA considers there would still be scope for foreclosure while applying the principle. The mechanisms the Parties argued as giving effect to that model (for example, enforcement by the Bank of England, who have a primary concern to secure financial stability, not to protect or promote competition) were not sufficient to make it likely that enforcement of open access principles would be effective and robust to the extent that it would address the risks of foreclosure. The CMA therefore placed limited weight on LSEG's commitment to open access in relation to the assessment of vertical effects in multilateral compression.

13. In relation to the Merged Entity's incentive to engage in foreclosure, the CMA has considered the costs and benefits of a vertical foreclosure strategy:

(a) The CMA believes that partial foreclosure strategies aimed at Quantile's rivals in multilateral compression would be unlikely to significantly harm the Merged Entity, especially those that are less detectable or that could be justified by LCH. For instance, the Merged Entity could favour Quantile in terms of multilateral compression runs and access to data by manipulating the automated nature of the process while carrying out routine updates.

Experience across a range of sectors suggests that such discrimination in favour of a related business may be very difficult to detect or prevent.

(b) The CMA found that any costs of engaging in total or partial foreclosure for the Merged Entity are likely to be limited. One cost is the risk of retaliation by customers, which the Parties argued would constrain their conduct. Based on the available evidence, including third-party feedback, the CMA believes that, although customers would disapprove of the Merged Entity's behaviour, they would not be able to move a significant number of trades from LCH to another clearing house, given switching is difficult. Furthermore, the available evidence does not show that customers would switch part of their spend on other LSEG services to alternative providers of those services. Based on the available evidence, the CMA believes customer switching would be limited and would not be enough to offset the benefits from foreclosure.

(c) The CMA further believes that the foreclosure strategies aimed at Quantile's rivals in multilateral compression would benefit the Merged Entity substantially, allowing it to gain market power in multilateral compression.

14. With regard to the effect of any foreclosure strategy, the CMA found that multilateral compression for OTC IRDs is already concentrated, with TriOptima and Quantile being the main providers. The CMA therefore found that foreclosure may raise significant barriers to entry for new providers and is likely to have a negative impact for customers as a loss of choice and competition may increase prices and reduce quality and innovation.

15. The CMA therefore believes that the Merger gives rise to a realistic prospect of a substantial lessening of competition (**SLC**) as a result of vertical effects in multilateral compression services for OTC IRDs in the United Kingdom.

Input foreclosure in margin optimisation

16. Margin optimisation services seek to reduce initial margin and therefore aim to reduce counterparty risk and the costs associated with funding the initial margin. Margin optimisation providers do not need to engage directly with clearing houses in order to be 'approved' and clearing houses do not need to provide them with data for the optimisation run or to register the trades following the run.

17. Quantile offers margin optimisation services in relation to derivative portfolios, including FX, OTC IRDs and equities.

18. LSEG has two services that are being used by margin optimisation providers. First, the SMART data and analytics tool is a product that is used to estimate the margin impact of adding new cleared trades at LCH. Second, SwapAgent is an LCH service that offers standardized infrastructure for non-cleared derivatives. The CMA, therefore, investigated whether the Merged Entity could use its control of these inputs to harm Quantile's rivals in margin optimisation services.

19. Based on third-party feedback and the Parties' submissions, the CMA found that (1) there are no current margin optimisation providers apart from Quantile that rely on the SMART data and analytics tool and (2) SwapAgent has no visibility of who creates the trades or if the trades are the result of an optimisation run, and therefore is not able to discriminate against Quantile's rivals.

20. Finally, the CMA investigated whether the Merged Entity could grant Quantile preferential or exclusive access to customer data necessary to offer or improve optimisation services (eg data on customers' trade positions at LCH). The CMA found that LCH does not have an active role in the margin optimisation process. The CMA considers that this aspect, and the fact that margin optimisation largely relates to uncleared trades, makes any preferential access to data in margin optimisation by itself unlikely to provide LCH the ability to foreclose.

21. For the reasons set out above, the CMA believes that the Merged Entity would not have the ability to foreclose Quantile's rivals in margin optimisation.

Decision

22. The CMA therefore believes that the Merger gives rise to a realistic prospect of an SLC as a result of vertical effects in multilateral compression services for OTC IRDs in the United Kingdom.

23. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (the **Act**). The Parties have until 10 May 2022 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Merger pursuant to sections 33(1) and 34ZA(2) of the Act.