COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

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Statement of Issues

Aon/Willis Towers Watson

21 December 2020

Introduction

1. On 15 October 2020, the Commerce Commission registered an application (the Application) from Aon plc (Aon/the Applicant) to acquire 100% of the shares of Willis Towers Watson Public Limited Company (WTW) (the Proposed Acquisition).[1]

2. To clear an application, the Commission must be satisfied that an acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This Statement of Issues (SoI) sets out the potential competition issues we have identified following our initial investigation. This is so that Aon and WTW (together, the Merging Parties) and other interested parties can provide us with submissions relating to those concerns.

4. In reaching the preliminary views set out in this SoI, we have considered information provided by the Merging Parties and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition issues may arise, as the investigation continues.

The concerns we are testing

5. We are still to conclude on the relevant markets for our assessment of the Proposed Acquisition. However, at this stage, we are testing the potential for the Proposed Acquisition to substantially lessen competition due to:

   5.1 horizontal unilateral effects resulting from a loss of competition in the supply of broking and associated services for:

      5.1.1 commercial insurance;

      5.1.2 reinsurance; and/or

      5.1.3 group health and welfare benefits; and/or

[1] A public version of the Application is available on our website at: www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

5.2 horizontal coordinated effects resulting from a change in market conditions making coordination more likely, more complete, or more sustainable.

6. We explain our current concerns below and invite submissions on our position.

Process and timeline

7. We have agreed an extension with the Applicant until 26 February 2021 from the initial 40 working day statutory timeframe in which to decide on the Application.

8. The Commission would like to receive submissions and supporting evidence from the Merging Parties and other interested parties on the issues raised in this SoI. We request responses by close of business on **26 January 2021**, including a public version of any submission made. Please read the instructions for making a submission, which can be found on page 18 of this document.

9. All submissions received will be published on our website with appropriate redactions.[2] All parties will have the opportunity to cross-submit on the public versions of submissions from other parties by close of business on **2 February 2021**.

10. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with the Commission at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The Merging Parties

11. Aon and WTW are both global professional services firms that provide consulting and brokerage services related to financial risk mitigation. Aon is listed on the New York Stock Exchange and WTW is listed on the NASDAQ Global Select Market.

12. In New Zealand, the two firms both provide a range of insurance broking services, including for commercial insurance, reinsurance, group health and welfare benefits, and personal and life insurance. In addition, both firms provide investment consulting services to institutional investors. Aon has 58 offices throughout New Zealand. WTW operates out of five office locations in Auckland, Wellington, Christchurch, Tauranga, and Dunedin.

13. The Proposed Acquisition would see WTW become a wholly owned subsidiary of Aon.

Background to the industry

14. Insurance brokers act as intermediaries between the customer that is purchasing cover for its risk, and the (re)insurance company (or companies) that underwrite that

[2] Confidential information must be clearly marked (by highlighting the information and enclosing it in square brackets). Submitters must also provide a public version of their submission with confidential material redacted. At the same time, a schedule must be provided which sets out each piece of information over which confidentiality is claimed and the reasons why the information is confidential (preferably with reference to the Official Information Act 1982).

risk. Brokers provide specialist advice on (re)insurance options, arrange cover on behalf of their customers, and provide a variety of related services such as cover renewal and claims management. These services are often tailored to the specific needs of the customer, particularly for larger customers and those seeking to cover complex and/or high-value risk.

15. Brokers are remunerated either through a brokerage commission (which is reflected in the (re)insurance premium paid by the broker's customer), or through a fee paid directly by the customer to the broker, or a mix of the two.[3]

16. The Proposed Acquisition would result in aggregation in the provision of broking and associated services related to commercial insurance, reinsurance, and group benefits.

16.1 *Commercial insurance broking* involves providing broking and related services to a company or organisation. A commercial customer may seek to insure a range of different risks depending on its activities, assets, and industry/area of operation.

16.2 *Reinsurance broking* involves providing broking and related to services to a primary insurer (called a cedent) seeking to cede some or all its insured risk to a reinsurance provider (or providers). The broker typically assists the cedent to arrange a reinsurance programme, ceding risk across several different reinsurers. There are two main types of reinsurance, as follows.

16.2.1 <u>Facultative reinsurance</u> refers to coverage purchased by a cedent to cover a single risk or a defined block of risks held in the primary insurer's book of business.

16.2.2 <u>Treaty reinsurance</u> refers to coverage purchased by a cedent to cover all its current and future policies within a predetermined class (for example, all of insurer A's professional indemnity risk). Insurance companies rely on access to treaty reinsurance to provide them with the financial security to sign new business in the knowledge that it will be covered under their reinsurance programme.

16.3 *Group benefits broking* involves arranging health insurance, life insurance and other insurance cover on behalf of a company or organisation, to cover its workforce. In New Zealand, the existence of the ACC no-fault personal injury cover means that group benefits are not relied upon to the same extent as elsewhere.

17. In this document, we use the term:

17.1 "customers" to refer to parties using the services of a broker for commercial insurance and/or group benefits purposes; and

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3 Application at [62] and [73].

17.2 “cedents” to refer to parties using the services of a broker for reinsurance purposes.

The relevant markets

18. We define markets in the way that we consider best isolates the key competition issues that arise from a merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products and services that fall outside the market, but which would still impose some degree of competitive constraint on the merged entity.

19. When assessing relevant markets we consider whether, in response to a small price increase in the relevant products:

19.1 customers/cedents could easily switch to alternative products or locations (known as ‘demand side’ substitution); and

19.2 firms could easily switch production to the products or locations in question without incurring significant costs (known as ‘supply side’ substitution).

20. Aon submitted that the relevant markets for the Commission’s consideration of the Proposed Acquisition are the national markets for the provision of:[4]

20.1 commercial non-life insurance distribution (brokered sales only);

20.2 non-life reinsurance distribution (brokered and direct sales); and

20.3 group health and welfare benefits distribution and associated services (brokered and direct sales).

21. In this document, we refer to these proposed markets as “commercial insurance”, “reinsurance”, and “group benefits”, respectively.

22. We have not reached final views on any of the relevant markets. However, we set out below our preliminary views based on our inquiries to date.

Commercial insurance

Relevant markets may be further segmented based on customer size and/or complexity

23. Our market inquiries to date have strongly suggested that large commercial insurance customers (e.g. large corporate entities), and those with more complex insurance requirements, have fewer available broking options.

24. Complexity can arise from, among other things, customers seeking to cover a particularly wide portfolio of risks, seeking to insure high-value assets or infrastructure, seeking to place risk with multiple insurers and/or into offshore insurance markets, or having a non-traditional insurance arrangement (such as a

[4] Application at [87]-[88].

captive insurer).[5] These types of customers have suggested they require a broker with global scope – including the ability to access offshore insurance markets and harness international expertise – as well as a strong New Zealand presence.

25. Our preliminary view is that Aon, WTW and Marsh Limited (Marsh)[6] are likely to be the only brokers able to meet the requirements of large and/or complex commercial insurance customers. Crombie Lockwood (NZ) Limited (Crombie) is a potential fourth option, which we discuss further below in the Unilateral Effects section.

26. On the other hand, we have heard that smaller customers (SMEs) are likely to have more options available to them, including Aon, Crombie, Rothbury Group Limited, and a variety of smaller local brokers. Moreover, WTW does not appear to have a major presence in supplying broking services to these smaller customers.

27. We continue to investigate whether and, if so, how to appropriately delineate between customers with different requirements due to size and/or level of complexity. We invite further submissions on this issue.

Possibility of further segmentation for some specialist industries and/or risk types

28. There may also be certain industries or types of risk that require additional broker specialisation. Specialist industries could include, for example, the aviation and/or energy industries. Specialist risk types could include some types of liability risk (such as Directors and Officers liability) and/or catastrophe risk. We have heard that risk associated with these categories can be more difficult to insure (or 'place'). Often, placement requires a broker to have specialist in-house expertise (such as engineering consultants) and access to overseas insurance markets.

29. Our interviews with market participants to date have not identified any specific industries or risk types that are likely to be impacted by the Proposed Acquisition materially differently from others. Rather, customers have tended to cite their large size and/or complexity as the primary drivers of any narrowing of broking options. Therefore, our preliminary view is that further segmenting the market based on customer industry or risk type is unlikely to assist in isolating the competition issues that may result from the Proposed Acquisition.

30. However, we continue to investigate whether there may be some industries and/or risk types for which it would be appropriate to define separate markets. We invite further submissions on this issue.

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5 A captive insurance company is a wholly owned subsidiary of a parent firm, existing to provide insurance coverage to the parent. A captive may be used as one part of a wider insurance programme that also involves traditional insurance. As discussed further below in the Unilateral Effects section, our inquiries to date have indicated that firms using captives typically still require the services of a broker.

6 Marsh Limited is one of the subsidiaries of Marsh & McLennan Companies. Other subsidiaries include Guy Carpenter, which focuses on reinsurance broking, and Mercer, which focuses on group benefits broking. For convenience, in this memo we refer to the subsidiaries of Marsh McLennan Companies collectively as "Marsh".

Reinsurance

Relevant markets may exclude direct sales of reinsurance

31. Aon submitted that the relevant reinsurance market encompasses two types of risk placement:[7]

    31.1 the direct transfer of risk from the cedent to the reinsurer (direct sales); and

    31.2 risk that is placed with a reinsurer using a broker as an intermediary (brokered sales).

32. We have heard from some cedents that they maintain relationships with reinsurers, but that transactions still tend to be conducted through brokers, because:

    32.1 reinsurers prefer not to transact directly with cedents (and, in many cases, would refuse to); and

    32.2 broker expertise is required to negotiate treaty reinsurance programs, which typically include many reinsurers.

33. Moreover, we have heard from cedents that they also rely on brokers for other services in addition to placement of risk, such as risk modelling and claims handling. This suggests that the reinsurance broking product market could be wider than simple risk placement, and therefore not comparable with the market for direct sales.

34. While there is some evidence that very large, multinational insurance companies may have a greater ability to transact directly with reinsurers, this does not appear to be the case for most cedents.

35. We continue to investigate whether it would be appropriate to narrow the relevant market to include brokered sales of reinsurance only and invite further submissions on this issue.

Group benefits

Possibility of separate markets for some classes of benefits

36. Aon defines "health and welfare benefits" to encompass life insurance, health insurance, income protection insurance, and cover for other disabilities, sickness, and trauma.[8]

37. However, there is some evidence that the competitive dynamics in the distribution of group *health* benefits may be materially different to those in the distribution of group *life and disability* benefits. For example, we have heard that the distribution of group life and disability benefits occurs mainly through brokers and is dominated by Aon, WTW, and Marsh, whereas the supply of group health benefits includes

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[7] Application at [201]-[210].

[8] Application at [75].

significant direct business from Southern Cross, New Zealand’s largest health insurance provider.

38. If customers are more restricted in their options for obtaining group life and disability insurance than they are for obtaining group health insurance, this may suggest the existence of a separate market. We continue to investigate whether this is likely to be an appropriate market segmentation and invite further submissions on this issue.

Geographic scope

39. We currently consider the relevant markets for commercial insurance and group benefits to be national in scope, since customers appear to value a New Zealand presence and New Zealand-specific expertise. While competition in reinsurance broking may occur on a global basis, this appears unlikely to reduce our competition concerns since (as discussed further below in the Unilateral Effects section) our inquiries to date have not suggested that there are likely to be viable overseas alternatives to Aon, WTW and Marsh.

With and without scenarios

40. Assessing whether a substantial lessening of competition is likely requires us to compare the likely state of competition if the Proposed Acquisition proceeds (the scenario with the acquisition, often referred to as the factual) with the likely state of competition if it does not (the scenario without the acquisition, often referred to as the counterfactual) and to determine whether competition is likely to be substantially lessened by comparing those scenarios.

41. With the Proposed Acquisition, WTW would become a wholly owned subsidiary of Aon. This would remove the current and potential competitive constraint from WTW on its competitors in the relevant markets.

42. Without the Proposed Acquisition, Aon submitted that the status quo would continue; that is, both it and WTW would continue to operate as separate entities, competing in the relevant markets as they currently do.[9]

43. We continue to consider the likely extent of competition between the Merging Parties and their competitors should the Proposed Acquisition not proceed, including whether either party would be likely to expand and/or enter other markets. We invite submissions on this issue.

Competition concern: Horizontal unilateral effects

44. Horizontal unilateral effects arise when a firm merges with or acquires a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that a market participant can profitably

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[9] Application at [124].

increase prices above (and/or reduce quality below) the level that would prevail without the merger.

Commercial insurance

45. For the reasons set out below, the Commission is not currently satisfied that the Proposed Acquisition would not be likely to substantially lessen competition in the supply of broking and associated services for commercial insurance.

Possible reduction from three to two commercial insurance brokers

46. As discussed above in the Market Definition section, our inquiries to date have strongly suggested that large commercial insurance customers, and those with more complex requirements, have fewer broker options available to them. Our preliminary view is that there is likely to be a class of large and/or complex customers who are restricted to three broking firms: Aon, Marsh and WTW.[10]

47. If this is the case, the Proposed Acquisition would result in the number of broking firms available to this class of customers reducing from three to two (the merged entity and Marsh).

48. We continue to consider the level of competitive constraint that Marsh is likely to provide post-merger. We have heard mixed views from industry participants regarding the likely sufficiency of constraint from Marsh.

 48.1 To date, all customers we have spoken with view Marsh as capable of meeting their needs due to its scale, global reach, established New Zealand presence, and expertise regardless of risk type.

 48.2 Some large customers have voiced concern about the lessening of competition resulting from the Proposed Acquisition. For example, a large commercial insurance customer told us that it is planning to conduct an RFP next year and would be concerned if only Aon and Marsh were left as viable contenders.

 48.3 Other customers have been less concerned, despite acknowledging that the Proposed Acquisition would reduce the number of brokers available to them. The possible reasons for this are discussed below.

49. An important consideration regarding evidence from customers is that, on the whole, they do not appear to be overly sensitive to the price they pay for brokerage services. This seems to be because customers:

 49.1 tend to view brokerage costs as a small proportion of their overall insurance costs;

 49.2 do not always have a clear understanding of how much they pay their broker;

[10] As noted, we are still investigating how best to define this class of customers.

49.3 tend to perceive that a good broker can significantly reduce their overall insurance costs by negotiating a favourable insurance arrangement with lower premiums; and

49.4 tend to place significant value on the ongoing relationship with, and services provided by, their broker, such as claims management and advisory services.[11]

50. Several customers have indicated that they would be reluctant to switch brokers and would be unlikely to seek out an alternative in response to an increase in brokerage costs alone. Rather, customers tend to cite a significant increase in their overall insurance costs (of which premium makes up the vast majority), or a drop in the quality of service provided by their broker, as possible reasons to consider switching. Therefore, we currently consider that brokers are likely to compete more on quality of service than on brokerage price.

51. This stickiness and low level of brokerage cost sensitivity may suggest that any lack of customer concern about a reduction in the number of available brokers from three to two should be viewed cautiously. Further, we note that even if Marsh is currently providing an effective competitive constraint on Aon and WTW, this may not necessarily continue to be the case post-merger. For example, Marsh could see a shift in customer demand post-merger, which may allow it to increase its prices or reduce service quality, since there would be less dynamic competitive pressure in the market.

Constraint from Crombie currently unclear

52. In addition to the three global brokers referred to above, we are considering the extent of competition provided by a fourth, Crombie. Crombie is a large New Zealand broking firm with a network of branches throughout New Zealand. In 2017 it was acquired by Gallagher, which Crombie describes as the fourth largest global insurance broking, risk management and consulting firm.[12]

53. To date, evidence has been mixed regarding the constraint that Crombie is likely to provide post-merger. Crombie describes itself as: [13]

53.1 having a specialist corporate broking team which has experience in advising institutional and corporate customers; and

53.2 able, with Gallagher's global backing, to source underwriting both locally and internationally from a position of strength.

54. However, our market inquiries to date have suggested that Crombie may not currently have the necessary scale, expertise and/or global reach to allow it to compete across all customers regardless of size and complexity. It appears that some

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11 We understand that broking contracts can be relatively long (3-5 years) and relationships between some brokers and clients can extend into decades.

12 www.crombielockwood.co.nz/about/our-company/gallagher/

13 www.crombielockwood.co.nz/corporate/

customers may not regard Crombie as a genuine alternative to Aon, Marsh and WTW.

55. We continue to investigate the degree of constraint that Crombie is likely to provide post-merger. We invite submissions on this issue, particularly:

55.1 whether Crombie's position as part of Gallagher would make it a viable alternative to the merged entity for large and/or complex commercial customers; and

55.2 how easily Crombie could expand the range and scope of the services it provides.

Constraint from new entry and expansion appears unlikely

56. At this stage, it appears unlikely to us that the merged entity would be constrained by the threat of new entry. Any entrant would require sufficient scale, expertise, global reach, and New Zealand presence to compete effectively for large and/or complex customers. We have not seen evidence that any such entry is likely to occur within a sufficient timeframe to prevent a substantial lessening of competition.

57. Nor do we consider it likely, for similar reasons, that any smaller New Zealand firms are likely to expand to constrain the merged entity (excluding Crombie which, as discussed, may provide some degree of constraint).

58. As described in the Importance of Data section below, we have also been considering the potential impact of the combination of the Merging Parties' datasets and/or data analytics capabilities. At this stage, these considerations appear relevant to the potential for the Proposed Acquisition to raise barriers to entry or expansion.

Other proposed competitive constraints may be insufficient

59. Aon submitted that the merged entity would be constrained by the ability of customers to bypass brokers and purchase commercial insurance directly from insurance companies (disintermediation).[14]

60. However, evidence from industry participants suggests that disintermediation is unlikely to provide a material constraint. Customers, particularly those with more complex risk portfolios, tend to rely on brokers for a broad range of services such as risk analysis/modelling, negotiating cover with insurers, arranging and administering programs comprising multiple insurers, and claims management. Bringing such services in house appears to be cost-prohibitive for most customers. Further, when the costs of doing so are compared to the cost of using a broker (which, as noted, customers tend to view as a small proportion of their overall insurance costs) we consider it unlikely that customers would have the incentive to disintermediate brokers.

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[14] Application at [156]-[159].

61. Aon also submitted that customers could exercise substantial countervailing power by:[15]

    61.1 controlling their engagement with brokers;

    61.2 purchasing broking services offshore; and/or

    61.3 reducing their reliance on brokers through, for example, use of captives (self-insurance).

62. To date, we have not seen evidence that customers would be able to use these methods to discipline an increase in price or reduction in service quality. As already noted, customers appear to value their broker having both global reach and a New Zealand presence. They do not tend to regard acquiring broking services offshore as a feasible option.

63. Some large organisations do make use of captives as part of their insurance arrangements. However, captives do not appear to significantly reduce reliance on brokers. Rather, captives are typically used to diversify a customer's risk portfolio and reduce the amount of risk it needs to place on the insurance market – thereby reducing exposure to volatile insurance premium pricing. Such a strategy does not completely remove the need to engage with traditional insurers (via a broker), since this would require the customer to take on too much risk. We are not aware of any firms that use captives for all their commercial insurance. Moreover, customers typically rely on brokers to advise them on the use of captives and to assist in setting up and managing a captive.

Reinsurance

64. For the reasons set out below, the Commission is not currently satisfied that the Proposed Acquisition would not be likely to substantially lessen competition in the supply of broking and associated services for reinsurance.

Possible reduction from three to two reinsurance brokers

65. As discussed above in the Market Definition section, we currently consider that the relevant reinsurance broking market may exclude direct sales. If this the case, it appears likely that the Proposed Acquisition would result in a reduction in available reinsurance brokers from three to two.

66. We have received consistent feedback from market participants that Aon, WTW and Marsh are the only brokers that have the expertise and global reach to meet the needs of New Zealand cedents looking to transfer risk by treaty onto the global reinsurance market. Cedents do not tend to regard other brokers, including other overseas brokers, as adequate alternatives, since they do not have the same level of access to reinsurers and have less bargaining power and expertise when dealing with claims or disputes.

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[15] Application at [160]-[174].

67. Despite this, we have received mixed views from cedents regarding their views on the Proposed Acquisition. For example:

67.1 one cedent expressed some concern about the reduction in available brokers, but said that it was not business critical since it would still be able to run an RFP involving the two remaining competitors if necessary;[16]

67.2 another cedent told us that the Proposed Acquisition would mean there would essentially be a duopoly post-merger, but was confident that its current broker would still look after its interests as a reinsurance customer;[17] and

67.3 a further cedent acknowledged that the Proposed Acquisition would reduce the number of brokers competing for its business but did not express significant concern about its ability to conduct a competitive RFP process.[18]

68. Like commercial insurance customers, it appears that reinsurance cedents are somewhat 'sticky' and are unlikely to be overly sensitive to the brokerage fee that they are charged. This is in part because brokerage fees make up a small part of cedents' overall reinsurance costs, and in part because cedents tend to value the relationship with their broker and the in-depth business knowledge that is built up over time. For example, one cedent advised that changing reinsurance brokers would be like changing GPs, since it is very important for the broker to have a high level of familiarity with the cedent's business.[19] This low broking cost sensitivity and reluctance to switch may go some way to explaining any lack of concern about a reduction in the number of alternative reinsurance brokers available.

Constraint from new entry and expansion appears unlikely

69. For similar reasons as those described above for commercial insurance broking, we do not currently consider that the merged entity is likely to be constrained by the threat of new entry. To compete effectively, an entrant in New Zealand would need to attain the global reach, expertise, and (re)insurance industry relationships necessary to arrange complex treaty reinsurance programs. We have not seen evidence that this is likely to occur in time to pose a meaningful constraint on the Merging Parties.

70. We have also been considering the potential impact of the combination of the Merging Parties' datasets and/or data analytics capabilities on barriers to entry and expansion. We discuss this further in the Importance of Data section below.

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16 Commerce Commission interview with [ ] (9 November 2020).

17 Commerce Commission interview with [ ] (9 November 2020).

18 Commerce Commission interview with [ ] (24 November 2020).

19 Commerce Commission interview with [ ] (9 November 2020).

Other proposed competitive constraints may be insufficient

71. Aon submitted that cedents exercise a substantial degree of countervailing power as sophisticated participants in the global reinsurance industry and can:[20]

 71.1 bypass brokers and acquire reinsurance directly;

 71.2 consolidate insurance liabilities and acquire reinsurance broking in multiple jurisdictions; and

 71.3 use co-broking, captives, and/or alternative capital as alternatives to traditional reinsurance.

72. We continue to investigate the degree of countervailing power likely to be exercised by cedents. However, market inquiries to date have not suggested that cedents would be able to materially constrain the merged entity through using such methods. As noted, cedents rely on brokers' expertise to arrange reinsurance programs on global markets. Captives and alternative capital appear to be, at best, ways for cedents to diversify their reinsurance arrangements, and would not remove the need to obtain traditional reinsurance as well. Similarly, co-broking and consolidation of liabilities still require access to brokers and would not increase the options available to cedents in this regard.

73. Aon also submitted that the merged entity would face constraint from insurtech platforms (which offer data-driven pricing models).[21] While we continue to assess this claim, we have not seen evidence that insurtechs are likely to provide a viable alternative to using brokers in the near future.

Group benefits

74. For the reasons set out below, the Commission is not currently satisfied that the Proposed Acquisition would not be likely to substantially lessen competition in the supply of broking and associated services for group benefits.

Possible high concentration depending on market definition

75. In general, market participants have not expressed major concerns about the potential impact of the Proposed Acquisition on competition in the distribution of group health and welfare benefits. The principal reason for this appears to be the presence of Southern Cross, which sells group health insurance directly to customers.

76. However, as discussed in the Market Definition section, we are considering whether it may be appropriate to assess the distribution of group life and disability benefits separately from group health benefits. If this is the case, the life and disability

20 Application at [201]-[237].
21 Application at [238]-[241].

market may exclude direct sales,[22] and the market share of the merged entity is likely to be higher than suggested in the Application as a result.

77. Therefore, the extent of our competition concerns in relation to group benefits is likely to be significantly impacted by:

    77.1 whether there is a separate market for the supply of broking services for group life and disability benefits; and

    77.2 if so, the extent of competitive constraint that WTW would be likely to provide in this market in the without-the-merger scenario (since the Proposed Acquisition would result in the removal of this constraint).

78. We are still gathering evidence on both these points and invite submissions from the Merging Parties and other interested parties.

Importance of data

79. We are investigating the importance of data and data analytics to the Merging Parties and their competitors.

80. Aon described a key aspect of the rationale for the transaction as being the combination of the Merging Parties' data analytics capabilities.[23] Other market participants have also described the ability to harness customer data as an important component of competitive dynamics in broking markets going forward.

81. To date, the Commission has been considering whether the combination of the Merging Parties' datasets and/or data analytics expertise may raise barriers to rivals seeking to enter or expand in commercial insurance and/or reinsurance markets.

82. We have not seen evidence to date to suggest that the Proposed Acquisition would be likely to significantly increase data-related barriers to entry. However, the Commission remains alive to the potential importance of data, and data analytics, to competition in the relevant markets generally – from both a unilateral and coordination perspective.

83. We invite further submissions on the importance of data and data analytics to market participants, including in relation to:

    83.1 the importance of these to future competition in the relevant markets; and

    83.2 the extent to which the Proposed Acquisition may in any way raise barriers to entry or expansion for rivals.

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[22] As discussed in the Market Definition section, we have heard that the distribution of group life and disability benefits occurs mainly through brokers.

[23] Application at [36]-[37].

Competition concern: Coordinated effects

84. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all, or some, of its remaining rivals to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase across a market. Unlike unilateral effects, which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[24]

85. Aon submitted that the relevant markets do not display any of the structural features that would potentially facilitate coordinated conduct and that the Proposed Acquisition would not increase the likelihood of coordinated effects.[25]

86. For the reasons set out below, we are not currently satisfied that (re)insurance broking markets are not vulnerable to coordination, or that the Proposed Acquisition would not be likely to change conditions in one or more relevant markets to make coordination more likely, more complete or more sustainable.

Market vulnerability to coordination

87. We have identified some features of commercial insurance and reinsurance broking markets which we consider may make them vulnerable to coordination. We invite submissions on the extent to which these conditions may make any relevant market(s) vulnerable to coordination.

Existing market concentration

88. As discussed, our preliminary view is that there may be only three large competitors in some of the relevant markets (the Merging Parties and Marsh). A small number of competitors can increase the likelihood of coordination, particularly in the absence of a particularly vigorous competitor or strong competition from outside any coordinating firms.[26] We have not seen sufficient evidence to date that such a competitor is likely to be present, though we note that we are still exploring the likely extent of constraint from Crombie in the commercial insurance market(s).

89. Further, and as noted, we do not currently consider new entry to be likely in the near future in the relevant (re)insurance markets, due to barriers relating to the need for sufficient scale, expertise, global reach, and New Zealand presence[27] to compete effectively for large and/or complex clients. Therefore, at this stage it appears to us that:

    89.1 the relevant markets would likely remain concentrated following the Proposed Acquisition; and

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[24] Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019) at [3.84].
[25] Application at [257].
[26] Commerce Commission, *Mergers and Acquisitions Guidelines* (July 2019) at [3.89].
[27] For commercial insurance. As noted, competition in reinsurance broking may occur on a global basis and a New Zealand presence is likely to be less important.

89.2 any coordination is unlikely to be prevented by new entry or the threat of it occurring.

Competition through tenders

90. Competition between insurance brokers, particularly for large customers and cedents, often occurs through tender processes. This may mean that competing brokers interact and/or observe one another's behaviour more frequently, and to a greater extent than they would otherwise, which could in turn increase market transparency and facilitate information exchange. We note that our market inquiries to date appear to suggest that tenders predominantly involve quality competition between competing brokers, rather than price competition.

91. We are considering whether the ongoing use of tenders by large customers/cedents may allow competitors to form a tacit[28] understanding:

91.1 to reduce the quality of their service offerings; and/or

91.2 not to outbid each other or offer insurance broking services below a certain price point in particular markets.

92. For example, it is possible that insurance broking firms could form a tacit customer allocation understanding through observing the outcomes of tenders over time. If competitors observe that there is little benefit in competing more vigorously for each other's customers, this could ultimately lead to weaker competition in the relevant market(s).

Industry relationships and market transparency

93. Frequent market interactions and multi-market contact make the sustainability of a coordinated outcome more likely, as any attempt to deviate from the coordinated outcome is more likely to be detected and punished.

94. The evidence we have received so far from our market inquiries suggests that there may be frequent movement of brokers between firms. This may have the potential to increase information sharing between competing insurance broking firms. Further, there is evidence that broking firms frequently conduct research on the activities of their competitors and have knowledge and visibility of competitors' pricing and customer strategies, thereby increasing transparency in the relevant markets.

95. We also note that the Merging Parties and their major competitors are all represented on the Insurance Brokers Association of New Zealand (IBANZ).

[28] Explicit coordination can also arise if competitors engage in bid rigging through predetermining an outcome that favours the coordinating brokers.

Effect of the Proposed Acquisition

Commercial and reinsurance broking markets

96. We are not currently satisfied that the Proposed Acquisition would not change conditions in the commercial insurance and/or reinsurance broking markets so that coordination is more likely, more complete and/or more sustainable.

Increase in market concentration

97. The Proposed Acquisition would lead to further concentration across the commercial and reinsurance insurance broking markets. As discussed, we currently consider that there may be a reduction in the number of competitors in some of these markets from three to two.

98. This change in market structure could make it easier to establish and sustain coordinated conduct because it is easier to coordinate with only one significant rival than with two. As discussed, we do not currently consider that any coordination would likely be disrupted by entry or expansion.

99. Regardless of how competition occurs (i.e. through tenders or otherwise), any coordination is likely to become easier to establish and sustain with fewer competitors in the market. In a highly concentrated market, firms may also have less incentive to deviate from a coordinated outcome.

Marsh and the merged entity may be more symmetric

100. Aon submitted that competitors vary substantially in size, background, cost structures and global footprint.[29] However, we are considering whether the Proposed Acquisition could increase the degree of symmetry between the merged entity and Marsh, which may make coordination more likely.

101. By adding WTW's market share, the Proposed Acquisition would increase Aon's scale and geographic footprint. If the merged entity and Marsh were to become more similar in size, structure and/or footprint in one or more market(s), this could potentially make it make it easier for the merged entity and Marsh to establish and/or sustain coordinated conduct. An increase in market symmetry may have the potential to align incentives for firms to coordinate and make reaching a coordinated outcome easier.

102. We are still considering these issues and invite submissions on whether the Proposed Acquisition would be likely to make coordination more likely, more complete, or more sustainable in commercial insurance and/or reinsurance broking markets.

Group benefits market/s

103. At this stage, it does not appear that we are likely to have coordination concerns in the group benefits market, provided it is not necessary to adopt a narrower market definition than that proposed in the Application. Our market inquiries to date appear

29 Application at [257.5].

to suggest that the Merging Parties and other brokers compete directly with insurers such as Southern Cross in this market, which we consider likely to reduce opportunities for coordination.

104. However, as noted above, the extent of our competition concerns in relation to group benefits is likely to be significantly impacted by whether there is a separate market for the supply of broking services for group life and disability benefits.

105. We are still gathering evidence on this issue and we invite submissions from the Merging Parties and other interested parties on the vulnerability of any group benefits broking market(s) to coordination.

Next steps in our investigation

106. The Commission is currently scheduled to decide whether or not to give clearance to the Proposed Acquisition by 26 February 2021. However, this date may change as our investigation progresses.[30] In particular, if we need to test and consider the issues identified above further, the decision date may be extended.

107. As part of our investigation, we are identifying and contacting parties that we consider will be able to help us assess the issues identified above.

Making a submission

108. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Acquisition. We welcome any further evidence and other relevant information and documents that the Merging Parties or any other interested parties are able to provide regarding the issues identified in this SoI.

109. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Aon/WTW" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **26 January 2021**.

110. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would be likely to unreasonably prejudice the commercial position of the supplier or subject of the information.

[30] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.