

Determination

Re IAG (NZ) Holdings Limited and AMI Insurance (Operations) Limited [2012] NZCC 6.

- The Commission:** Dr Mark Berry
Sue Begg
Anita Mazzoleni
- Summary of application:** The application by IAG (NZ) Holdings Limited to acquire certain business assets of AMI (being all assets related to AMI's current insurance business excluding AMI's Canterbury earthquake liabilities), through subscription to 100% of the shares in a newly created company, AMI Insurance (Operations) Limited.
- Determination:** Pursuant to s 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for IAG (NZ) Holdings Limited to acquire certain business assets of AMI (being all assets related to AMI's current insurance business excluding AMI's Canterbury earthquake liabilities), through subscription to 100% of the shares in a newly created company, AMI Insurance (Operations) Limited.
- Date of determination:** 29 February 2012

Confidential material in this report has been removed. Its location in the document is denoted by [].

The proposal

1. A notice under s 66(1) of the Commerce Act 1986 (the Act) was registered on 20 December 2011. The Notice sought clearance for IAG (NZ) Holdings Limited (IAG or the Applicant) to acquire certain business assets of AMI (being all assets related to AMI's current insurance business excluding AMI's Canterbury earthquake liabilities), through subscription to 100% of the shares in a newly created company, AMI Insurance (Operations) Limited (AMI Newco).

The decision

2. The Commission considers that the markets relevant to its consideration of this application are:
 - 2.1 The national market for domestic house and contents insurance;
 - 2.2 The national market for domestic motor vehicle insurance;
 - 2.3 The national market for the provision of windscreen repair services; and
 - 2.4 The national market for the provision of collision repair services.
3. The Commission considers that competition from existing domestic insurance companies, coupled with the competitive constraint provided by bank insurance distributors, is likely to be sufficient to constrain the merged entity. The Commission also considers that the proposed acquisition is unlikely to strengthen the buying power of the merged entity in the windscreen/repair and collision repair markets sufficiently to enable it to exercise market power. Accordingly, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in any of the relevant markets.

Procedure

4. Section 66(3) of the Act requires the Commission to either clear or decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and IAG. Accordingly, a decision on the application was required by 29 February 2012.
5. The Commission's approach to analysing the proposed acquisition is based on principles set out in the Commission's Mergers and Acquisitions Guidelines.¹

Analytical framework

6. The Commission uses an analytical framework for assessing a substantial lessening of competition in the context of an acquisition. An important tool in this assessment is the determination of the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target, and then

¹ Commerce Commission *Mergers and Acquisitions Guidelines* (2004).

considers what, if any, products and geographic regions, constitute relevant close substitutes from both a customer's and a supplier's point of view.

7. The Commission uses a forward-looking type of analysis to assess whether a substantial lessening of competition is likely, so an important subsequent step is to establish the appropriate hypothetical future with and without scenarios, defined as the situations expected:
 - 7.1 With the acquisition (the factual);and
 - 7.2 Without the acquisition (the counterfactual).
8. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.²
9. The High Court³ has noted that:

Because "likely" means something less than "more likely than not", there may be more than one "likely" counterfactual.... We consider that where there is more than one real and substantial counterfactual it is not a case of choosing the one that we think has greater prospects of occurring....We are to discard those possibilities that have only remote prospects of occurring. We are to consider each of the possibilities that are real and substantial possibilities. Each of these real and substantial possibilities become counterfactuals against which the factual is to be assessed.
10. The Court further noted that:⁴

If in the factual, as compared with any of the relevant counterfactuals competition is substantially lessened then the acquisition has a "likely" effect of substantially lessening competition in a market.
11. Accordingly where there is more than one potential counterfactual, the Commission assesses the possibilities, discards those that have only remote prospects of occurring, and considers each of the real and substantial possibilities as counterfactuals against which the factual is to be assessed.
12. A comparison of the extent of competition in the relevant markets in the factual and counterfactual scenarios enables the Commission to assess the probable extent of the lessening of competition under the proposed acquisition, and whether that contemplated lessening is likely to be substantial.

Industry Background

Distribution of Insurance Products

13. Insurance products are distributed through 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 such as house, contents, and motor vehicles. Traditionally, insurers have relied upon branches, agents and brokers to sell their products. More

² *New Zealand Electricity Market* (Commerce Commission Decision 277, 1996), at p 16.

³ *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 at 116, 118 and 122.

⁴ *Ibid* at 122. This view was not challenged before the Court of Appeal.

recently however, insurance companies have 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 suggest there will be greater use of this medium in the future.

Brokers

14. Brokers are an intermediary service between the insurance company and the customer. Brokers generally specialise in a particular form of insurance (eg commercial), and act 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.

Banks

15. Trading banks are active in insurance markets in that they re-sell or distribute a range of insurance products (including house, contents, and motor vehicle policies), through their branch networks and customer interactions. None of the banks currently distributing insurance products in New Zealand underwrite the policies they sell. Instead, the banks will contract with an underwriter to distribute their product. In some instances the products offered are standard policies re-branded with the bank's logo, with the banks receiving a commission on sales, but some banks [] have a much greater involvement in the design of the product and receive a share of profits as well as a commission.
16. The insurance policies sold through the banks carry the bank's brand but all of the claims management services are carried out by the underwriting company. Banks generally offer insurance products as an adjunct to other financial services, in particular, mortgage lending.

Reinsurance

17. 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.

The Canterbury Earthquakes

18. In September 2010 and February 2011, the Canterbury region experienced significant earthquakes which resulted in significant damage and loss of life. The Insurance Council of New Zealand has estimated that the cost of the earthquakes will exceed \$10 billion.
19. As a result of claims resulting from the earthquakes, and the higher perceived risk of earthquakes in New Zealand, insurance companies are under pressure. Insurance companies are now facing considerably higher re-insurance costs in order to meet the requirements of the new regulatory regime (see paragraphs 84 to 85).

Background to the transaction

20. In early 2011, AMI determined that the size of the insured losses stemming from the September 2010 and February 2011 earthquakes in Canterbury would exceed its available reinsurance cover and require a considerable injection of capital. AMI therefore approached the New Zealand Government (the Crown) requesting assistance to allow it to continue trading.
21. In April 2011, AMI entered into a capital support arrangement (the Crown Support Deed) with the Crown whereby the Crown would provide a \$500 million capital facility to AMI. In return, the Crown obtained redeemable, convertible, called but unpaid shares in AMI (the convertible shares). In addition to the convertible shares, the Crown also obtained two ordinary shares which had special rights attached to them. These ordinary shares gave the Crown the ability to appoint an independent director to the board of AMI, and (in certain circumstances), the right to assume control of AMI.
22. During the latter half of 2011, AMI began the process of seeking a strategic investor in AMI in order to release the Crown from its obligations and to secure the ongoing future of the company. A tender process was initiated with IAG ultimately the successful purchaser.
23. Under the terms of the agreement entered into by IAG, the insurance business of AMI will be split into two separate companies:
 - 23.1 AMI (Operations) NZ Limited (AMI Newco), which constitutes all of the assets and operations of AMI Insurance but excludes those liabilities resulting from the 2010 and 2011 Canterbury earthquakes. This company will be owned by IAG; and
 - 23.2 AMI Insurance NZ Limited, which constitutes the liabilities resulting from the 2010 and 2011 Canterbury earthquakes. This company will be owned by the Crown, with IAG providing claims management and related services under a Deed of Undertaking entered into with the Crown.

Key parties

IAG

24. IAG is a large, Australian based general insurer which offers both personal and commercial insurance products. In New Zealand it provides personal insurance products (including house, contents, and motor vehicle insurance), through two main brands, NZI and State.
25. IAG distributes its State branded products directly to the customer, and its NZI brand is distributed through brokers. IAG also distributes its products through other intermediaries such as motor vehicle dealers, banks, and other financial service providers.

AMI

26. AMI is a large, New Zealand based general insurer offering a range of personal insurance products including house, contents, motor vehicle, and boat insurance. AMI distributes its insurance products direct to the customer through a nationwide network of branches and agencies, as well as through online and 0800 number channels.

Other parties

Vero

27. The Vero Insurance New Zealand Group (Vero) is owned by the Suncorp Group and provides a range of insurance and risk management services, including commercial, health, personal, motor vehicle, liability and marine insurance products.
28. Vero is a fully intermediated business which means that it does not sell its products direct to the customer. Instead, Vero's products are sold through brokers and other intermediaries, including [].

AA Insurance

29. AA Insurance is a joint venture insurance company owned by the Suncorp Group (68%) and the NZ Automobile Association (32%). AA Insurance provides house, contents, and motor vehicle insurance through a nationwide network of AA branches, and a national call centre and internet presence.

Lumley

30. Lumley (part of the Australian owned Wesfarmers Group) is a personal and commercial insurance underwriter which distributes its products predominantly through brokers and other intermediaries, including Westpac Bank.

Tower

31. Tower Insurance was formed in 1869 as a Government department selling life insurance policies and pensions. In New Zealand, Tower provides a range of personal insurance products including life, health, travel, house, contents, and motor vehicles. In addition, Tower provides retail and wholesale funds management services such as Kiwisaver.

Market definition

32. The Commission considers the relevant markets for the assessment of this application are:
- 32.1 The national market for domestic house and contents insurance;
 - 32.2 The national market for domestic motor vehicle insurance;
 - 32.3 The national market for the provision of windscreen repair services; and
 - 32.4 The national market for the provision of collision repair services.

33. The Act defines a market as:⁵
- a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
34. For the purpose of competition analysis, the internationally accepted approach is to assume the relevant market is the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant (the SSNIP test). The smallest space in which such market power may be exercised is defined in terms of the dimensions of the market discussed below.

General Insurance

Previous decisions

35. The Commission last considered general insurance products in *CGU Plc and Norwich Union Plc*.⁶ In that decision, the Commission defined the relevant markets in a way that corresponded to the different products offered by the insurance industry, namely:
- 35.1 Domestic house and contents insurance;
 - 35.2 Domestic motor vehicle insurance;
 - 35.3 Commercial motor vehicle insurance;
 - 35.4 Commercial liability insurance; and
 - 35.5 Commercial property insurance.
36. The Commission also considered that the relevant markets were national in scope as there was considerable uniformity of insurance products available throughout the country. Many appeared to have a physical presence in the major metropolitan and regional centres, and all of the parties were accessible nationally by telephone, fax and the internet.
37. The Commission has considered whether or not the current market situation, particularly in the Christchurch region, would suggest a separate Christchurch or Canterbury market. All of the insurance companies spoken to by the Commission indicated that they were not underwriting any new house or contents policies in Christchurch at the current time and that this position will continue until aftershocks diminish.
38. Given that all of the insurance companies are unwilling to provide new house or contents policies to Christchurch customers, the Commission considers that a national market is appropriate. In addition, in the present case, the Commission

⁵ Section 3(1A) of the Act.

⁶ *CGU Plc and Norwich Union Plc* (Commerce Commission Decision 391, 2000).

considers that there have not been any significant changes that would cause it to depart from the previously defined insurance markets.

39. As outlined above, the provision of personal general insurance products can be delineated into an underwriting component and a distribution component (sale to the customer). AMI and IAG operate at both of these levels, whilst other insurers (such as Lumley) provide only the underwriting component.
40. The Applicant submitted that it is appropriate for the Commission to consider the underwriting and distribution components together. In *AMP Limited and AXA Asia Pacific Holdings Limited*,⁷ the Commission did not define separate markets for the underwriting and retail supply of wealth protection insurance products and services. The Commission considered that it was possible to define separate underwriting and retail distribution markets but to do so would not materially change the analysis of the competitive effects of the acquisition.
41. In the present case, the Commission intends to consider the underwriting and distribution components together when assessing the competition effects of the proposed acquisition. This is because the conclusions reached are unlikely to be different if the underwriting and distribution components were considered separately.

Related markets

42. The proposed acquisition will result in aggregation in the national market for domestic motor vehicle insurance. As a consequence of this aggregation the Commission considers that the acquisition may impact on one or more downstream markets, namely those for the provision of motor vehicle repairs.
43. Broadly speaking, motor vehicle repairs undertaken as a consequence of an insurance claim can be broken down into two main types: repair/replacement of windscreens, and general collision repair.

Windscreen repair/replacement

44. The Commission has previously considered that the retail markets for the repair and replacement of automotive glass are a series of regional markets with similar characteristics and that it is appropriate to consider separate national markets for windscreen repair and windscreen replacement.⁸
45. The provision of windscreen repair/replacement services in New Zealand is dominated by two main firms; Smith & Smith Autoglass, and Novus Autoglass. There are also a number of smaller firms offering windscreen repair and replacement services.
46. In the present case, the Commission considers that for the purposes of assessing the competition effects of the proposed acquisition it is appropriate to consider

⁷ *AMP Limited and/ AXA Asia Pacific Holdings Limited* (Commerce Commission Decision 694, 2010).

⁸ *Carglass (NZ) Limited and Smith and Smith Limited* (Commerce Commission Decision 319, 1998).

windscreen repair and replacement together. The analysis of the competition effects of the proposed acquisition are likely to be the same if the Commission were to consider the windscreen repair and replacement markets separately.

Collision repair

47. The Commission considers that collision repair markets share similar characteristics to windscreen repair markets. The key difference is that instead of two relatively large nationwide operators, and a number of smaller operators, the collision repair industry is characterised by a large number of small participants, operating within narrow geographic areas. Also, the provision of collision repair services encompasses a wide range of services including panel repair, mechanical repair, parts replacement, and painting.
48. The Commission considers that the analysis of the competition effects of the proposed acquisition is likely to be the same in the present case, whether analysed on a regional or national basis. The Commission also considers it is appropriate to consider the different collision repair services together as the issues are consistent across the different collision repair services.

Conclusion on market definition

49. The Commission considers that the relevant markets for considering the competition effects of the proposed acquisition are the national markets for:
 - 49.1 Domestic house and contents insurance;
 - 49.2 Domestic motor vehicle insurance;
 - 49.3 Windscreen repair and replacement; and
 - 49.4 Collision repair services.

Factual/counterfactual

Factual

50. With the acquisition, AMI's operations would be separated into two companies.
 - 50.1 AMI (Operations) NZ Limited, which constitutes all of the assets and operations of AMI Insurance but excludes those liabilities resulting from the 2010 and 2011 Canterbury earthquakes. This company will be owned by IAG.
 - 50.2 AMI Insurance NZ Limited, which constitutes the liabilities resulting from the 2010 and 2011 Canterbury earthquakes. This company would be owned by the Crown, with IAG providing claims management and related services under a Deed of Undertaking entered into with the Crown.

Counterfactual

51. [].
52. [].
53. Mr Park said that without the acquisition [].
54. As noted, the term of the Crown Support Deed is for [].
55. All three of the scenarios outlined above represent the sale of AMI to a third party []]. Mr Park informed the Commission that []].
56. [].
57. The Commission considers that without the acquisition, AMI will be split into two separate companies, with the Canterbury Earthquake liabilities being owned by the Crown and the remaining assets and operations of AMI being offered for sale to a third party.

Competition analysis

Domestic house, contents, and motor vehicle markets

58. The Applicant submitted that post-acquisition, it would continue to face constraint in both the domestic house and contents market, and the domestic motor vehicle market from:
- 58.1 Existing competitors: Tower, Lumley and Vero/AA Insurance;
 - 58.2 The increased competition at the retail level from AA Insurance and the major banks; and
 - 58.3 The low cost to the consumer of switching to an alternative insurance provider.
59. Having considered the competition effects of the proposed acquisition, the Commission is satisfied that the proposed acquisition will not have, or would not be

likely to have, the effect of substantially lessening competition in either the domestic house and contents market or the domestic motor vehicle market. The Commission considers that the presence of strong existing competition, coupled with the competitive tension provided by the major banks, is likely to be sufficient to constrain the merged entity.

Existing competition

60. Table 1 outlines the market shares for the major firms in the domestic house and contents, and motor vehicle markets in New Zealand.

Table 1: Market share estimates for Domestic House and Contents and Motor Vehicle Markets 2011

Party	Domestic House and Contents		Domestic Motor Vehicle	
	GWP ⁹ (\$)	%	GWP (\$)	%
IAG	\$ []	[]%	\$ []	[]%
AMI	\$ []	[]%	\$ []	[]%
Merged entity	\$ []	[]%	\$ []	[]%
Vero (Including AA volumes)	\$ []	[]%	\$ []	[]%
Tower	\$ []	[]%	\$ []	[]%
Lumley	\$ []	[]%	\$ []	[]%
FMG	\$ []	[]%	\$ []	[]%
Other	\$ []	[]%	\$ []	[]%
Total	\$ []	100.00%	\$ []	100.00%

Source: Estimates from information provided by industry participants

61. Table 1 shows that post-acquisition the merged entity would have a market share in the house and contents market of [] and in the motor vehicle market of []%. In the factual, the next largest competitor in both markets would be [] with []% and []% respectively. In the house and contents market this creates a three firm concentration ratio of []%, and for the motor vehicle market a concentration ratio of []%.
62. The Applicant submitted that post acquisition, the merged entity would continue to face meaningful competition from a number of credible competitors including Vero, Tower and Lumley. It further submitted that customers are able to readily compare different insurance providers and that customers face little (if any) switching costs.
63. Tower submitted that the acquisition would remove existing close competition between AMI and IAG's State Insurance brand. Tower stated that AMI and State are the only two insurance companies that have a significant 'bricks and mortar' presence and that in the factual, the merged entity would face no significant competition for the sale of domestic insurance products through this means of distribution.

⁹ Gross Weighted Premium, the total premium less premium refunds and rebates.

64. The Commission understands that currently, AMI has approximately 94 branches or sales agencies throughout the country, State has 29 sales centres, Tower has three, and AA has 28. Therefore, the purchaser of AMI would have the majority of physical branch locations in both the factual and the counterfactual, irrespective of whether or not they currently have a physical branch network.
65. Both Tower and AA Insurance submitted that while consumers face limited costs in switching insurance providers, actual switching behaviour is low with the majority of customers choosing to stay with their existing insurer. [].
The Commission considers that while the number of customers switching is lower than those who shop around, it does indicate that customers have a choice of insurance provider. The Commission is of the view that this choice will remain in the factual.
66. The Commission considers that post acquisition, the existing competitors would be able to constrain any ability of the merged entity to raise prices or decrease quality. Vero, Lumley and Tower are significant, well resourced and established insurance companies with trusted and respected brands. The Commission also considers that consumers are able to switch insurance providers readily and at little or no cost. Industry participants informed the Commission that the percentage of customers who renew their insurance policies at renewal date is generally between 80% – 90%. This means that in any given year up to 20% of policy holders switch providers. The Commission considers that this switching behaviour is likely to continue in the factual.
67. Geoff Blampied, CEO of AON New Zealand (a large nationwide insurance broker) told the Commission [].
68. Brian Coleman of Allianz, a general insurer that offers a range of commercial and specialist domestic insurance products to the New Zealand market predominantly through brokers, stated [].
69. The Commission considers that while the acquisition would diminish customer choice of domestic insurer, there would remain sufficient existing competition in the factual to constrain the merged entity. The remaining competitors are well established and resourced companies with trusted insurance brands.
70. Further, the Commission considers that while switching rates appear to be low, customers can and do switch insurance providers readily.

Competitive constraint from banks

71. In some circumstances the potential for the merged entity to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a substantial lessening of competition.
72. The Applicant submitted that banks possess meaningful countervailing power due to the size of the insurance portfolios distributed by banks, and the ability that the banks have to switch to distributing an alternative underwriters product.
73. In *CGU Plc and Norwich Union Plc*,¹⁰ the Commission accepted that banks provide a degree of constraint over insurance companies due to their size, and because of their ability (and willingness) to change insurance underwriter readily if faced with a decline in service, quality or increased prices.
74. The Applicant informed the Commission that [] are worth in excess of [] Insurance companies spoken to by the Commission have noted that the position has been made clear by the Court of Appeal that in most cases (depending on contract terms) the customer database is the property of the insurance underwriter.¹¹
75. []
76. The banks interviewed by the Commission have stated that they consider brand protection and service quality to be the most important factors in their relationships with insurance underwriters. [] informed the Commission that the key factor which would prompt it to move to another insurance underwriter would be poor customer service from a claims management perspective. [] also noted that protection of the customer and [] brand is paramount.
77. ASB stated that []

¹⁰ *CGU Plc and Norwich Union Plc*, above n 6.

¹¹ In 2008, the National Bank attempted to terminate its relationship with its underwriter Tower and enter into a relationship with Vero. The parties could not agree on who was able to have access to customer information, and whether or not the National Bank could use that information to offer new, Vero – underwritten policies to its existing customers (who were insured by Tower). The Court of Appeal determined that while the customer was in effect ‘owned’ by Tower, the National Bank was able to approach those customers and offer them the alternative of insuring with Vero (*ANZ National Bank Ltd v Tower Insurance Ltd* (2010) 16 ANZ Insurance Cases 61-849).

78. All of the banks interviewed by the Commission were of the opinion that []. The Commission notes that while the majority of banks tend to stay with the same underwriter, there have been examples of banks switching underwriters. Further, the banks generally test the market on a [] basis to ensure that prices and service levels are competitive.
79. The Commission considers that in the factual, the major banks will continue to provide a level of competitive constraint on the merged entity through their ability to switch insurance underwriters and [].

Potential competition

80. An acquisition is unlikely to result in a substantial lessening of competition in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry. The Commission's focus is on whether businesses would be able to enter the market and thereafter expand should they be given an inducement to do so, and the extent of any impediments they might encounter should they try.
81. The Applicant submitted that there are no meaningful barriers to new entry into any of the relevant markets and that entry could come from three potential sources; new entry from one or more of the major banks, entry by an overseas insurer or expansion by a New Zealand based insurer into a complementary market (such as a commercial insurer).
82. The Commission considers that while barriers to entry are not significant, current market conditions make new entry into the New Zealand insurance market unlikely in the short to medium term due to the cost of re-insurance. However, the Commission considers that if the merged entity were to raise prices above the competitive level, specific new entry could occur.
83. As outlined in paragraphs 18 and 19, the New Zealand insurance industry is currently experiencing difficult times. The majority of companies are facing significant claims pressure as a result of the Canterbury earthquakes and the costs of obtaining and maintaining the appropriate level of reinsurance cover are increasing.
84. In addition, from March of 2012, a party wishing to carry on business as an insurer in New Zealand must comply with the new regulatory and prudential requirements. Among other things, an insurer must carry sufficient reinsurance or capital cover for a one in 1000 year event (previously the cover required was only for a one in 250 year event).
85. There are considerable similarities between the new regulatory environment and those operating overseas. The Commission understands that if a party is in compliance with the regulatory requirements in either Australia or the United Kingdom, they are deemed to be in compliance with the new requirements.

86. Allianz exited the house and contents market in late 2011 [].

87. The Commission is of the opinion that barriers to entry into personal insurance markets in New Zealand are not onerous, especially for an existing overseas or domestic insurer. However, while such entry could occur within a relatively short timeframe, entry is not likely in the short to medium term due to the current depressed market conditions, higher perception of risk due to the Canterbury earthquakes, and the increased cost of reinsurance.

Windscreen repair/replacement & collision repair markets

88. A potential theory of harm from the proposed acquisition is that the aggregation of IAG's and AMI's market share could give it monopsony¹² power. That is, if the proposed acquisition arrangements created, enhanced or maintained the merged entity's market power, it could depress the prices paid for windscreen repair/replacement and collision repair services to below the competitive level.

89. The Commission generally views lower prices favourably as lower prices are often to the long-term benefit of consumers. Increases in countervailing power are often associated with reduced prices. When buyers have greater negotiation power, for example through the ability to threaten to switch their custom to another supplier, they can often achieve lower prices. Further, countervailing power can often help constrain the exercise of a supplier's market power.¹³ Countervailing power can be efficiency enhancing if prices are pushed down closer to 'competitive levels'.

90. In this instance, if the merged entity had monopsony power it could refuse to pay competitive prices, leading to some collision repair or windscreen repair providers exiting the market. It could also result in a reduction in the scope, extent and quality of service.

Windscreen repair/replacement market

91. Industry participants informed the Commission that approximately 60% of motor vehicle claims (by volume) are for windscreen repair or replacement. This equates to approximately 10% by value. IAG estimates that the merged entity would account for approximately []% of windscreen repair/replacement sales.

92. The windscreen repair/replacement market in New Zealand is dominated by two large nationwide players, Smith & Smith Autoglass and Novus Windscreen Repairs. The majority of insurance companies operate a preferred supplier arrangement with a windscreen repairer and have a competitive tender process to set the price and

¹² Monopsony is the market power-equivalent on the demand side of the market to the monopolist on the supply side. See, for instance, D Carlton and J Perloff *Modern Industrial Organization* (2005), at p 107.

¹³ "The potential for a business to wield market power may be constrained by countervailing power in the hands of customers." Commerce Commission *Mergers and Acquisitions Guidelines* (2004), at p 31.

terms of the arrangement. []).

93. The Commission considers that the presence of two large nationwide windscreen repairers, as well as the merged entity's relatively low market share would be insufficient to substantially lessen competition in the windscreen repair/replacement market.

Collision repair market

94. A number of parties expressed concern to the Commission that the proposed acquisition would have an adverse impact on the market for collision repair services by driving down the time allowed to carry out repairs, removing the flexibility of AMI's current claim assessment process, and by directing AMI repair volumes through the IAG approved repairer network.
95. The Motor Trade Association submitted that the proposed acquisition would enable the merged entity to keep the cost of collision repairs to a minimum. They further submitted that this could lead to the exit of repairers or a decline in the quality of repairs.
96. Generally, when a claim is made under a motor vehicle insurance policy the customer will notify their insurer and then the vehicle will be taken to a repairer for assessment and repair. The majority of insurers have a network of repairers who they consider meet a certain standard but in most cases the customer is able to choose their own preferred repairer.
97. In the case of a claim made under an AMI policy, an AMI claims assessor will physically inspect the vehicle and determine the work required, and the time that the repair should take. If the repairer has concerns over the stipulated time then they are able to discuss that directly with the assessor.
98. When a claim is made under an IAG policy, however, the repairer takes digital photographs of the damage and submits them to a centralised assessment centre where an assessor views them and determines the work and time requirements. Where the repairer considers that more time is needed to complete the repair to the required standard, IAG will negotiate with the repairer over the time allowed.
99. Collision repairers spoken to by the Commission stated that the AMI model allows for flexibility and compromise over what needs to be done and the time that the repair should take. By contrast, the IAG system, which lacks the face-to-face interaction and on-site appraisal of the damage, does not allow for flexibility in repair time allowances. The Commission notes that the majority of insurance companies now use digital assessment tools similar to IAG.

100. The Commission recognises that in the factual, the merged entity would face incentives to minimise the cost of claims, even at the expense of lost premium income in the domestic motor vehicle insurance market.¹⁴
101. Currently, IAG accounts for approximately []% of sales in the collision repair market. The Commission estimates that this would increase to approximately []% in the factual. Typically, this would not be a sufficiently high market share to raise concerns over monopsony power and the Commission does not consider that this level of market share would enable the merged entity to depress prices for collision repair services below competitive levels, or to reduce the quality of repair work. This is because:
- 101.1 Collision repair service providers would continue to have the opportunity to compete for insurance work from other motor vehicle insurers, approximately []% of sales. In addition, there would be no major impact on non-insurance work (which makes up approximately 20% of sales in the collision repair market); this would remain open to all market participants.
- 101.2 Consumers would continue to have choice over their preferred repairer, and IAG will offer AMI's current approved repairer network the opportunity to become part of the IAG preferred repairer network.
- 101.3 While the merged entity would have the short term incentive to depress prices paid for collision repair services to below competitive levels, it would be unlikely to be able to sustain such prices in the long term. To do so would result in the exit of repairers from the market, or a decrease in the quality of repairs carried out. IAG is likely to face a reputational risk if it were to either force players out of the market, or to decrease the quality of repairs.
- 101.4 IAG currently provides a guarantee of the work carried out by its approved repairers. Therefore, it is incentivised to encourage its repairers to deliver the best service and quality to customers. This requires IAG to support its repairers with pricing that enables them to achieve such service outcomes.
- 101.5 As outlined in paragraphs 69 and 70, the Commission considers that there is strong existing competition in the domestic motor vehicle insurance market and that customers would switch to an alternative insurer if faced with declining claims quality.
102. The Commission concludes that the proposed acquisition is unlikely to strengthen the buying power of the merged entity such that the acquisition would result in a substantial lessening of competition in the collision repair market.

¹⁴ A number of insurance companies spoken to by the Commission highlighted the importance of managing claims costs in retaining profit margins.

Determination on Notice of Clearance

103. Pursuant to s 66(3)(a) of the Commerce Act 1986, the Commission determines to give clearance for IAG (NZ) Holdings Limited to acquire certain business assets of AMI (being all assets related to AMI's current insurance business excluding AMI's Canterbury earthquake liabilities) through subscription to 100% of the shares in a newly created company, AMI Insurance (Operations) Limited (AMI Newco).

Dated 29 February 2012

Dr Mark Berry
Chair

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