

M&A in the insurance sector - steering through EU merger control

Philip Woolfson August 18 2006

On July 29, the European Union's official journal published notice of the filing under the EU's merger control rules of AXA's proposed €7.9bn cash acquisition of Swiss insurance group, Winterthur, owned by Credit Suisse Group.

This major deal is one of the most recent of a flurry of mergers and acquisitions activities in the European insurance sector, some consummated (Old Mutual/Skandia, Generali/Toro), some rumoured (Aviva/Prudential). More can be expected, since it is common knowledge that the European sector is long overdue for consolidation.

Consolidation raises legal issues of merger control. This article summarises the merger control rules from an EU perspective and comments on how they apply to M&A in the insurance sector.



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Background

Competition policy has been at the heart of the European single market since its inception in the 1950s. The current founding text, the Treaty on European Union, therefore includes a chapter setting out rules on competition covering "restrictive practices" (e.g., cartels) "abuse of dominant position" (e.g., discriminatory pricing by a monopoly) and regulation of state aid.

Initially, the European Court applied the provisions on abuse of dominant position — which target monopolistic behaviour — in an attempt to regulate Europe-wide mergers. In the absence of a specific legal instrument, however, applying the provisions in this way proved to be piecemeal and unsatisfactory. In 1989, therefore, the council adopted the first Merger Control Regulation. That regulation was updated and expanded by regulation 139/2004, which came into force on May 1 2004 (the "Merger Regulation").

Merger control — who and what is controlled

Rules on restrictive practices and abuse of dominant position seek to regulate market behaviour; merger control is concerned with market structure. The Merger Regulation accordingly provides a regulatory framework for the control of pan-European M&A transactions in the insurance markets and, in particular, prevents anti-competitive concentrations of market power.

To do this, the Merger Regulation applies a "one-stop shop" principle: this enables mergers over certain turnover thresholds to be notified, as "concentrations with a community dimension", to the European Commission alone, rather than being subject to administratively burdensome and costly multiple filings with numerous member state competition authorities. The "one-stop shop" has proven to be a major success.

The main turnover thresholds are "combined aggregate worldwide turnover" of €2.5bn or €5bn: the application of either turnover figure depends on how the "community wide turnover" is allocated among the EU's national markets (and for which further sub-thresholds apply). In fact, reflecting the fine line between member state and European Commission areas of competence, the Merger Regulation applies these thresholds as alternative tests. The European Commission's "one-stop shop" is therefore available as follows:

Test 1

- “The combined aggregate worldwide turnover of all the undertakings concerned is more than €5,000m.”
- “The aggregate community wide turnover of each of at least two undertakings concerned is more than €250m”.

Even if both of these cumulative criteria are satisfied, the concentration will nevertheless not be deemed to have a community dimension if each of the undertakings concerned achieves more than two-thirds of its aggregate community-wide turnover within one and the same member state (the so-called “two-thirds rule”). In that case, national competition rules, rather than the Merger Control Regulation, would apply.

Test 2

- “The combined aggregate worldwide turnover of all the undertakings concerned is more than €2,500m.”
- “The aggregate community wide turnover of each of at least two undertakings concerned is more than €100m.”
- “In each of at least three member states, the combined aggregate turnover of all the undertakings concerned is more than €100m.”
- “In each of at least three member states included for the purposes of [the above bullet], the aggregate turnover of each of at least two of the undertakings concerned is more than €25m.”

Again, even if all these cumulative tests are satisfied, the concentration will nevertheless not be deemed to have a community dimension if the two-thirds rule applies.

Specific rules — based on “gross premiums written” — apply to the calculation of turnover in the insurance sector. Where a transaction does not meet the turnover thresholds, parties must consider whether one or more sets of national, merger control rules will apply.

When reviewing whether a proposed merger will cause competition concerns, the commission decides whether a merger will “significantly impede effective competition, in particular as a result of the creation or strengthening of a dominant position” in the common market or a substantial part of it.

Parties — usually the buyer — are required to complete and file a standard form when notifying their concentration. This form sets out numerous questions regarding: the parties to the concentration; the nature of the agreement (e.g., a public bid document, a sale and purchase agreement or a joint venture agreement); details of turnover; relevant geographical and product markets (e.g., whether these are national, European or international in their scope); the structure of supply; demand and distribution in the markets; market entry; and memberships of relevant trade associations, etc.

Since the replies are essential for the commission to conduct its review — including contacting competitors and other interested parties for their views on the proposed concentration — notifying parties cannot afford to provide anything less than a comprehensive reply. Legal advice is, therefore, essential (in any event, the commission welcomes appointment by notifying parties of suitably qualified lawyers to assist with this filing, including any pre-notification discussions).

The commission’s review is subject to a strictly defined timetable, known as “Phase I” and “Phase II”. Phase I takes approximately five weeks from the date of notification of the proposed merger. Most cases are cleared within this period. Phase II applies thereafter in situations where the commission has “serious doubts” as to the compatibility of the concentration with the common market.

Phase II can take several months with variable deadlines depending on whether the commission imposes conditions for clearance, for example a structural requirement to divest a business line or where the parties offer behavioural “remedies” to dispel the commission’s doubts. A decision by the commission to proceed to Phase II is, therefore, a sure sign of trouble.

The commission sets out the result of its review in a legally binding decision, whether it is conditionally clearing, unconditionally clearing, or refusing the concentration. Parties can appeal against the decision to the European Court.

Merger control in practice in the insurance sector

Since the adoption of the 1989 Regulation, the European Commission has dealt with several thousand notifications that have covered a wide range of economic sectors. Although more high-profile, strategic or traditional sectors, such as the media and IT, utilities and natural resources, have attracted the most attention, the insurance sector has had its fair share of notifications over the years.

Ten significant transactions since 2003 may be summarised as follows:

Date	Buyer	Target	Amount
September 2003	AXA	Money	€1.3bn
March 2005	Aviva	Royal Automobile Club	£1.1bn
June 2005	Resolution	Britannic	€2.7bn
September 2005	Allianz	RAS	€3.3bn
April 2006	Stone Point	AXA Re	unknown
May 2006	Old Mutual	Skandia	€4.6bn
June 2006	Resolution	Scottish Mutual Assurance/Scottish Provident/Abbey National Life	£3.6bn
June 2006	Swiss Re	GE Insurance Solutions	US\$7.4bn
June 2006	AXA	Winterthur	€7.9bn
June 2006	Generali	Toro Assicurazioni	€3.85bn

Source: Bloomberg, Les Echos

Of these ten transactions, several met the turnover thresholds set out above. They were therefore concentrations with a community dimension and so were subject to notification to the commission. They were not, however, subjected to Phase II and so with the exception of AXA/Winterthur, which is still pending, were cleared without significant delay.

Each transaction was, in fact, an acquisition i.e., purchase by a buyer of the share capital of the target. Joint ventures can, however, also be subject to notification under the Merger Regulation. For example, the 1999 joint venture in which Commercial Union and Banca delle Marche combined forces to distribute insurance through the bank’s branches.

In practice, a significant number of M&A transactions in the insurance sector fail to meet the turnover thresholds (evidence of the national, rather than pan-European, focus of insurers); thus, AXA/Winterthur is notifiable, yet Generali’s €3.85bn acquisition of Toro from De Agostini group fell short of the thresholds. In such cases, national merger control rules continue to apply, and the sale and purchase agreement must, therefore, make compliance with these requirements prior conditions of the deal.

Outlook

The EU’s merger control regime reflects experience built up since 1989. The commission has also published extensive guidance notes, communications, reports, etc., designed to assist economic operators to predict whether a proposed concentration is likely to pass muster.

The insurance industry can benefit from this legal certainty and the above table illustrates the steady pace of consolidation and reorganisation in the sector in recent years. The most recent announcements involving AXA and Generali demonstrate the continuing appetite of major players, while specialist press reports and studies suggest that other groups — in particular, in the UK, Germany, Switzerland and Italy — are considering options. Whether buyer or target in the EU or elsewhere, each needs to beware of the vigilant eye of competition authorities and, accordingly, plan their transactions so as to comply with merger control rules.

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Postscript

Since publication of the above article, there have been two further developments:

- (i) on 23 August, the commission announced that it had cleared the AXA/Winterthur concentration;*
- (ii) following discussions between the commission and the Italian competition authority, Generali's acquisition of Toro - initially considered to meet the Regulation's thresholds - has now been referred back to the Italian authority for clearance on the ground that the principal effects of the concentration will be restricted to the Italian market.*

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