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COMMERCE COMMISSION

Decision No. 391

Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance of a business acquisition involving:

CGU Plc

and

Norwich Union Plc

The Commission:	M J Belgrave (Chair) M N Berry P R Rebstock
Summary of Proposed Acquisition:	CGU Plc and Norwich Union Plc to merge, by means of a scheme of arrangement between Norwich Union and its shareholders.
Determination:	Pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for the proposed acquisition.
Date of Determination:	9 May 2000

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THE PROPOSAL

1 Pursuant to section 66(1) of the Commerce Act 1986 (the Act), CGU Plc and Norwich Union Plc (the Applicants) gave notice to the Commission dated 6 April 2000 (the Application), seeking clearance to merge by means of a scheme of arrangement between Norwich Union and its shareholders under section 425 of the United Kingdom Companies Act.

2 This Application is part of a decision to merge the global activities of the ultimate parent companies. In New Zealand the scheme of arrangement between CGU and Norwich Union has been considered only to the extent that the proposal affects the relevant New Zealand markets.

THE PROCEDURES

3 Section 66(3) of the Act requires the Commission either to clear, or to decline to clear, a notice given under section 66(1) within 10 working days, unless the Commission and the person who gave the notice agree to a longer period. An extension of 10 working days was sought by the Commission, and agreed to by the Applicants. Accordingly, a decision on the Application is required by 9 May 2000.

4 The Applicants sought confidentiality for certain information contained in the Application, and a confidentiality order was made in respect of that information for a period of 20 working days from the Commission's determination of the Application. When the confidentiality order expires, the provisions of the Official Information Act 1982 will apply to the information.

5 The Commission's determination is based on an investigation conducted by its staff, and their subsequent advice to the Commission.

6 In the course of their investigation of the proposed acquisition, Commission staff have discussed the Application with a number of parties. These parties included other insurance companies, trading banks, insurance brokers, and the Insurance Council of New Zealand.

THE PARTIES

CGU

7 CGU is an international company operating in the United Kingdom, Europe, and other international markets including Poland, Ireland, Canada, Australia, New Zealand, and Asian countries.

8 CGU operates in New Zealand through its wholly owned subsidiary, New Zealand Insurance Limited and through its Australian CGU subsidiary, CGU Insurance Australia Ltd. New Zealand Insurance Limited is CGU's principal operating company in New Zealand, and is involved in the provision of short term general insurance services.

Norwich Union

9 Norwich Union is a United Kingdom based company, which also operates internationally in a number of countries including France, Ireland, Poland, Spain, Belgium, Italy, Canada, the Middle East, Australia, and New Zealand.

10 The Norwich Union Group in New Zealand includes Norwich Union Holdings (NZ) Limited, the principal operating subsidiary of which is State Insurance Limited. The principal activity of State Insurance Limited is the provision of short-term general insurance services. State Insurance also owns and operates an automobile parts supplier, New Zealand Car Parts Limited, as an adjunct to its motor vehicle insurance operations.

11 State Insurance Limited has a 50% shareholding in First Rescue and Emergency (NZ) Limited. The business of this company is primarily as an assistance company (travel, roadside assistance and a call centre operation).

OTHER RELEVANT PARTIES

Other General Insurers

12 There are approximately 30 insurance companies registered and currently operating in New Zealand. The major companies offering a range of general insurance products include:

- Lumley General Insurance (NZ) Limited ("Lumley")
- Royal & Sun Alliance Insurance (NZ) Limited ("RSA")
- Tower Insurance Limited ("Tower")
- HIH Casualty & General Insurance (NZ) Ltd ("HIH")
- ACE Insurance Limited ("ACE")
- AMI Insurance Limited ("AMI")
- AA-GIO Insurance Ltd ("AA-GIO")
- MMI General Insurance (NZ) Ltd ("MMI")
- QBE Insurance (International) Ltd ("QBE")
- Farmers Mutual Group ("Farmers Mutual")

Insurance Council of New Zealand

13 The Insurance Council of New Zealand is an association representing fire and general insurers regarding industry matters such as legislation, marketing, and self-regulation. Membership of the Insurance Council is voluntary. As at 1999, there are 31 members.

BACKGROUND

14 The primary function of insurance is to provide financial compensation for any loss sustained, provided that risk has been covered. That is a fund, into which all who are insured will pay an assessed contribution (premium) and, in return, have the right to call on the fund for an appropriate payment should the insured event occur.

15 A brief description of the elements of the insurance industry follows.

International Trends in Insurance

16 There is a global trend in the insurance industry towards fewer but larger internationally owned companies, as a result of recent mergers and acquisitions.

17 Internationally, insurance is increasingly being seen as part of a bundled financial services market. As a result there has been an increasing convergence between banks, financial services companies and insurance companies. In some areas this has lead to a trend now known as "bancassurance", the combination of banking and insurance, particularly with regard to life insurance operations.

18 In addition, e-commerce and the Internet are expected to significantly impact upon the traditional roles that these organisations have had in the past. The impact of these technological advancements is likely to result in easier access to insurance markets.

Regulatory Environment

19 New Zealand has one of the least regulated insurance markets in the world. The Insurance Companies (Ratings and Inspections) Act 1994 requires companies to obtain, register and disclose a credit rating from an approved rating agency (AM Best or Standard & Poor's), to show their ability to pay claims.

20 The Insurance Companies Deposits Act 1953 requires an insurance company to lodge approved securities with a market value of not less than $500,000 with the Public Trustee. This Act further requires annual reports and statements of financial condition to be provided to the Ministry of Economic Development.

Distribution of Insurance Products

21 Insurance products are distributed in a number of ways, using a variety of distribution channels. These channels include direct selling, which involves retail branches, call centres, insurance agents, and the Internet. Direct selling is the most common channel for domestic insurance products. Traditionally, insurers relied upon branches, agents and brokers to sell their products. More recently however, insurance companies introduced telephone call centres as a method of direct selling. The Commission understands that the Internet is currently not a major distribution outlet for insurance companies. However, technological advancements indicate that there will be greater use of this medium in the future.

22 Brokers provide a further distribution network, as an intermediary advice service between insurer and potential customers, as discussed below.

23 Banks also provide a distribution channel for insurance companies, particularly with regard to domestic insurance products. Major general insurers regard banks as an important retail outlet.

Brokers

24 Brokers are an intermediary service between the insurance company and the customer. Brokers generally specialise in a particular form of insurance (eg commercial), although some brokers offer a wider range of services, such as actuarial services and risk management advice.

25 Brokers generally operate on behalf of the customer, seeking the most appropriate cover for the risk involved, and the best price for the insurance cover. Local insurance brokers have a network that is used to service major commercial customers, and provide access to international insurance services. Industry sources estimated that between 15-25% of commercial insurance business is transacted offshore.

26 Currently in New Zealand, it is understood that a significant proportion of commercial insurance (around 90%) is transacted through brokers. However, brokers only account for a small proportion of domestic insurance transacted (estimated at no more than 10%).

Banks

27 Trading banks offer a range of insurance products, primarily house and content insurance, and domestic motor vehicle insurance. Banks brand their own insurance products, and these are underwritten by established general insurance companies. Banks generally offer insurance products as an adjunct to other financial services, in particular, mortgage lending.

28 One general insurer advised that 50% of its domestic products were sold through banks. The Applicants advised that between [ ]% and [ ]% of their premiums were sold through banks. On the basis of these figures, banks therefore represent a significant distribution outlet for insurance companies.

Captive Insurance

29 Captive insurance (also known as "self insurance") is used by large corporations that bypass the broker network and insurance companies, and set up their own insurance facility. The corporation incurs a certain level of risk, with a reinsurance company covering the balance.

Reinsurance

30 Reinsurance is the insuring again (by the insurer) of a risk already insured. Insurers seek to reduce their liability by covering part of their potential liability with other insurers. The object is to indemnify the original insurer against loss that they may sustain in their capacity as insurers. Internationally, there are a significant number of insurance companies specialising in reinsurance services.

MARKET DEFINITION

Introduction

31 The purpose of defining a market is to provide a framework within which the competition implications of a business acquisition can be analysed. The relevant markets are those in which competition may be affected by the acquisition being considered. Identification of the relevant markets enables the Commission to examine whether the acquisition would result, or would be likely to result, in the acquisition or strengthening of a dominant position in any market in terms of section 47(1) of the Act.

32 Section 3(1A) of the Act provides that:

> ". . . the term 'market' is a reference to a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them."

33 Relevant principles relating to market definition are set out in *Telecom Corporation of New Zealand Ltd v Commerce Commission*,[1] and in the Commission's *Business Acquisition Guidelines* ("the Guidelines").[2] A brief outline of the principles follow.

34 Markets are defined in relation to three dimensions, namely product type, geographical extent, and functional level. A market encompasses products that are close substitutes in the eyes of buyers, and excludes all other products. The boundaries of the product and geographical markets are identified by considering the extent to which buyers are able to substitute other products, or across geographical regions, when they are given the incentive to do so by a change in the relative prices of the products concerned. A market is the smallest area of product and geographic space in which all such substitution possibilities are encompassed. It is in this space that a hypothetical, profit-maximising, monopoly supplier of the defined product could exert market power, because buyers, facing a rise in price, would have no close substitutes to which to turn.

35 A properly defined market includes products which are regarded by buyers or sellers as being not too different ('product' dimension), and not too far away ('geographical' dimension), and are therefore products over which the hypothetical monopolist would need to exercise control in order for it to be able to exert market power. A market defined in these terms is one within which a hypothetical monopolist would be in a position to impose, at the least, a "small yet significant and non-transitory increase in price" (the *"ssnip"* test), assuming that other terms of sale remain unchanged.

36 Markets are also defined in relation to functional level. Typically, the production, distribution, and sale of products takes place through a series of stages, which may be visualised as being arranged vertically, with markets intervening between suppliers at one vertical stage and buyers at the next. Hence, the functional market level affected by the application has to be determined as part of the market definition. For example, that between manufacturers and wholesalers might be called the "manufacturing market", while that between wholesalers and retailers is usually known as the "wholesaling market".

37 The above discussion focuses on "demand-side" factors in line with the Commission's general approach to market definition. Supply-side factors are not generally considered by the Commission in its preliminary analysis of market definition, but are considered as part of the competition analysis which identifies market participants, including "near entrants" and the potential constraint from market entry.

The Relevant Markets

38 The Applicants in this case have contended that the relevant market is that for the provision of insurance against general domestic and commercial risks (the general insurance market). They have suggested that the various products that fall in the category of general insurance display similar characteristics, and that insurers providing one product could quickly move to supply other general insurance products in response to a change in market circumstances; that is, there is ready supply-side substitution. These are matters which are relevant to the market definition issue.

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[1] (1991) 4 TCLR 473.

[2] Commerce Commission, *Business Acquisition Guidelines*, 1999, pp. 11-16.

39 The Applicants also state:

> "While CGU and Norwich consider the General Insurance Market as the correct definition in this instance, it is anticipated that the Commission may wish to obtain further comfort by examining the position in respect of each of the main segments within this overall market so as to determine if any issue would arise if each of these segments were considered as a separate market. As a result, this notice provides information both in respect of the overall General Insurance Market, as well as each of the main segments within it."

40 The main market segments referred to are those for the provision of insurance for:

- domestic house and contents;
- domestic motor vehicle;
- commercial motor vehicle;
- commercial liability; and
- commercial property.

41 The Commission accepts that many insurance products are sold in similar ways and face similar competitive features. However it is not convinced at this time that this is true of all insurance products. For instance, domestic insurance appears to have different distribution characteristics from commercial insurance. Most commercial insurance business is distributed through brokers, while banks only distribute domestic insurance. In addition self-insurance and direct offshore insurance provide a significant competitive influence on commercial insurance, but not on domestic insurance. Similarly, the degree of demand-side and supply-side substitutability varies considerably when one considers the main market products within these groupings.

42 The Commission considers it is not necessary for the purpose of assessing the current Application to determine whether product markets are as wide as, say, that for domestic insurance and that for commercial insurance. Rather the Commission considers that the competitive effects of the proposal can be fully assessed by adopting markets corresponding with each of the main segments described in the Application. In doing so it is noted that if there are no dominance concerns arising out of these narrower markets, there are unlikely to be any dominance concerns within the wider markets.

43 The Commission accepts that these product markets are national in scope. There is considerable uniformity in products available throughout the country, many of the insurers have a physical presence in the major provincial and metropolitan centres and all appear to be accessible nationally by telephone, fax and/or the Internet.

Other Insurance Products

44 As well as the main insurance products described in the Application, the Commission has also assessed the Application with regard to other insurance products, namely personal accident insurance, travel insurance, marine insurance, consumer credit insurance, engineering insurance, bonds insurance and extended warranty insurance.

45 With respect to consumer credit insurance, there is no aggregation as a result of the proposed acquisition. In relation to personal accident insurance, the aggregation that would occur as a result of the acquisition would be minimal, and well within the Commission's "safe harbours" (refer paragraph 59).

46 With regard to the remaining insurance products, namely travel, marine, engineering, bonds, and extended warranty, aggregation is also well within the minimum level at which the Commission considers competition concerns could arise. The Commission notes that there are a number of other insurers in those markets providing effective competition.

47 The Commission does not propose to assess these insurance products (listed in paragraph 44) further below.

Conclusion on Market Definition

48 The Commission considers that the following national markets are relevant for the consideration of the present proposal:

- the market for domestic house and contents insurance;
- the market for domestic motor vehicle insurance;
- the market for commercial property insurance;
- the market for commercial motor vehicle insurance; and
- the market for commercial liability insurance.

COMPETITION ANALYSIS

Introduction

49 The competition analysis assesses competition in the relevant markets in order to determine whether the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of dominance.

50 Competition in a market is a broad concept. It is defined in section 3(1) of the Commerce Act as meaning "workable or effective competition". In referring to this definition the Court of Appeal said:[3]

> "That encompasses a market framework which participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency."

51 Section 3(9) of the Commerce Act states:

> "For the purposes of sections 47 and 48 of this Act, a person has … a dominant position in a market if that person as a supplier … of goods and services, is or are in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in that market and for the purposes of determining whether a person is … in a position to exercise a dominant influence over the production, acquisition, supply, or price of goods or services in a market regard shall be had to-
>
> (a) The share of the market, the technical knowledge, the access to materials or capital of that person or those persons:
>
> (b) The extent to which that person is … constrained by the conduct of competitors or potential competitors in that market:
>
> (c) The extent to which that person is … constrained by the conduct of suppliers or acquirers of goods or services in that market."

[3] *Port Nelson Limited v Commerce Commission* (1996) 3 NZLR 554, 564-565

The Dominance Test

52 Section 47(1) of the Commerce Act prohibits certain business acquisitions:

> "No person shall acquire assets of a business or shares if, as a result of the acquisition, -
>
> (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
>
> (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened."

53 The test for dominance has been considered by the High Court. McGechan J stated:[4]

> "The test for 'dominance' is not a matter of prevailing economic theory, to be identified outside the statute."
>
> …
>
> "Dominance includes a qualitative assessment of market power. It involves more than 'high' market power; more than mere ability to behave 'largely' independently of competitors; and more than power to effect 'appreciable' changes in terms of trading. It involves a *high degree of market control*."

54 Both McGechan J and the Court of Appeal, which approved this test,[5] stated that a lower standard than "a high degree of market control" was unacceptable.[6] The Commission has acknowledged this test:[7]

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor or customer reaction."

55 The Commission's *Business Acquisitions Guidelines* state:

> "A person is in a dominant position in a market when it is in a position to exercise a high degree of market control. A person in a dominant position will be able to set prices or conditions without significant constraint by competitor {or} customer reaction."
>
> …
>
> "A person in a dominant position will be able to initiate and maintain an appreciable increase in price or reduction in supply, quality or degree of innovation, without suffering an adverse impact on profitability in the short term or long term. The Commission notes that it is not necessary to believe that a person will act in such a manner to establish that it is in a dominant position, it is sufficient for it to have that ability." (p21)

56 The role of the Commission in respect of an application for clearance of a business acquisition is prescribed by the Commerce Act. Where the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in an acquisition or strengthening of a dominant position in a market, the Commission must give a clearance. Where the Commission is not satisfied, clearance is declined.

57 The Commission applies the dominance test in the following competition analysis.

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[4] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC)
[5] *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)
[6] *Commerce Commission v Port Nelson Ltd* (1995) 5 NZBLC 103,762 103,787 (HC) and *Commerce Commission v Port Nelson Ltd* (1996) 5 NZBLC 104,142 104,161 (CA)
[7] *Business Acquisition Guidelines*, Section 7

The Market for Domestic House and Contents Insurance

Market Concentration

58 An examination of concentration in a market often provides a useful first indication of whether a merged firm may or may not be constrained by others participating in the market, and thus the extent to which it may be able to exercise market power.

59 The *Business Acquisitions Guidelines* specify certain "safe harbours" which can be used to assess the likely impact of a merger in terms of s 47 of the Act -

> "In the Commission's view, a dominant position in a market is generally unlikely to be created or strengthened where, after the proposed acquisition, either of the following situations exist:
>
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 40% share of the relevant market;
> - the merged entity (including any interconnected or associated persons) has less than in the order of a 60% share of the relevant market and faces competition from at least one other market participant having no less than in the order of a 15% market share." (p 17)

60 These safe harbours recognise that both absolute levels of market share, and the distribution of market shares between the merged firm and its rivals, is relevant in considering the extent to which the rivals are able to provide a constraint over the merged firm. The Commission went on to state (at page 17) that:

> "Except in unusual circumstances, the Commission will not seek to intervene in business acquisitions which, given appropriate delineation of the relevant market and measurement of shares, fall within these safe harbours."

61 Although, in general, the higher the market share held by the merged firm, the greater the probability that dominance will be acquired or strengthened (as proscribed by s 47 of the Act), market share alone is not sufficient to establish a dominant position in a market. Other factors intrinsic to the market structure, such as the extent of rivalry within the market and constraints provided through market entry, also typically need to be considered and assessed.

62 Market shares in respect of this Application have been assessed using Gross Written Premium ("GWP") data. GWP is the actual premium charged clients, less all premium refunds. While there are other possible measures as to market share, industry sources generally agreed that GWP was an accurate indicator. For the purposes of assessing the competitive impact of this proposal, the Commission considers that the appropriate measure of market share is that of GWP.

63 The Commission has obtained GWP figures from the Applicants, and other major industry parties. The Commission has also received total GWP figures from the Insurance Council of New Zealand. The Commission understands that the Insurance Council's figures do not include GWPs from HIH for particular markets, rather an overall total. HIH has, however, provided the Commission with GWP figures for particular markets, and these have been included in the overall total. It is also noted that the Insurance Council totals of GWP exclude some business not reported to the Insurance Council, for example business written direct by offshore insurance companies, and companies which "captive insure" (discussed in paragraph 29). As a result, the market share figures of the Applicants represent a likely "maximum estimate" for the combined entity.

64 On the basis of the GWP information provided by the Applicants and other insurance companies, the Commission has determined the respective market shares of the major

insurance companies. This approach has been adopted for the market share analysis in each market that has been considered in this proposal.

65 Table One provides the market shares in the market for domestic house and contents insurance.

Table One
Market Shares in the Market for
Domestic House and Contents Insurance

Parties	**GWP (NZ$million)**	**Estimated Market Share (%)**
CGU	[ ]	[ ]
Norwich Union	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
RSA	[ ]	[ ]
Tower	[ ]	[ ]
AMI	[ ]	[ ]
Lumley	[ ]	[ ]
Farmers Mutual	[ ]	[ ]
HIH	[ ]	[ ]
AA-GIO	[ ]	[ ]
MMI	[ ]	[ ]
Other parties	[ ]	[ ]
Total	[ ]	**100%**

66 On the basis of the above figures, the combined entity's market share of the domestic house and contents insurance market is [ ]%.

67 From this data, the combined entity's market share falls outside the Commission's "safe harbours" (refer paragraph 59). However, as stated earlier, the fact that a proposed acquisition may lead to a market share falling outside these "safe harbours" does not necessarily mean that it will be likely to result in the acquisition or strengthening of a dominant position in a market. Additional factors must also be considered before a conclusion on dominance is reached. These other factors are discussed below.

Existing Competition

68 The Applicants submit that the combined entity would continue to be constrained by the conduct of existing competitors. In particular, the Applicants identified AMI, Tower and RSA as being "substantial" competitors in this market. Further competition, as submitted by the Applicants, is provided by a number of smaller operators including AA-GIO, AMP and Farmers Mutual Group.

69 The Commission notes that there are a number of other insurers currently in the market. In particular, there are three insurers with between [ ]% of the market each. The Commission considers that these insurers, and other smaller insurers, are effective competitors. This view is based upon market enquiries, with industry sources advising that insurers such as RSA, Tower and AMI provide competitive options for customers seeking domestic insurance. These insurance companies, and other insurers, have a national presence, backed by either retail outlets, broker networks, call centres, or a combination of these distribution options.

70 It is understood that there are no "switching costs" in domestic insurance products that prevent customers from readily changing insurance company. For example, "no claims bonuses" are generally transferable between insurance companies. Industry sources advised further that, while a proportion of customers are unlikely to compare premium rates when an annual account is received, a significant number do source competitive quotes from a number of insurance providers.

71 Industry sources also advised that the merged entity would be unlikely to be able to increase premiums, and still maintain market share. That is, it was considered that the competitive response of these other insurers is likely to be significant, and is likely to constrain the combined entity.

72 The Commission concludes that other insurance companies, in particular RSA, Tower and AMI, provide a competitive constraint to the Applicants at present, and are likely to continue to do so if the proposed acquisition was to be implemented.

Constraint from Potential Competition

73 The Applicants submit that there are few barriers to entry into this market and, consequently, that the combined entity will be effectively constrained by the threat of potential entry.

74 For new entrants, companies must lodge a bond of $500,000 with the Public Trustee as required by the Insurance Companies Deposits Act 1953. Companies must also obtain and disclose a claim paying ability rating from an approved agency (Standard and Poor's, or A M Best).

75 In addition to these regulatory requirements, a potential entrant requires an insurance product, and an appropriate distribution channel (or channels). Actuarial and underwriting services can be retained by an entrant, to formulate risk profiles and premium rates. Thereafter an entrant selects the most appropriate distribution channel for the product. This may involve a retail presence, a broker network, or a centralised call-centre. None of these options is likely to represent a significant barrier for a properly resourced entrant.

76 While noting the low barriers to entry, the Commission has also been advised that new entry is unlikely at the present time. It is understood that this is mainly due to the absence of attractive market conditions. In addition, as noted earlier, there is a global trend towards rationalisation of insurance services, further impacting upon the likelihood of new entry.

77 However, if the market conditions were attractive, it is likely that a potential entrant would choose to enter by forming an alliance with an existing operator, in order to take advantage of an established distribution network. Alternatively, an entrant may design an insurance product for a particular group or association (for example, a particular sporting pastime), and enter the market targeting that consumer. It is understood that the AA-GIO joint venture started in a similar manner with GIO, an Australian insurer, entering the market offering insurance services to AA members.

78 Industry sources advised that the Internet has not been utilised as a possible distribution channel to date. Some insurance companies have introduced a facility whereby customers can request insurance quotes through an Internet site, although this practice is not widespread. However, the use of the Internet by insurers is expected to increase significantly in the future, particularly with regard to standardised insurance products

such as the domestic lines. The ability to offer insurance through the Internet represents a low-cost, manageable option for a potential entrant.

79 For incumbent insurers looking to expand their product range, entry conditions are lower. The regulatory requirements will have already been met, and incumbents will have the necessary underwriting experience and distribution channels. Industry sources advised that there is ready supply-side substitution with regard to general insurance products. That is, an insurer offering a particular insurance product could switch (or expand) its operation to offer another insurance product, and that such a switch can be effected quickly. This is particularly so in the case of general insurance products, where the products are relatively standardised and exhibit similar characteristics.

80 The Commission concludes that, if the market conditions were attractive, entry is likely to occur. This threat of potential entry is likely to provide a competitive constraint upon the combined entity.

Countervailing Power

81 The Applicants argue that the position of brokers and banks in the distribution chain provides a constraint to the insurance companies, as banks and brokers effectively "own" the customer relationship. They state that consumers depend on the recommendation of the broker or the branding of the bank, and this means that the insurance company tends to become a commodity provider to the broker or bank, and the insurance provider is chosen largely on price.

82 The Commission recognises that brokers play an important role in respect of commercial business, but this role is much less important in respect of domestic business such as domestic house and contents insurance. While some domestic business is transacted through brokers, it is understood that it is usually an adjunct to commercial business (for instance the personal insurance for staff of major commercial clients). Consequently the Commission has placed little weight on the countervailing power brokers may exercise in respect of the domestic house and contents market.

83 The Commission accepts, however, that banks can have a significant influence in this market. It has been advised that [ ] of CGU's domestic business and [ ]% of State's domestic business comes through banks. While the percentage varies significantly amongst the insurers, one major domestic insurer [ ] said that 50% of its domestic business is transacted through banks. The normal requirement of banks is that a house insurance policy is a condition of providing a house mortgage, means that banks are an especially important distribution outlet for house and contents policies.

84 It is understood that banks typically design the insurance products they wish to sell, and then obtain competitive tenders for the underwriting of their products. The underwriting period may be for three to four years, after which the banks may re-tender. This allows them to change underwriters periodically and, while there may be a cost associated with this, there are examples where this has occurred. The Commission has been advised by one trading bank that underwriters tend to be very anxious to retain this business, and they place considerable emphasis on addressing concerns of the banks. The bank did not believe that this would be affected by the proposed acquisition.

85 The Commission considers that banks provide a countervailing power in the domestic insurance products and would therefore provide a competitive constraint on the combined entity.

Conclusion on the Market for Domestic House and Contents Insurance

86 The proposed acquisition will result in an aggregation of market share in the market for domestic house and contents insurance. However, the combined entity is likely to be constrained by the presence of a number of existing national operators.

87 Further, if the market conditions are attractive, entry conditions are unlikely to represent a major barrier to any prospective entrant wishing to enter the market, or to existing participants seeking to expand their operations. In addition, banks are likely to exercise a degree of constraint upon the conduct of the combined entity post-acquisition.

88 Given these factors, the Commission concludes that the acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in the market for domestic house and contents insurance.

The Market for Domestic Motor Vehicle Insurance

Market Concentration

89 The market shares for domestic motor vehicle insurance have been estimated using the same information and process as that outlined above in paragraphs 62 – 64. On the basis of this information, the market shares of the major insurers in this market are shown in Table Two.

Table Two
Market Shares in the Market for
Domestic Motor Vehicle Insurance

Parties	**GWP (NZ$million)**	**Estimated Market Share (%)**
CGU	[ ]	[ ]
Norwich Union	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
AMI	[ ]	[ ]
RSA	[ ]	[ ]
Tower	[ ]	[ ]
AA-GIO	[ ]	[ ]
Lumley	[ ]	[ ]
Farmers Mutual	[ ]	[ ]
HIH	[ ]	[ ]
MMI	[ ]	[ ]
Other parties	[ ]	[ ]
Total	[ ]	**100%**

90 On the basis of the above figures, the combined entity would have a market share of [ ]%. One other operator [ ] has an estimated market share in excess of 15%. Therefore, the combined entity is likely to fall within the Commission's "safe harbour" guidelines (refer paragraph 59).

Existing Competition

91 As with domestic house and contents insurance, there are a number of established insurance companies offering domestic motor vehicle insurance. Of these, [ ] has the largest market share, with [ ]%.

92 As with domestic house and contents insurance, the Commission considers that effective competition is also provided by insurance companies currently holding smaller market shares (for example, RSA and Tower). These significant competitors have an established operation, a national presence, and currently provide a competitive constraint to the Applicants in the market for domestic motor vehicle insurance. This is expected to continue post-merger.

Constraint from Potential Competition

93 The threat of potential entry into this market closely resembles the threat of entry into the domestic house and contents insurance market, discussed above at paragraphs 73 - 80. The low barriers to entry and expansion, and the countervailing power of banks with regard to domestic insurance, are likely to constrain the combined entity from exercising any degree of market power.

Conclusion on the Market for Domestic Motor Vehicle Insurance

94 The combined entity would have a market share of [ ]%, with other insurers having in the order of 15% or greater. On the basis of these figures, the combined entity will fall within the "safe harbour" guidelines.

95 In addition to the current competition, the combined entity is likely to face effective constraints from the threat of potential entry or expansion, and the countervailing power exercised by banks and (to a minor degree) brokers.

96 Given these factors, the Commission concludes that the acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for domestic motor vehicle insurance.

The Market for Commercial Property Insurance

Market Concentration

97 As with the previous two markets, market shares for commercial property insurance have been determined using information as outlined in paragraphs 62 – 64. The market shares for this market are shown in Table Three.

Table Three
Market Shares in the Market
for Commercial Property Insurance

Parties	**GWP (NZ$million)**	**Estimated Market Share (%)**
CGU	[ ]	[ ]
Norwich Union	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
RSA	[ ]	[ ]
HIH	[ ]	[ ]
ACE	[ ]	[ ]
MMI	[ ]	[ ]
Lumley	[ ]	[ ]
QBE	[ ]	[ ]
Farmers Mutual	[ ]	[ ]
Tower	[ ]	[ ]
Other parties	[ ]	[ ]
Total*	[ ]	**100%**

*the "Total" figure does not include insurance underwritten offshore, and self-insurance

98 On the basis of the above figures, the combined entity's market share will fall within the Commission's "safe harbours", as it is less than the 40% guideline (refer paragraph 59).

Existing Competition

99 Effective competition is likely to continue post-merger, particularly from RSA, with a market share of [ ]. In addition, as with the analysis of other competitors in the domestic lines, the Commission considers that other insurers such as HIH, ACE and MMI are currently providing effective competition, and that this is likely to continue following the proposed acquisition.

100 In addition to the current competition in New Zealand, the Commission has been advised that an increasing amount of commercial insurance is being underwritten offshore. Industry sources estimated that between 15-25% of commercial insurance is underwritten by overseas insurance companies. Major brokers advised that New Zealand clients are progressively utilising the ability to place insurance offshore, and that brokers themselves investigate the international commercial insurance market when obtaining prices on behalf of clients.

101 The Commission has also been advised that the modern practice of multinational companies is to manage procurement of services from one head office or regional office, for the international (or regional) operations. The result is that insurance is procured for the New Zealand "arm" by an overseas office, and (invariably) through an overseas insurer. There is no involvement in sourcing insurance by the New Zealand office of the multinational company.

102 The Applicants submit further that there is a constraint afforded by the ability of larger corporates in New Zealand to "self insure" or arrange captive insurance for part or all

of their insurance risks (refer paragraph 29). The Commission understands that a small number of significant New Zealand companies [ ] have arranged their insurance in this manner. However, the Commission also notes that this option is only available for a very limited number of companies.

Countervailing Power

103 The countervailing power of banks and brokers has already been discussed at paragraphs 81 - 85. Banks do not involve themselves significantly in commercial insurance products. However, as stated earlier, an estimated 90% of all commercial insurance is placed through brokers. Major brokers advised that commercial insurance is particularly competitive in New Zealand, and that this competition is likely to continue post-merger.

104 Brokers also source competitive quotes through overseas insurers, as described above in paragraph 100. Given the significant quantity of commercial insurance managed by brokers, the Commission concludes that brokers provide a countervailing power, and would therefore provide a competitive constraint on the combined entity.

Constraint from Potential Competition

105 Entry conditions for domestic insurance products have been examined at paragraphs 73 - 80 and are the same as those entry conditions for commercial products. It is not proposed to repeat that analysis, other than to record that in favourable entry conditions, entry is likely to be effected.

Conclusion on the Market for Commercial Property Insurance

106 The combined entity is likely to acquire a market share that will place it within the Commission's "safe harbours". Effective competition will continue to be provided by a number of current insurers, in particular RSA, with an estimated market share of [ ]%.

107 Further constraint upon the combined entity is likely from the ability of customers to readily source overseas insurance, the countervailing power of brokers, and low entry barriers into this market.

108 On the basis of these factors, the Commission concludes that the acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for commercial property insurance.

The Market for Commercial Motor Vehicle Insurance

Market Concentration

109 The market shares for commercial motor vehicle insurance, based on GWP data as outlined in paragraphs 62 – 64, is shown below in Table Four.

Table Four
Market Shares in the Market for
Commercial Motor Vehicle Insurance

Parties	GWP (NZ$million)	Estimated Market Share (%)
CGU	[ ]	[ ]
Norwich Union	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
Lumley	[ ]	[ ]
RSA	[ ]	[ ]
HIH	[ ]	[ ]
Farmers Mutual	[ ]	[ ]
MMI	[ ]	[ ]
QBE	[ ]	[ ]
Tower	[ ]	[ ]
Other parties	[ ]	[ ]
Total*	[ ]	**100%**

*the "Total" figure does not include insurance underwritten offshore, and self-insurance

110 On the basis of the above figures, the combined entity's market share falls within the Commission's "safe harbours" (refer paragraph 59).

111 An analysis of this market results in similar findings to that for the commercial property market above. The Commission concludes that the competitive constraints discussed at paragraphs 99 – 105 are also present in this market.

Conclusion on the Market for Commercial Motor Vehicle Insurance

112 On the information provided, the market share of the combined entity falls within the Commission's "safe harbours". The combined entity is likely to be constrained post merger by the competition effected by current insurers, particularly Lumley, with an estimated market share of [ ]%. Competition is also provided by other current insurers, as evidenced in Table Four.

113 In addition, the ability to place insurance coverage with overseas insurers, the threat of potential entry or expansion into the market, and the countervailing power exercised by brokers are all likely to constrain the combined entity from exercising market power.

114 Given these factors, the Commission concludes that the acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for commercial motor vehicle insurance.

The Market for Commercial Liability Insurance

Market Concentration

115 As with previous market share determinations, GWP data has been received from major insurance providers (refer paragraphs 62 – 64). On the basis of this information, market shares for commercial liability insurance are shown in Table Five.

Table Five
Market Shares in the Market
for Commercial Liability Insurance

Parties	**GWP (NZ$million)**	**Estimated Market Share (%)**
CGU	[ ]	[ ]
Norwich Union	[ ]	[ ]
Combined entity	**[ ]**	**[ ]**
HIH	[ ]	[ ]
QBE	[ ]	[ ]
RSA	[ ]	[ ]
ACE	[ ]	[ ]
MMI	[ ]	[ ]
Lumley	[ ]	[ ]
Farmers Mutual	[ ]	[ ]
Tower	[ ]	[ ]
Other parties	[ ]	[ ]
Total*	[ ]	**100%**

*the "Total" figure does not include insurance underwritten offshore, and self-insurance

116 On the basis of the above figures, the combined entity would have a market share of [ ]%. This figure places the combined entity well within the Commission's "safe harbour" guidelines (refer paragraph 59).

117 As with the markets for commercial property and commercial motor vehicle insurance, there is significant competition effected by other insurers. In addition, the competitive constraints at play in this market are similar to those in the other commercial insurance markets, discussed above at paragraphs 99 - 105. It is not proposed to repeat that analysis, other than to record that there are a number of constraints that are likely to prohibit the combined entity from exercising any degree of market power.

Conclusion on the Market for Commercial Liability Insurance

118 On the information provided, the market share of the combined entity falls within the Commission's "safe harbours". The combined entity is likely to be constrained post merger by the continuing competition effected by current insurers, the ability to place insurance coverage with overseas insurers, the threat of potential entry or expansion into the market, and the countervailing power exercised by brokers.

119 On the basis of these factors, the Commission concludes that the acquisition would not result, and would not be likely to result, in any person acquiring or strengthening a dominant position in the market for commercial liability insurance.

OVERALL CONCLUSION

120 The Commission has considered the impact of the proposed acquisition in the following markets:

- the market for domestic house and contents insurance;
- the market for domestic motor vehicle insurance;
- the market for commercial property insurance;
- the market for commercial motor vehicle insurance; and
- the market for commercial liability insurance.

121 The Commission has also considered the impact of the proposed acquisition in the markets for personal accident insurance, travel insurance, marine insurance, consumer credit insurance, engineering insurance, bonds insurance, and extended warranty insurance.

122 Having regard to the factors set out in section 3(9) of the Commerce Act, and all other relevant factors, the Commission is satisfied that the proposed acquisition would not result, or would not be likely to result, in any person acquiring or strengthening a dominant position in a market.

DETERMINATION ON NOTICE OF CLEARANCE

123 Accordingly, pursuant to section 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance to CGU Plc and Norwich Union Plc to merge by means of a scheme of arrangement under section 425 of the United Kingdom Companies Act.

Dated this 9th day of May 2000

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M J Belgrave
Chair