



DETERMINATION OF MERGER NOTIFICATION M/17/054 - KKR/PEPPER

Section 21 of the Competition Act 2002

Proposed acquisition by KKR Credit Advisors (US) LLC of sole control of Pepper Group Limited

Dated 7 November 2017

Introduction

1. On 3 October 2017, in accordance with section 18(1)(a) of the Competition Act 2002, as amended (“the Act”), the Competition and Consumer Protection Commission (the “Commission”) received a notification of a proposed transaction (the “Proposed Transaction”) whereby Red Hot Australia BidCo Pty Limited (“Red Hot”), an entity controlled by funds managed by KKR Credit Advisors (US) LLC (or its affiliates), would acquire sole control of Pepper Group Limited (“Pepper”).¹ KKR Credit Advisors (US) LLC is an indirect subsidiary of KKR & Co. L.P. (“KKR”).

The Proposed Transaction

2. The Proposed Transaction is to be implemented pursuant to a Scheme Implementation Deed dated 10 August 2017 between Red Hot and Pepper.

The Undertakings Involved

Acquirer - KKR

3. KKR, [...], is a global investment firm offering a broad range of alternative asset funds and other investment products to investors. KKR’s affiliated private equity funds invest in companies across a variety of sectors. Each KKR-affiliated portfolio company has its own board of directors, which generally includes at least one KKR representative, and is operated independently of other KKR-affiliated portfolio companies.
4. In 2016, the following [...] KKR-controlled portfolio companies generated turnover in the State: [... Activate Capital (“Activate”); ... Lunar Commercial Mortgages DAC (“Lunar”); ...].
5. Activate, established in July 2015, is a joint venture between KKR and the Irish Strategic Investment Fund (“ISIF”), which is managed by the National Treasury Management

¹ The parties have informed the Commission that the Proposed Transaction is also subject to merger control approval by the Korea Fair Trade Commission and the Australian Competition and Consumer Commission.



Agency.² Activate provides “stretch” senior loans in excess of €10 million to developers of multi-family residential housing schemes.³ This finance can be used by borrowers to fund site acquisition, construction, infrastructure and capitalisation of interest up to 90% of residential development costs. Activate does not provide small-scale corporate loans or residential mortgages to individuals.

6. In June 2017, Lunar began providing corporate mortgage products in the State to customers seeking to refinance or acquire new property. Lunar is solely controlled by KKR but Pepper currently owns a non-controlling [...]% shareholding in Lunar. Lunar is active in the acquisition, servicing and management of Irish commercial real estate backed loans. [...] The loans provided by Lunar are expected to range between €250,000 and €7.5 million. As of 3 October 2017, drawdowns by customers of Lunar stand at approximately €[...].
7. For the year ending 31 December 2016, KKR’s worldwide turnover was approximately €[...], of which approximately €[...] was generated in the State.

The Target - Pepper

8. Pepper, incorporated in Australia, is a financial services provider active across three broad geographic regions: Australia and New Zealand; Asia-Pacific (South Korea and Hong Kong); and Europe (Spain, the United Kingdom and in the State).
9. In the State, Pepper, through its subsidiary Pepper Finance Corporation (Ireland) DAC (“Pepper Ireland”), provides consumer finance and third party loan management and related services. Pepper Ireland commenced operations in 2012 when it acquired GE Capital Woodchester Home Loans Limited, which comprised approximately 3,500 residential mortgage accounts in the State. Pepper Ireland initially focused on the administration, servicing and management⁴ of these loans and other loans on behalf of third party banks and financial institutions. In January 2016, Pepper Ireland expanded its operations in the State to the provision of residential mortgage products to customers directly and through brokers.
10. As noted above, Pepper, in partnership with KKR, owns a non-controlling [...]% shareholding in Lunar.
11. For the year ending 31 December 2016, Pepper’s worldwide turnover was approximately €468 million, of which approximately €[...] was generated in the State.

Rationale for the Proposed Transaction

² KKR provided the following information in the notification: “KKR contributed €175 million in capital to Activate, with the ISIF contributing the remaining €325 million.”

³ KKR provided the following explanation of “stretch” loans in the notification: ““Stretch” senior loans are a specific type of loan instrument to a corporate borrower, which comprise elements of asset-based loans and cash-flow loans. Stretch senior loans usually provide financing that is equal to more than the total lending value of the borrowers’ current and fixed assets. Borrowers must therefore show the capacity to repay this type of loan either through high operational cash flows or a strong balance sheet consisting of a substantial asset base.” Further details about Activate’s lending model are set out on its website which can be accessed at: <http://www.activatecapital.ie/lending-approach/>

⁴ The notification states the following: “Pepper Ireland provides asset management services solely as an ancillary function to the servicing of loans, e.g., in circumstances where a receiver may be appointed. Pepper Ireland does not otherwise offer asset management services to any customers in Ireland.”



12. The parties state the following in the notification:

“The Proposed Transaction is consistent with KKR’s strategy of investing in commercially attractive companies with a view to increasing the value of the business and optimising investment returns.

....

[...]”

Third Party Submissions

13. During the Phase 1 investigation, the Commission received one third party submission concerning the licensing of the business activities of Pepper in the State over the period September 2012-October 2016. The Commission considers that this third party submission raises no competition issues in relation to the Proposed Transaction.

Competitive Analysis

The Provision of Residential Mortgage Products in the State

14. There is no horizontal overlap between the parties in the State in relation to the provision of residential mortgage products. None of the portfolio companies controlled by KKR that generated turnover in the State in 2016 are active in Pepper Ireland’s core area of business, namely the servicing of residential mortgage loans owned by Pepper Ireland and third parties. Furthermore, none of the portfolio companies controlled by KKR that generated turnover in the State in 2016 are active in the provision of residential mortgage products. The Commission therefore considers that the Proposed Transaction does not raise any competition concerns in relation to the provision of residential mortgage products in the State.

The Provision of Corporate Mortgage Products in the State

15. One of KKR’s portfolio companies, Activate, provides loans to developers of multi-family residential housing schemes in the State. In June 2017, Lunar began providing corporate mortgage products in the State to customers seeking to refinance or acquire new property. Lunar is solely controlled by KKR but Pepper currently owns a non-controlling [...] % shareholding in Lunar. Since KKR currently controls both Activate and Lunar, it could be argued that there is no horizontal overlap between KKR and Pepper in the State in relation to the provision of corporate mortgage products.
16. However, even if one were to assume the existence of a horizontal overlap between KKR and Pepper in the State as a result of Pepper’s [...] % shareholding in Lunar, the Proposed Transaction would not raise any competition concerns in relation to the provision of corporate mortgage products in the State.
17. The Commission defines markets to the extent necessary depending on the particular circumstances of a given case.



18. In its 2014 decision in *Case M.7078 – Santander Consumer Finance/El Corte Ingles/Financiera El Corte Ingles*, the European Commission noted that “banking services can be divided into three main segments, (i) retail banking (ii) corporate banking and (iii) financial market services.”⁵
19. In its 2007 decision in *Case M.4692 – Barclays/ABN Amro*, the European Commission noted the following in relation to the relevant product market for corporate banking services:
- “Corporate banking comprises a broad range of banking services offered to general corporate clients. The Commission has found that within this segment, products such as deposits, lending, payment transactions, documentary credits and international payments may constitute distinct product markets. The Commission has further considered whether it could be appropriate to distinguish between services offered to SMEs and large corporate clients.*
- The market investigation indicated that the sub-segmentation by product within the corporate banking sector was plausible.”*⁶
20. The European Commission, however, did not conclude in its 2007 decision in *Case M.4692 – Barclays/ABN Amro* on the relevant product market definitions in the banking sector.
21. In its 2007 decision in *Case M.4692 – Barclays/ABN Amro*, the European Commission noted the following in relation to the relevant geographic market for corporate banking services:
- “With regard to corporate banking services, the Commission has considered the markets to be national in scope (especially for SMEs) but with a tendency to have a more international dimension for products offered to large corporate clients.”*⁷
22. The Commission will assess the competitive impact of the Proposed Transaction in the State. This is likely to be the narrowest geographic market affected by the Proposed Transaction.
23. In light of the recent decisional practice of the European Commission, the Commission will assess the competitive impact of the Proposed Transaction in the potential market for the provision of corporate mortgage products in the State.

Competitive Assessment

⁵ Paragraph 34 of the European Commission’s decision in *Case M.7078 – Santander Consumer Finance/El Corte Ingles/Financiera El Corte Ingles* which can be accessed at

http://ec.europa.eu/competition/mergers/cases/decisions/m7078_20140129_20310_3505600_EN.pdf

⁶ Paragraphs 11 and 12 of the European Commission’s decision in *Case M.4692 – Barclays/ABN Amro* which can be accessed at

http://ec.europa.eu/competition/mergers/cases/decisions/m4692_20070806_20310_en.pdf

⁷ Paragraph 18 of the European Commission’s decision in *Case M.4692 – Barclays/ABN Amro* which can be accessed at

http://ec.europa.eu/competition/mergers/cases/decisions/m4692_20070806_20310_en.pdf



24. For the reasons set out below, the Commission considers that the Proposed Transaction raises no competition concerns in the potential market for the provision of corporate mortgage products in the State.
25. First, Activate and Lunar have a minimal presence in the potential market for the provision of corporate mortgage products in the State. KKR was unable to provide the Commission with any share estimates for the potential market for the provision of corporate mortgage products in the State.
26. KKR states in the notification that Activate, as of 31 December 2016, had advanced “[...]. *In view of these modest lending figures, KKR estimates that Activate’s share of the overall corporate banking category in Ireland is de minimis.*”
27. As noted above, Lunar only began providing corporate mortgage products in the State in June 2017. As of 3 October 2017, drawdowns by customers of Lunar stood at approximately €[...]. KKR states in the notification that “*this figure is expected to [...] by the end of October 2017.*”
28. Second, both Activate and Lunar will face competition from several providers of corporate mortgage products in the State following completion of the Proposed Transaction. These include Bank of Ireland Group plc, Allied Irish Banks plc, Permanent TSB Group Holdings plc and Ulster Bank Ireland DAC. These banks have a well-established presence in the provision of corporate mortgage products in the State. For example, in its 2017 *SME Market Report*, the Central Bank of Ireland states the following: “*The [small and medium enterprise] lending market remains highly concentrated...the market share of the three main lenders in new lending flows is currently 82 per cent.*”⁸ KKR also lists in the notification two smaller providers of corporate mortgage products currently active in the State: Lotus Investment Management Limited and Castlehaven Finance Limited.
29. Third, Activate and Lunar are not close competitors in the provision of corporate mortgage products in the State. While Activate provides corporate loans in excess of €10 million, Lunar provides corporate loans ranging from €250,000 to €7.5 million. The minimum corporate loan offered by Activate is therefore €2.5 million higher than the maximum corporate loan offered by Lunar. While Activate provides loans to professional developers for the acquisition, construction and development of new multi-family residential developments, Lunar’s commercial mortgages are targeted at small and medium enterprises and small professional investors looking to acquire properties or to redevelop existing properties.
30. In conclusion, even if one were to assume the existence of a horizontal overlap between KKR and Pepper, the Commission considers that the Proposed Transaction does not raise any competition concerns in the potential market for the provision of corporate mortgage products in the State.

⁸ The Central Bank of Ireland’s 2017 *SME Market Report* can be accessed at <https://www.centralbank.ie/docs/default-source/publications/sme-market-reports/sme-market-report-2017h1.pdf?sfvrsn=6>



31. There is no identifiable vertical relationship between KKR and Pepper in the State. Therefore, the Commission considers that the Proposed Transaction does not raise any vertical competition concerns in the State.

Conclusion

32. In the light of the above, the Commission considers that the Proposed Transaction will not substantially lessen competition in any market for goods or services in the State.

Ancillary Restraints

33. The Shareholders Deed contains a number of restrictive obligations. These include non-compete and non-solicitation clauses. The duration of those non-compete and non-solicitation clauses does not exceed the maximum duration acceptable to the Commission. The Commission considers these restrictions to be directly related to and necessary for the implementation of the Proposed Transaction insofar as they relate to the State.



Determination

The Competition and Consumer Protection Commission, in accordance with section 21(2)(a) of the Competition Act 2002, as amended, has determined that, in its opinion, the result of the proposed transaction whereby Red Hot Australia BidCo Pty Limited, an entity controlled by funds managed by KKR Credit Advisors (US) LLC (or its affiliates), would acquire sole control of Pepper Group Limited will not be to substantially lessen competition in any market for goods or services in the State, and, accordingly, that the acquisition may be put into effect.

For the Competition and Consumer Protection Commission

Brian McHugh
Member
Competition and Consumer Protection Commission