Completed acquisition by Grainger Equity Release Limited of Sovereign Reversions plc

ME/4670/10

The OFT's decision on reference under section 22(1) given on 16 November 2010. Full text of decision published 4 February 2011.

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

PARTIES

1. **Grainger plc** ('Grainger') is the UK's largest listed UK residential landlord with £2.1 billion of assets.[1] Grainger's subsidiary Grainger Equity Release Limited (trading as Bridgewater) supplies home reversion products and other home equity release products. Grainger's home reversions property portfolio is valued at around £270 million.

2. **Sovereign Reversions plc** ('Sovereign') which trades under the name of 'Home and Capital' supplies home reversion products, provides financial advice on home equity release to consumers and non-specialist financial advisors, and equity release administration. Sovereign's home reversions property portfolio is valued at around £70 million.

TRANSACTION

3. The acquisition by Grainger of Sovereign was completed on 9 August 2010 by way of a court sanctioned scheme of arrangement under Part 26 of the Companies Act 2006. Grainger paid 202p per share for Sovereign providing an estimated value of £34.6 million.

[1] As at 30 September 2009, the group's wholly owned portfolios of 13,259 residential properties in the UK and 7,180 primarily residential properties in Germany, were together valued at £2.1 billion.

4. The administrative deadline for the OFT to make a decision is 16 November and the statutory deadline is 8 December 2010.

JURISDICTION

5. As a result of this transaction Grainger and Sovereign have ceased to be distinct. The UK turnover of Sovereign was below £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is not satisfied.

6. The parties submitted that the correct reference market for the application of the share of supply test is the supply of equity release products in the UK and that Grainger's estimated share of this market is less than one per cent. Hence, the parties argue, the share of supply test is not met. Further, even if the narrower supply of home reversions is considered, the parties argue that whilst Sovereign Reversions historically held a share of supply of nearly 10 per cent, it has not originated any new business in the equity release market since April 2009. Accordingly, the parties argue that there has been no increment in share of supply as a result of the transaction and hence the share of supply test is not satisfied.

7. The Act expressly provides the OFT with a wide discretion in considering a reasonable description of a set of goods or services to determine whether the share of supply test is met. Whilst Sovereign is not currently originating new business, the OFT does not consider that it has exited the market such that it is not active in the supply of goods or services. Rather, it has maintained its portfolio and in so doing continues to service its contracts with customers and therefore remains active in the market. These services include:

   - answering calls and queries from clients in relation to their home reversion plan

   - processing applications for further releases, and

   - dealing with the sale of the property upon vacation or death and liaising with the solicitors until completion of the sale.

8. The OFT believes that the supply of home reversion products is a reasonable description of goods or services in this case and that Sovereign, due to the services it provides to its clients, continues to have a market presence. Furthermore, Sovereign still has authorisation from the Financial Services Authority (FSA) to supply home reversion plans.

9. The OFT therefore believes that the parties overlap in the supply of home reversion plans and post merger will have a share of supply of more than 25 per cent based on their existing portfolios of home reversions. The share of supply test in section 23 of the Act is therefore met and the OFT believes that it is or may be the case that a relevant merger situation has been created.

RATIONALE FOR THE MERGER

10. The parties submitted that the primary motivation for the acquisition was to acquire Sovereign's existing stock of reversion assets. Grainger is the largest private landlord in the UK. The acquisition of these reversion assets at a favourable price is consistent with Grainger's commercial interests in increasing its stock of properties.

MARKET DEFINITION

11. Home reversion plans are one of the main types of equity release products, which enable homeowners to benefit from the value of their home without having to move out of it. The other type of equity release is lifetime mortgages. Around 67 per cent of equity release products are sold via intermediaries, such as independent financial advisors. According to one third party, an independent financial advisor will undertake a complete review of the client's demands and needs before advising on suitable products.

12. Under a home reversion plan, the client sells a proportion of their property to the provider. In return, the client receives a cash lump sum plus a lease for life, allowing the client to continue to occupy the property until their death. For some plans no rent is payable whilst the client occupies the property, for others a small rent is charged.[2] The cash lump sum is a discounted value (typically 40-50 per cent of the open market value

[2] One supplier advised that the rent is mainly a way of staying in contact with the customer.

(OMV) of the share of the property acquired by the provider) and is based on an actuarial reflecting the fact that the provider cannot recoup its investment for 10-20 years, depending on the longevity of the client. Given that this is an outright sale of the property, the client cannot exit the plan without repurchasing their share of the property.

13. Under a lifetime mortgage, the client takes out an 'interest roll-up' loan[3] secured on the property, which is repaid on the client's death from the proceeds of the sale of the property. Customers have options that provide a lump sum[4] and options that allow the consumer to draw down funds on request. The tenant is guaranteed that the total amount repayable cannot be more than the value of the property. The loan can be repaid at any time, although this could be subject to an early repayment charge.

14. Mintel's, May 2010 report, 'Equity Release Schemes, Financial Intelligence, (Mintel) notes two principle differences between home reversion plans and lifetime mortgages: the minimum age for home reversion plans is typically 65, whereas for lifetime mortgages it is around 55; and home reversion customers can typically release a higher amount of equity. Even though a higher level of equity can be released via home reversion products, lifetime mortgages make up around 98 per cent of equity release sales.

15. Another product which should be noted is 'sale and rent back' which, although not considered an equity release product does have some similarities. Under 'sale and rent back', the customer sells their home in exchange for a lump sum (typically 60-75 per cent of the OMV) and remains in their home under a tenancy agreement for a minimum of 5 years. Rent is payable to the new property owner and is typically at normal market rates.

16. Providers of all of these products are subject to regulation by the FSA.

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[3] Interest roll-up means that the customer does not pay interest on the loan, but rather the interest is added to the loan, thus increasing the size of the principle. In the next period, the interest is charged on the new higher loan principles.

[4] At age 65, the typical lump sum available under a lifetime mortgages is approximately 25 per cent of the OMV

Product scope

17. The parties submitted that the appropriate candidate market is the supply of equity release products on the basis that,

    - consumers consider home reversion products and lifetime mortgages to be alternatives when evaluating their option to release home equity

    - lifetime mortgages and home reversion products are subject to the same FSA regulation

    - lifetime mortgages and home reversion products are generally marketed as alternatives

    - the OFT's 'sale and rent back' report contains a commentary on the equity release market which treats the home reversion plan market as part of the wider equity release market.[5]

18. Third parties largely agreed with the parties' views that home reversion products are constrained by lifetime mortgages for some customers. In particular, for customers with significant equity in their property, lifetime mortgages could be considered to be in the same market as home reversion products. However, for those customers with a higher loan to value on their property, 'sale and rent back' may be considered a better alternative.

19. It therefore appears that a customer's choice of product will depend on their individual circumstances and therefore the OFT has decided to adopt a cautious approach and examine the acquisition using a narrow frame of reference, that is, the supply of home reversion plans. Given the OFT's conclusions in this case, however, it has not been necessary to conclude on the product scope.

Geographic scope

20. The parties submitted that for regulatory reasons their activities are confined to the UK and hence the market is national. This is consistent

[5] The OFT Report, 'Sale and rent back – a market study' October 2008 included a comparison of equity release products with sale and rent back.

with the fact that home reversion providers value properties throughout the UK and do not have local offices.

21. However, as noted in Sovereign's accounts, geographic spread is an important way of diversifying risk. To the extent that future house prices are expected to vary because of local demand and supply factors and the extent to which consumers do not move house, then prices are set locally.

22. Given the OFT's conclusions in this case, however, it has not been necessary to conclude on the geographic scope.

HORIZONTAL ISSUES

23. Under the competitive assessment, the OFT considered two aspects of the merger: the impact on Grainger's home reversion property portfolio (the stock of property) and the acquisition of new customers (the flow).

Market shares

The stock of property of home reversions

24. The parties provided estimates of market shares for the capital stock of home reversions[6] which are set out in the table below.

	£m value	Per cent of total
Grainger	[ ]	[20-30]
Sovereign	[ ]	[0-10]
Hodge	[ ]	[0-10]
Max Property (GE portfolio)	[ ]	[20-30]
Abbey National (IRS portfolio)	[ ]	[0-10]
Abbey National (AMP portfolio)	[ ]	[10-20]
Private Investors (Sovereign Administered)	[ ]	[0-10]
Delancey/Milton Homes	[ ]	[0-10]
Other private investors (estimated)	[ ]	[0-10]
Total	**[1,000-,1500]**	**100**

[6] Parties' estimates based on aggregation of the publicly available information of each firm

Source: the parties

25. The parties will post-merger have an estimated share of around 29 per cent, with an increment of six per cent of the capital stock of home reversions in the UK (based on value). Considering the market shares of competitors in the market, this is not a level which would typically give the OFT cause for concern. Furthermore, it may be that the parties' stock is part of a wider property market, in which case the parties' market share would be much lower.

The flow of new customers for home reversions

26. Several third parties noted that firms had exited or temporarily exited the industry in the past two years as reversion product providers have found it difficult to obtain funding. One third party also told us that consumers have been receiving lower levels of equity from their properties because of the general decline in the property market, the fall in house price expectations, and the fact that investors are seeking to limit their exposure to the property market. In 2009, sales of equity release schemes fell by more than 27 per cent on the 2008 level.

27. Competition for customers generally takes place at the point of releasing equity; the secondary market for customer switching appears to be very small. One competitor told us that just one to two per cent of its customers switch to an alternative supplier per annum. Other third parties told us that customers do not enter into home reversion agreements with the intention of exiting in the future. One third party told us that, whilst there are no penalties for switching provider, the customer would have to buy back the home reversion provider's share of the property and that there are very few circumstances in which this would be economic for the customer.

28. There are two types of provider active in the supply of home reversion products: 'white label' suppliers, that is, funded by third parties (including Grainger) who also administer and secure (take a legal charge over the property) home reversion products. Relevant to the current case, Aviva is a white label supplier. We have taken a cautious approach and included Aviva's sales under Grainger's umbrella.

29. On this more restrictive assessment of property acquirer (that is, Grainger taken together with Aviva), the parties estimate that, based on data supplied by an industry body, they have a share of supply of 40 per cent, with an increment based on Sovereign's historic share of 10 per cent. It is important to note that this is a cautious approach as Sovereign has not originated any new business since 2009 and the third parties whom Grainger is funding devise their own products, although Grainger finances the purchase.

30. The OFT notes that not all third parties consider Grainger and Sovereign to be close competitors as Sovereign had not invested in product design and systems (see also paragraph 57). The OFT was also told by third parties that the number of providers is expected to increase as new and existing providers are expected to start offering reversion products (see also paragraph 57).

31. The OFT also considered the competitive constraint of other products. One third party told us that home reversions need to be marketed relative to lifetime mortgages so that the value of the plans move in line with each other. This was supported by another third party who told us that the main advantage of home reversion products is that customers can release more money from a home reversion product than a lifetime mortgage product. Therefore, if the percentage of the OMV paid to consumers fell by five per cent, it is expected that some customers would be recommended lifetime mortgages where previously they had been recommended a home reversion product.

32. Therefore, on the basis of the information provided, lifetime mortgages appear to provide a competitive constraint on providers of home reversions. For those customers seeking to maximise the capital release from their home, 'sale and rent back' may offer a more suitable alternative.

Conclusion

33. Through the direct provision of home reversions and indirectly through the provision of finance to third parties, Grainger is estimated to have at most 40 per cent of the home reversion market. In the light of this, the merger does not raise competition concerns as there are alternative providers in the market and this is expected to increase in the next 12 months.

Furthermore, the merged entity will also be subject to the competitive constraints of lifetime mortgages and 'sale and rent back' products.

34. The OFT, therefore, considers that post-merger, there will be sufficient competitive constraints on the parties to preserve competition in the provision of home reversion plans.

VERTICAL ISSUES

Advisory services[7]

35. The OFT considered whether the merging parties could foreclose third parties downstream through the acquisition of Sovereign's advisory services arm. The parties have advised that since completion they have ceased providing these services, albeit they retain Sovereign's licence to do so.

36. In assessing vertical issues, the OFT frames its analysis around three questions:

    - would the merged firm have the ability to harm rivals ('ability')
    - would it find it profitable to do so ('incentive'), and
    - would the effect of any such foreclosure be sufficient to reduce competition in the affected market, giving rise to an SLC ('effect')?[8]

37. On ability, the Mintel report states that 67 per cent of equity release sales are through intermediaries. The remaining 33 per cent are direct sales by the product provider. Mintel notes that the market has trouble attracting advisors because of the fear of mis-selling, product complexity, and the requirement to pass product-specific exams.

38. The FSA told us that firms must manage any potential conflict of interest between the adviser providing the service and the interests of the client.

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[7] Advisory services include, for example, sourcing and marketing to clients; discussing client needs, producing suitability reports and letters of recommendation; administering client files and ensuring all appropriate FSA documentation is in place following initial enquiry through to completion.

[8] Merger Assessment Guidelines, paragraph 5.6.6.

Firms must also disclose to the consumer any commissions received. The FSA noted that it monitors firm conduct to ensure that they demonstrate appropriate 'skill, care and diligence'.

39. One third party told us that Key Retirement Solutions is the largest home reversions broker, with an estimated share of new issues of 30-40 per cent. Another third party told us that Sovereign's 'advisory function is relatively minor by comparison to other advisory organisations within the equity release market and as such, closure of this route would have negligible impact on their business'.

40. Further, Sovereign supplies a very small share of the advisory services pertaining to equity release advice: the value of the transactions arranged by Sovereign in 2009 was £18.2 million whilst Mintel estimates the total value of equity release new sales was £946 million (meaning Sovereign supplied just 1.9 per cent).

41. On this basis, the cessation of supply by the merged firm of Sovereign's advisory services does not appear sufficient to foreclose downstream rivals. Given this finding, it is not necessary for the OFT to conclude on incentive and effect.

Administrative services

42. Sovereign administers home reversion products on behalf of third parties. This involves, for example, biennial visits to the customer and reporting on any issues arising in relation to the property. It appears that none of the tasks involved would require specialist equipment or knowledge. One third party told us that entry would require training staff in 'systems and procedure'. The provision of these services in-house would therefore appear relatively easy to replicate.

43. The parties advised that Sovereign provides administration services for just 722 properties. The parties estimate that third parties providing administration services to GE and AMP are responsible for portfolios of around 3,000 properties in each portfolio. Although the administrator for these portfolios did not provide comment to us on the merger, it would appear as though those firms would be capable of supplying services to the parties' competitors if the parties were to refuse to supply or to increase the cost of administration services.

44. On this basis, the merged firm does not appear to have the ability to foreclose rivals downstream by refusing to supply, or increasing the cost of, administration services. Given this finding, it is not necessary for the OFT to conclude on incentive and effect.

Coordinated Effects

45. The OFT has received no evidence of pre-existing coordination amongst firms active in the supply of equity release products.

46. As well as whether or not there is evidence of pre-existing coordination, in assessing coordinated effects the OFT analyses the market for evidence of the ability to coordinated. For coordination to be possible, all three of the following conditions must be satisfied:

    - firms must be able to reach and monitor the terms of coordination
    - coordination must be internally sustainable and
    - coordination must be externally sustainable.[9]

47. In terms of the ability to reach and monitor the terms of coordination, the market is not very concentrated. This means that it will be harder for firms to reach an implicit understanding, and it will be harder for them to monitor what their rivals are doing.

48. Also, the competitive environment in which firms interact appears complex because of the role of intermediaries in selling these products and also because providers have a mixed portfolio of investments with varying redemption dates. Further, prices are negotiated on a customer by customer basis using actuarial models, meaning that firms cannot observe one another's prices and cannot therefore monitor the terms of any price coordination.

49. Set against this, there are structural links between firms in the market (see paragraphs 28 and 29) that could assist in reaching and monitoring the terms of coordination.

[9] Merger Assessment Guidelines, paragraph 5.5.9.

50. However, on balance, it does not appear that firms could reach or monitor the terms of any coordinated outcome. Given this finding, it is not necessary for the OFT to conclude on internal and external sustainability.

BARRIERS TO ENTRY AND EXPANSION

51. The parties submitted that barriers to market entry are primarily regulatory while the most significant ongoing cost of market participation is the cost of capital. This was supported by third parties. One provider told us that FSA authorisation can take six to nine months (the statutory deadline for approval is 12 months). Home finance providers must have net assets of £100,000 or one per cent of their total assets, whichever is the higher.

52. Other third parties told us that obtaining funding has caused several firms to discontinue supplying home reversion products and this has been a particular factor in the past two years.

53. One provider told us that re-entry for a firm with a reversion portfolio that had stopped originating new finance would cost £0.5-1 million to develop a sales team, marketing, operations and IT. The FSA told us that firms may have ceased supplying these products (for example because of funding constraints) and then resumed without changing their permissions.

54. Given the absence of competition concerns in this case, it is not necessary for the OFT to conclude on whether — in the light of these barriers — entry or expansion would be timely, likely and sufficient enough to avert any SLC.

BUYER POWER

55. The parties submitted that in the current market conditions, even individual home owners have buyer power. However, independent financial advisors who responded to the OFT during the investigation did not indicate that they have buyer power, and as end customers are individuals, the OFT considers it unlikely that they would have buyer power.

56. Given that the OFT has no concerns that a substantial lessening of competition will arise as a result of the merger, it has not been necessary to conclude on buyer power.

THIRD PARTY VIEWS

57. No specific concerns were raised by third parties in relation to this merger. Generally, third parties did not consider Sovereign to be a strong competitor to Grainger in the provision of home reversions. It also became apparent from discussions with third parties that a number of firms were expected to enter or re-enter the market for the provision of home reversions in the coming year.

58. However, two third parties expressed some concerns that there would be one less provider present in the currently limited market of home reversion products. But it was also recognised that home reversions are a small part of the total equity release market.

59. No financial advisors responding to the OFT's information request expressed concern in relation to the merger.

ASSESSMENT

60. The OFT assessed the completed merger on the narrowest candidate market of the supply of home reversion plans and considered the parties' market shares in both the stock and flow of home reversions. As a result of the merger, Grainger will have an estimated market share of the stock of home reversions, based on value, of 29 per cent and for the flow of new customers in home reversion products of no more than 40 per cent.[10]

61. The OFT found that for some customers, a lifetime mortgage is a substitute for home reversion products while for other customers, sale and rent back is a substitute. Therefore these products are likely to provide a competitive constraint on providers of home reversions.

62. The OFT was told by a third party that they are seeking to re-enter the market. Furthermore, [ ] several firms [ ] are likely to enter in the coming

[10] This figure is based on Sovereign's historic share of 10 per cent and therefore represents a very cautious approach in estimating market shares

year. Consequently, the OFT believes that there will be sufficient competitive constraints on Grainger post merger.

63. The OFT further considered vertical aspects of the merger and the potential to foreclose third parties downstream by acquiring Sovereign's advisory services arm. However, the FSA indicated that its rules governing fair dealing constrain advisors from offering biased advice to customers and it monitors firms' conduct. In addition, Sovereign's share of advisory services was very small. The OFT considered whether the withdrawal of administrative functions to third parties would foreclose the market to competitors. However, the OFT considers that there are others in the market who could provide these services which appear relatively easy to replicate. The OFT also considered whether the merger might give rise to coordinated effects. The OFT received no evidence of pre-existing coordination and concluded that firms would not have the ability to reach and monitor the terms of coordination.

64. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

65. This merger will therefore **not be referred** to the Competition Commission under section 22(1) of the Act.

ENDNOTES

1. With reference to paragraph 1 and 2, the parties clarified that Bridgewater and Home and Capital are brands rather than trading names.

2. With reference to paragraph 12, the parties clarified that rent is rarely charged in relation to home reversion plans.

3. With reference to footnote 6 of paragraph 24, the parties clarified that the figures represent a best estimate of competitor market shares based on information available in the most recently published accounts of the

companies included, and press releases issued at the time of reversion portfolio purchase/sale transactions.

4. With reference to paragraph 43, the parties subsequently clarified that Sovereign provides administration services to around 1700 properties. Despite the significant difference in the numbers provided by the parties (722 and 1700), this clarification does not impact on the OFT's conclusion that the merged firm is unlikely to have the ability to foreclose rivals downstream by refusing to supply, or increasing the cost of, administration services.

5. With reference to paragraph 63, the FSA clarified that it is its high level principles (rather than rules) that constrain advisors from offering biased advice to customers and it monitors firms' conduct.