

## Statement of Preliminary Issues

### IAG (NZ) Holdings Limited / Lumley General Insurance (N. Z.) Limited

30 January 2014

#### Introduction

1. On 19 December 2013, the Commerce Commission received an application from IAG (NZ) Holdings Limited (IAG), seeking clearance to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited (Lumley).
2. The public version of the application is available on our website at: <http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/detail/807>
3. This Statement of Preliminary Issues outlines the key competition issues we currently consider will be important in deciding whether or not to grant clearance. The issues highlighted in this statement are based on the information available at the time of publication, and may change as our assessment of the application for clearance progresses. Therefore, the issues highlighted in this statement are not binding on us.
4. We invite interested parties to make comment on the likely competitive effects of the proposed merger and request that parties who wish to make a submission do so by **Friday 21 February 2014**.

#### The transaction

5. The application relates to IAG's proposed acquisition of Lumley. The transaction forms part of a wider acquisition by IAG's parent, Insurance Australia Group Limited, of the Australian and New Zealand insurance underwriting businesses of Lumley's parent, Wesfarmers Limited. Wesfarmers will retain ownership of Crombie Lockwood (NZ) Limited, which operates an insurance broking business in New Zealand, and Lumley Finance (N.Z.) Limited, which is a premium funding company specialising in short-term premium finance for clients of insurance brokers.

#### Relevant parties

##### The acquirer – IAG (NZ) Holdings Limited (IAG)

6. IAG is a wholly-owned subsidiary of Insurance Group Limited, an Australian general insurance company. In New Zealand, IAG offers a range of personal and commercial insurance products, including domestic home, contents and motor vehicle insurance, commercial motor vehicle and property, and marine cargo insurance. IAG supplies the majority of its products under the State, AMI and NZI brands.

## The target – Lumley General Insurance (N.Z.) Limited (Lumley)

7. Lumley is ultimately 100%-owned by Wesfarmers Limited, which is an ASX-listed company. In New Zealand, Lumley offers a range of commercial and personal insurance products, including commercial motor, property, marine and domestic house, contents and motor vehicle insurance, through brokers and other intermediaries.

## Our framework

8. As required by the Commerce Act 1986, we assess whether a merger is likely to result in a substantial lessening of competition. How we assess this is set out in our Mergers and Acquisitions Guidelines.<sup>1</sup>
9. We ask whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).<sup>2</sup>
10. A tool often used to assess competitive effects is market definition. Market definition provides a framework to help identify and assess the close competitive constraints the merged firm would likely face.<sup>3</sup> A market is defined in the Commerce Act as a market in New Zealand for goods or services as well as other goods or services that are substitutable for them as a matter of “fact and commercial common sense”.<sup>4</sup>
11. We define markets in the way that we consider best isolates the key competitive constraints on the merging parties. In many cases this may not require us to precisely define the boundaries of a market.
12. We analyse the extent of competition in each relevant market both with and without the merger to determine whether the merger would be likely to substantially lessen competition.
13. We assess the following three factors when considering whether this is likely to be the case.
  - 13.1 Existing competition – the degree to which existing competitors compete.

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<sup>1</sup> Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013. Available on our website at [www.comcom.govt.nz](http://www.comcom.govt.nz)

<sup>2</sup> *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

<sup>3</sup> *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 (HC), at [123]. *Brambles New Zealand Ltd v Commerce Commission* (2003) TCLR 868 (HC) at [137].

<sup>4</sup> Similarly, the courts have said that “[t]he boundaries of the market are defined by substitution between one product and another and between one source of supply and another, in response to changing prices”. See *Commerce Commission v New Zealand Bus Limited* (HC), above n 3 at [123] citing *Re Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,247.

- 13.2 Potential competition – the extent to which existing competitors would expand their sales or new competitors would enter and compete effectively if prices were increased.
  - 13.3 The countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser’s ability to exert substantial influence on negotiations.
14. A comparison of the extent of competition both with and without the merger enables us to assess the degree by which the proposed merger might lessen competition. If the lessening is likely to be substantial, we may not give clearance to the proposed merger.

### **Preliminary issues**

- 15. We will investigate the prospect of the proposed merger to substantially lessen competition in the relevant markets.

### **Market definition**

#### *Product dimension*

- 16. The proposed acquisition involves overlap in the supply of a range of personal and commercial insurance products. We are currently focusing our investigation on the following product categories:
  - 16.1 domestic house and contents;
  - 16.2 private motor vehicle;
  - 16.3 pleasure craft;
  - 16.4 commercial motor vehicle;
  - 16.5 commercial property insurance;
  - 16.6 liability;
  - 16.7 commercial hull; and
  - 16.8 marine cargo.
- 17. In view of the overlap in the supply of private and commercial motor vehicle insurance, we will also consider the following related markets:
  - 17.1 auto-glass and windscreen repair services; and
  - 17.2 collision repair services.
- 18. We will also consider whether there is any significant overlap in respect of any other insurance products.

### *Geographic dimension*

19. We will consider whether it is appropriate to define the relevant insurance products and related markets as national in scope, as we have done previously, or to modify that approach. For instance, we will consider whether or not the market situation in the Canterbury region following the 2010/2011 earthquakes warrants defining a separate geographic market for the Christchurch/Canterbury region.

### *Functional dimension*

20. As the proposed acquisition would result in aggregation at the underwriting level of the market, this area is likely to be the major focus of our investigation. However, we will also consider the impact of the proposal on the distribution of insurance to retail consumers through intermediaries such as brokers and banks.

### **Existing competition**

21. IAG considers that in both personal and commercial insurance lines:
- 21.1 the merged entity would continue to face strong competition post-acquisition from large, well-established existing competitors, various smaller competitors and from retail banks;
  - 21.2 it would be relatively straightforward for an existing insurance provider to expand into new insurance markets; and
  - 21.3 there is a significant degree of competition from offshore insurers for larger commercial insurance contracts.
22. We will consider:
- 22.1 the closeness of competition between IAG and Lumley;
  - 22.2 the closeness of competition between the merged entity and alternative insurance providers, including overseas providers;
  - 22.3 the extent to which retail banks are likely to act as a competitive constraint on the merged entity;
  - 22.4 the scope for existing insurance providers to expand so as to more closely compete with the merged entity;
  - 22.5 the scope for purchasers of insurance products to switch to alternative providers in the event the merged entity raises its prices (or decreases the quality or its products); and
  - 22.6 whether the merged entity would have the ability to strengthen its buyer market power, including depressing the prices paid to suppliers to below the competitive level, so as to result in a substantial lessening of competition in the auto-glass/windscreen repair and collision repair markets.

### Potential competition

23. IAG submits that there are no significant barriers to new entry or expansion in the relevant insurance markets. It identifies two main credible sources of potential competition:
- 23.1 an existing New Zealand insurer starting to provide other insurance products (eg, expanding from commercial insurance products into personal insurance products or vice versa); and
  - 23.2 one or more of the major banks moving into the underwriting of their own personal insurance products.
24. We will consider entry and expansion conditions and whether entry or expansion is likely, timely, and sufficient in extent to prevent a substantial lessening of competition.

### Countervailing power

25. IAG considers that in personal insurance markets, retail banks exercise strong countervailing power due to their ability to cross-sell insurance products into their customer base. In commercial insurance, IAG considers brokers exercise significant countervailing power due to, amongst other things, their importance as a distribution channel and their ability to influence customer purchasing decisions.
26. We will consider the extent of countervailing power held by insurance brokers and retail banks, including the scope for them to discipline the merged firm in other markets, or sponsoring new entry (including self-supply).

### Next steps

27. We are currently aiming to make our final decision by **Friday 28 March 2014**, which is the revised deadline agreed with IAG. However, this date may change as the investigation progresses.
28. To keep up to date with any changes to our deadline and to find relevant documents, visit our clearance register on our website at <http://www.comcom.govt.nz/clearances-register/>
29. As part of our investigation, we will identify the parties we believe will provide the best information to help us assess the preliminary issues identified above. We will be contacting those parties over the next few weeks.
30. We also invite submissions from any other parties who consider they have information relevant to our consideration of this matter. If you wish to make a submission, please send it to us at [registrar@comcom.govt.nz](mailto:registrar@comcom.govt.nz) with the reference IAG/Lumley in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by close of business **Friday 21 February 2014**. Please clearly identify any confidential information contained in the submission and provide contact details.