
Anticipated acquisition by Pearl Group Limited of Resolution plc

No. ME/3428/07

The OFT's decision on reference under section 33(1) given on 28 December 2007. Full text of decision published 18 January 2008.

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

PARTIES

1. **Pearl Group Limited (Pearl)** is the holding company of a number of life assurance companies which manage life insurance products.¹ Pearl manages closed funds only.
2. **Resolution plc (Resolution)** is a specialist manager of life funds which operates closed and open funds, seeks to acquire closed funds and operates an asset management business. Resolution's UK turnover in 2006 was [greater than £70 million].

TRANSACTION

3. Pearl proposes to acquire the entire share capital of Resolution through its subsidiary, Impala. The acquisition will be partially funded through finance provided by Royal London Mutual Insurance Society (Royal London); on completion of the acquisition by Pearl, various Resolution businesses and assets relating to new business capability (including that of the off-shore life protection business) and in-force funds will be on-sold to Royal London, at a price off-set against the finance provided by Royal London (effectively a prepayment). Although it is envisaged that Pearl will end up with only

part of Resolution's assets and business after the on-sale, this decision considers the impact on competition from Pearl owning the whole of Resolution.

4. Given the way this transaction is arranged, the OFT has considered whether Pearl and Royal London should be treated as associated persons. Section 127(4)(d) of the Enterprise Act 2002 states that the concept of associated persons applies to 'two or more persons acting together to secure or exercise control of a body of persons corporate or un-corporate or to secure control of any enterprise or assets.' However, the transaction raises no competition concerns whether the parties are treated as associated persons or not. Even if the shares of Royal London and Pearl were considered together, the post-merger share of supply and increment would be small and therefore the OFT has not concluded on the matter. The OFT has addressed the subsequent transaction by Royal London in a separate decision.²
5. Pearl notified the OFT on 23 November 2007. The extended statutory deadline is 9 January 2008.

JURISDICTION

6. As a result of this transaction Pearl and Resolution will cease to be distinct. The UK turnover of Resolution exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

FRAME OF REFERENCE

7. Pearl and Resolution overlap in the management and acquisition of closed life insurance funds in the UK. This gives rise to overlaps in the markets for life insurance, consolidators of closed funds, off-shore life insurance and asset management, each of which are considered below.

¹ Pearl Assurance Limited, National Provident Life Limited, London Life Limited and NPI Limited.

² *Anticipated acquisition by Royal London Mutual Insurance Society of certain assets and business of Resolution plc*, OFT decision of 28 December 2007.

Life insurance

Product market

8. Life insurance is a contract between the policy owner and the insurer, whereby the insurer agrees to pay a sum of money on the occurrence of the policy owner's (or some other named person's) death, attainment of a particular age or succumbing to a critical illness. In return, the policy owner agrees to pay a premium at regular intervals, which may be invested by the fund in a number of ways (including equities, property, fixed interest securities and cash deposits).
9. Life insurance can be segmented into three sub-categories: protection policies, pensions and annuities policies, and investment savings products. Previous OFT decisions have not reached a conclusion on whether the three products should be considered in the same frame of reference.³ Pearl submitted that there was a degree of supply-side substitutability within the life insurance product market, as most insurance providers are present in most, if not all, parts of the market and that most life insurance products satisfy similar consumer needs and can therefore be considered demand-side substitutes.
10. One competitor considered that, depending on the context, the three categories of life insurance should be considered as separate markets, while another competitor that responded to the OFT information request agreed with the Pearl's approach. Further segmentation may be also possible between with-profits and non-profit funds⁴ and between closed and open funds.⁵
11. The OFT has considered the various frames of reference described above in the context of the present case. However, given that the merger raises no competition issues even on the narrower frames of reference, the OFT does

³ See OFT decision of 10 August 2005 on the anticipated acquisition by Britannic Group plc of Resolution Life Group Limited; and, the OFT decision of 12 October 2007 on the anticipated acquisition by Resolution plc of Friends Provident plc.

⁴ A non-profit policy is one where the value of the policy is linked directly to the performance of the underlying assets or guaranteed by the insurer; a with-profits policy is one where payouts are determined by bonuses declared by the insurer.

⁵ Closed funds are those that no longer accept new business and are managed solely for existing policy holders, who can continue to top up their policy. Conversely, open funds continue to write new business and accept new customers.

not consider it necessary to conclude on the appropriate frame(s) of reference in this case.

Geographic market

12. Pearl submits there is a separate UK market for the provision of life insurance products. Despite a trend towards intra-community selling, the European Commission in *Axa/Wintherthur*⁶ noted that markets remain national in scope as a result of national distribution channels, established market structures, fiscal constraints and differing regulatory regimes. In the absence of evidence to suggest a sufficient number of individuals look beyond the UK for life insurance, the OFT considers the UK to be the relevant geographic frame of reference.

Consolidators of closed funds

Product market

13. Some companies, including the parties, specialise in and actively buy closed funds, which may indicate that there is a market for such 'consolidators' of closed life funds and past cases have acknowledged that it may be the case that consolidators of closed funds form a separate frame of reference.⁷
14. While the transaction raises no competition concerns on any basis and as such it is not necessary to conclude whether consolidators form a separate product frame, the competitive assessment takes a cautious approach and considers the consolidation of closed funds as a separate frame of reference.

Geographic market

15. A number of the bidders in auctions for closed funds detailed in information submitted by Pearl are from outside the UK. However, in the absence of

⁶ COMP M.4284, EC decision of 28 August 2006.

⁷ See OFT decision of 6 May 2005 on the completed acquisition by Britannic Assurance plc of Allianz Cornhill Insurance plc's life operations; OFT decision of 16 August 2005 on the anticipated acquisition by Britannic Group plc of Resolution Life Group Limited; and, the OFT decision of 19 October 2007 on the anticipated acquisition by Resolution plc of Friends Provident plc.

any conclusive evidence, the OFT takes a cautious approach and considers the geographic frame of reference to be UK wide.

Off-shore life insurance

Product market

16. Off-shore life insurance products allow funds to be invested in a low-tax jurisdiction which is not the policy holder's country of residence. While supply side substitution appears straightforward (most suppliers of off-shore life insurance are also suppliers of onshore life insurance), it is acknowledged that from a demand perspective, investors may prefer off-shore investments where there are greater potential gains than from a fund subject to a different taxation regime. Such a return may or may not be greater than an equivalent 5-10 per cent increase in premiums and as such off-shore funds may not be considered substitutable with onshore life insurance. While no competition concerns arise on either basis, the competitive assessment takes a cautious approach and considers off-shore life insurance as a separate frame of reference.

Geographic market

17. While it is straightforward for consumers to be supplied by providers operating in different countries, some of the same factors that make onshore life insurance national in scope are also present, particularly national distribution channels and established market structures. While the competitive assessment does not materially differ under either a UK or global frame of reference, a cautious approach is taken and the relevant frame of reference is considered to be the supply of off-shore life insurance to UK consumers.

Asset management

Product market

18. Pearl submits that asset management constitutes a single market incorporating the creation, establishment and marketing of retail pooled funds and the provision of portfolio management services. Operating a life fund involves the ownership of the fund but also the management of the funds and administration of the policy portfolio. The latter two can be

carried out internally, but also outsourced to third parties who may or may not themselves be life insurance providers or specialist asset management companies. In addition, we consider that firms which currently only provide asset management internally may be able to switch with relative ease to providing such services to third parties.

Geographic market

19. Pearl submits that the market is increasingly international. Past cases⁸ have noted that many asset management companies operate on an international basis but that a national presence can have a commercial advantage, particularly where customers have a preference for local managers. As the competitive assessment does not materially differ under either a global or UK market, the OFT has not come to a conclusion but takes a cautious view for the purposes of the competitive assessment and considers the frame of reference to be the UK.

HORIZONTAL ISSUES

Market shares

Life insurance

20. Pearl provided estimates (taken from various independent sources such as Standard & Poor's and the Association of British Insurers) of shares of supply based on a number of measures: new business, net written premia and total long-term assets or assets under management (AuM). By any measure, the parties combined share and the increment are low. The industry is highly fragmented with numerous competitors and, post merger, Pearl would be the fourteenth largest provider based on new business, with a share of supply of [less than five] per cent (increment of [less than two] per cent). Even if the market were considered along the smaller segments outlined above, the parties' share in any segment would remain below 10 per cent with competition from a number of alternative suppliers and new non-traditional entrants.

⁸ See OFT decision of 19 August 2004 on the anticipated merger between ISIS Asset Management and Foreign & Colonial Group (Holdings) Limited.

Consolidators of closed funds

21. On the basis of AuM, Pearl estimates the combined share of supply to be [less than 15] per cent of total assets in funds that are wholly or substantially closed. Given the fact that open funds could be easily closed, this share could be quickly diluted and so these shares of supply are not necessarily an accurate reflection of the market power of the merging parties.
22. Pearl provided details of ten other companies involved in acquiring closed funds, including a significant new entrant (Deutsche Bank) and noted that there was a wide range of potential purchasers (such as other insurance companies, banks, hedge funds and private equity firms). There was evidence of increasing price competition in auctions for closed funds over recent years, with Pearl supplying details of auctions which showed a number of different acquirers and a significant increase in prices paid to acquire closed funds between July 2004 and June 2007. The OFT did not receive any contrasting evidence in its investigation.

Offshore life insurance

23. Off-shore life insurance accounts for only one per cent of Pearl's policy holders and the increment accounted for by Resolution is similarly small. Post-merger, Pearl will have a share of supply of less than five per cent based on new business premiums.

Asset management

24. Pearl does not currently offer asset management services to third parties. Post merger, the parties' combined share of all AuM in life insurance will be [less than 10] per cent. As this figure relates only to assets under management by those involved in the provision of life insurance, and excludes those managing assets but not otherwise involved in life insurance, it is considered to significantly overestimate the parties' share of supply.

Barriers to entry and expansion

25. FSA authorisation is required to operate in the UK life insurance sector, however Pearl submits that the life insurance sector is served by a wide

range of third party administration firms (including insurance companies operating in other sectors) which would allow entry without major capital expenditure. Expertise is available at low cost through the highly competitive UK reinsurance market and there are low costs to access the network of brokers and independent financial advisors that make up an important distribution channel. Pearl estimates that it would take approximately 12 months for a new entrant to set up. For closed funds, it would require the acquisition of an existing life insurance company. Pearl submits also that there have been a number of acquisitions where competitors or potential competitors appear to have entered or bid with ease.

26. Pearl provided evidence of a number of recent new entrants such as existing insurance providers or financial services companies acquiring closed funds and non-traditional entrants with an established distribution network, such as supermarkets.

Buyer power

27. The parties customers are numerous and disparate, with none making up a significant share of either of the parties' respective businesses. Buyer power is highly unlikely, however the lack of any competition concerns means that it is not necessary for the OFT to conclude on the matter.

VERTICAL ISSUES

28. The OFT is not aware of any vertical issues arising in this case.

THIRD PARTY VIEWS

29. The OFT received very few third party comments, receiving responses from just two competitors and one customer. None raised any merger-specific competition concerns.

ASSESSMENT

30. Pearl and Resolution overlap in the management and acquisition of closed life insurance funds in the UK.

31. For the purposes of this assessment, the OFT has considered the impact of the anticipated transaction on the life insurance market in the UK, as well as the market for the consolidation of closed funds in the UK, the provision of off-shore life insurance in the UK and asset management in the UK.
32. This merger raises no competition concerns given that the shares of supply in any of the segments looked at under this competitive assessment are below 10 per cent with increments below five per cent, and that the market is fragmented with a number of larger competitors.
33. Pearl will be acquiring Resolution with the help of finance from Royal London which will be used as a prepayment for the subsequent on-sale of certain Resolution businesses and assets. As such the OFT also considered whether Royal London and Pearl would be considered associated persons for the purposes of the investigation under the Enterprise Act 2002. However, even if the shares of Royal London and Pearl were considered together, the resultant post-merger shares of supply and increment are small enough such as to raise no competition concerns and the OFT therefore has not concluded on the matter of associated persons.
34. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

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