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Determination

Re IAG (NZ) Holdings Limited and Lumley General Insurance (N.Z.) Limited [2014] NZCC 12

The Commission:	Dr Mark Berry Pat Duignan Dr Jill Walker
Summary of application:	IAG (NZ) Holdings Limited seeks clearance to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission gives clearance for IAG (NZ) Holdings Limited to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited.
Date of determination:	06 May 2014

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

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Executive Summary

The application

1. On 19 December 2013 IAG (NZ) Holdings Limited (IAG) applied for clearance to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited.

Key parties

2. IAG offers a range of personal and commercial insurance products, including domestic home, contents, motor vehicle and pleasure craft insurance as well as commercial motor vehicle, property and marine cargo insurance.

3. IAG supplies the majority of its personal insurance products directly to consumers, primarily through the State and AMI brands. Additionally, IAG sells commercial and personal insurance under its NZI brand via intermediaries, such as brokers and banks (including ASB and BNZ).

4. Lumley offers a range of commercial and personal insurance products, including commercial motor, property, marine and domestic house, contents, motor vehicle and pleasure craft insurance.

5. In contrast with IAG, Lumley supplies its insurance products predominantly through intermediaries, such as brokers and banks (including Westpac).

Relevant Markets

6. We consider that the relevant markets for the purposes of considering this application are the national markets for a number of personal and commercial insurance products:

    6.1 domestic house and contents;

    6.2 private motor vehicles;

    6.3 private pleasure craft;

    6.4 commercial motor vehicles;

    6.5 commercial property (including material damage and business interruption);

    6.6 various forms of liability (including commercial liability);

    6.7 commercial hulls;

    6.8 marine and air cargo; and

    6.9 other commercial products (eg, contract works and engineering).

7. As a result of the potential overlap in the supply of various personal and commercial insurance products, including the supply of private and commercial motor vehicle insurance, we also consider the following related buying markets:

7.1 collision repair services; and

7.2 other buying markets, including auto-glass replacement and windscreen repair services.

With the acquisition / without the acquisition

8. With the acquisition, IAG would acquire 100% of the shares in Lumley.

9. Absent the acquisition, we consider that the current level of competition is likely to prevail.

Competition assessment in personal insurance products markets

10. We are satisfied that post-acquisition, IAG is unlikely to be able to profitably increase prices for personal insurance products above, or reduce quality below the levels that would prevail without the acquisition.

11. First, Lumley has only a minor existing involvement in direct sales of personal insurance products, and we have seen no evidence to suggest that would change in the future absent the acquisition. It follows that the acquisition will not result in any material change to those parts of the markets.

12. Secondly, in terms of Lumley's participation in personal insurance products as an underwriter, which is primarily as an underwriter for Westpac and a potential underwriter for other banks, we consider:

12.1 retail banks will still have (at least) two credible options in Vero (provides services for ANZ) and TOWER (provides services for Kiwibank) in addition to IAG should they wish to switch to an alternative insurance underwriter. Further, other insurers may also be available to bid for bank contracts; and

12.2 raising prices (or lowering quality) to banking customers would be a high risk strategy for IAG, particularly given the size of the contracts being awarded by those banks.

Competition assessment in commercial insurance products markets

13. The acquisition will result in limited aggregation in a number of commercial insurance products markets, including commercial property and professional liability, so we did not consider those markets further.

14. We found that the greatest aggregation from the acquisition in commercial insurance products markets would occur in the underwriting of commercial motor vehicle insurance (including heavy commercial vehicles), where IAG would increase its market share to over 50%.

15. However, we are satisfied there is unlikely to be a substantial lessening of competition in the commercial motor vehicle insurance market. In particular, this is because of:

15.1 competition from existing insurance providers, such as Vero in respect of the full range of commercial motor vehicle insurance products, Allianz and Zurich for some purchasers of commercial motor vehicle insurance as well as for purchasers of heavy motor vehicle insurance; and

15.2 the ability and incentive for some existing insurance providers, including QBE, to expand.

16. In addition, we considered the aggregation arising from the acquisition in the provision of commercial insurance products sold in bundles to small to medium business (SME) customers. We received concerns from insurance brokers that the acquisition would reduce the number of insurers able to provide the requisite bundle of commercial insurance products to SMEs from four to three, therefore enabling IAG to increase prices and/or reduce the quality of its services post-acquisition.

17. We found that there are currently four major underwriters that supply SMEs with the full range of general commercial insurance products: IAG, Lumley, Vero and QBE. However, we consider that the two remaining alternative providers of SME commercial bundles – Vero and QBE – have the incentive and ability to expand their existing offerings in the event IAG attempted to increase prices or reduce service post-acquisition. We consider this is sufficient to satisfy us that there is unlikely to be a substantial lessening of competition for SME customers.

Competition assessment in buyer markets

18. We considered the competitive impact of the acquisition in a number of buying markets where IAG and Lumley compete to buy services. These included collision repair services, windscreen repair/replacement services, vehicle salvage services and claims adjustment services.

19. Our primary focus has been on collision repair services, where concerns have been raised by industry participants.

20. We do not consider that the removal of Lumley from the market is likely to strengthen IAG's buyer power to such an extent that a substantial lessening of competition is likely. This is because:

20.1 50% of the remaining market share for all collision repair work would be accounted for post-acquisition by alternative purchasers of collision repair services. In particular, Vero/ AA Insurance would hold the next largest market share after IAG and various other insurers, including TOWER and FMG, would have smaller shares;

20.2 non-insured work, which is estimated to account for around 20% of the total collision repair market, would remain unaffected by the acquisition; and

20.3 it is unlikely IAG would have the incentive to depress prices post-acquisition below competitive levels because any consequent reduction in the quality of repair work would likely cause IAG to lose insurance customers.

Decision

21. We are satisfied the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

22. Therefore, we determine to give clearance under section 66(3) of the Commerce Act 1986 for IAG (NZ) Holdings Limited to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited.

The proposal

1. On 19 December 2013 IAG (NZ) Holdings Limited (IAG) applied for clearance to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited.

2. The proposed acquisition forms part of a wider acquisition by IAG's parent, Insurance Australia Group Limited of the Australian and New Zealand insurance underwriting businesses of Wesfarmers Limited, Lumley's parent. On 26 March 2014, the Australian Competition and Consumer Commission announced that it would not oppose Insurance Australia Group's proposed acquisition of Wesfarmers' Australian insurance writing business.

3. The acquisition remains subject to approval by the Reserve Bank of New Zealand under the Insurance (Prudential Supervision) Act 2010.

The decision

4. The Commission gives clearance to the proposed acquisition as it is satisfied the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

5. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[1]

The substantial lessening of competition test

6. As required by the Commerce Act 1986 (the Act), we assess whether the proposed merger is likely to result in a substantial lessening of competition.

7. We determine 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).[2]

8. A lessening of competition is generally the same as an increase in market power. Market power is the ability of supplier(s) to raise price above the price that would exist in a competitive market (the 'competitive price'), or reduce non-price factors such as quality or service below competitive levels.

9. Similar to a merger between competing suppliers, a merger between competing buyers may lessen competition by increasing the merged firm's ability, unilaterally or in coordination with other firms, to exercise market power when buying products. Buyer market power is the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time. This can lead to the withdrawal of supply from the market.

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1 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2013.

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

10. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.

11. We define markets in the way that we consider best isolates the key competition issues that arise from the merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.[3]

When a lessening of competition is substantial

12. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[4] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[5]

13. There is no bright line that separates a lessening of competition that is substantial from one that is not. What is substantial is a matter of judgement and depends on the facts of each case. Ultimately, we assess whether competition will be substantially lessened by asking whether consumers in the relevant market(s) are likely to be adversely affected in a material way.

When a substantial lessening of competition is likely

14. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility, but does not mean that the effect needs to be more likely than not to occur.[6]

The clearance test

15. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[7] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.[8]

Key Parties

Insurers

IAG

16. IAG is a wholly-owned subsidiary of Insurance Group Limited, an Australian general insurance company listed on the ASX. In New Zealand, IAG offers a range of personal

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3 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

4 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].

5 Ibid at [129].

6 Ibid at [111].

7 Section 66(1).

8 In *Commerce Commission v Woolworths Limited* (CA), above n 2 at [98], the Court held that "the existence of a 'doubt' corresponds to a failure to exclude a real chance of a substantial lessening of competition". However, the Court also indicated at [97] that we should make factual assessments using the balance of probabilities.

and commercial insurance products, including domestic home, contents, motor vehicle and pleasure craft insurance as well as commercial motor vehicle, property and marine cargo insurance.

17. IAG supplies the majority of its products under the State, AMI and NZI brands. IAG sells its personal insurance products directly to consumers, primarily through the State and AMI brands. State also offers a range of commercial insurance policies for business customers. However, the NZI brand is used by IAG to sell commercial and personal insurance via intermediaries, such as brokers, banks and motor vehicle dealers. Currently, IAG provides personal insurance products through a relationship with several banks, including ASB and BNZ.

Lumley

18. Lumley is 100% owned by Wesfarmers Limited, which is an ASX-listed company. Lumley offers a range of commercial and personal insurance products, including commercial motor, property, marine and domestic house, contents, motor vehicle and pleasure craft insurance.

19. In contrast with IAG which retails insurance directly, Lumley supplies its insurance products predominantly through intermediaries, such as brokers, banks (including Westpac) and other corporate partners.

Other insurance providers

Vero Insurance New Zealand Limited (Vero)

20. Vero is 100% owned by the Suncorp Group. Suncorp Group is a top 20 listed ASX company.[9]

21. Vero provides a range of general and specialist insurance and risk management products, including home, contents and private motor vehicle insurance as well as commercial property, motor vehicle, liability and marine insurance.

22. Like Lumley, Vero is an intermediated insurer, which sells its products through a range of brokers and other intermediaries, including ANZ and other corporate partners.

AA Insurance Limited (AA Insurance)

23. 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 private motor vehicle insurance directly through a nationwide network of AA branches, a national call centre and internet presence.

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[9] http://www.suncorp.com.au/corporate/about.

TOWER Insurance Limited (TOWER)

24. TOWER is a publicly listed New Zealand-based insurance company. TOWER provides a range of general insurance products, including house, contents and private motor vehicle and pleasure craft, which it sells directly to consumers. It also offers for direct sale commercial and rural insurance policies to customers, including business asset, interruption and liability cover.

QBE Insurance (International) Limited (QBE)

25. QBE is an Australian-based insurance company listed on the ASX, with operations in 52 countries worldwide. In New Zealand, QBE provides a wide range of commercial insurance products, including property, business interruption, liability and motor vehicle, which are primarily sold through brokers. QBE provides such products for businesses of all sizes.

Other insurance providers

26. There are a large number of other companies providing general insurance products, including:

    26.1 AIG Insurance New Zealand Limited (AIG), which as part of the global AIG organisation describes itself as the world's largest insurance organisation.[10] In New Zealand, AIG primarily sells commercial insurance lines via brokers, including property, liability and marine cover;

    26.2 Zurich New Zealand (Zurich), which is part of the global Zurich Insurance Group with operations in 170 countries worldwide. In New Zealand Zurich is involved in selling a range of commercial insurance products, via brokers, including commercial vehicle, marine and property (excluding natural catastrophe cover for properties south of Hamilton);

    26.3 ACE Insurance Limited (ACE), which is part of the ACE Group and operates in 54 countries worldwide. In New Zealand, ACE offers commercial property and casualty insurance, and corporate travel insurance products, mainly via brokers;

    26.4 Allianz New Zealand (Allianz), which is similarly part of the worldwide Allianz Group, operating in more than 70 countries. In New Zealand, Allianz provides a range of personal, commercial and corporate insurance products sold mainly through intermediaries, including for private motor vehicles and pleasure craft, commercial motor vehicle, property, business interruption, liability and corporate travel; and

[10] http://www.aig.co.nz/new-zealand_919_213959.html

26.5 Farmers' Mutual Group (FMG), a New Zealand-based rural mutual insurer which provides agribusiness, personal and commercial insurance products, predominantly for rural customers.

Lloyd's

27. Lloyd's of London (Lloyd's) operates a market in which one or more of its members form a syndicate to insure risk. Lloyd's is not a company but a market which provides specialist insurance cover for various categories of risk, such as commercial property, marine and liability. This can be placed either with a local coverholder[11] (eg, Crombie Lockwood), or by approaching a Lloyd's agent overseas, who then places the cover directly on the Lloyd's market.

Insurance Council of New Zealand

28. The Insurance Council of New Zealand (ICNZ) represents the interests of 30 fire and general insurance companies in New Zealand, including the parties to the acquisition and the other insurers referred to above.

Insurance brokers

29. An insurance broker is an intermediary between the insurance company and the customer. The broker provides specialist advice on insurance protection to their clients. Brokers generally specialise in providing advice on commercial insurance products, but also offer advice on personal insurance products.

30. A broker's role is to:

30.1 help identify the risks faced by clients;

30.2 provide advice on the insurance products available to cover those risks; and

30.3 approach the insurance market to obtain and arrange the best insurance protection to meet the needs of the client at the most competitive price.

31. There are around 200 insurance broking businesses in New Zealand. These range from large global broking firms, such as AON, Crombie Lockwood and Marsh, to medium-sized and small broking businesses.

32. Some insurance brokers have facilities to place insurance offshore. For example, Crombie Lockwood's subsidiary, Offshore Market Placements Limited, specialises in placing insurance outside New Zealand, primarily with Lloyd's.

33. Around 80% of broking businesses are members of the Insurance Brokers' Association of New Zealand (IBANZ), the trade association representing the interests of the industry.

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[11] A coverholder is a person that is authorised to enter into insurance contracts and /or issue insurance documentation, on behalf of the members of a Lloyd's syndicate.

Other relevant parties

34. The proposed acquisition also involves a number of markets where IAG and Lumley compete to acquire services to fulfil their claim obligations. These include collision repair services, windscreen repair/replacement services, vehicle salvage services and claims adjustment services.

Industry background

Types of insurance products

35. The proposed acquisition relates to what is generally referred to as general (or non-life) insurance. General insurance is often divided into two broad categories.

Personal insurance products

36. The first category is personal insurance products. These include home, contents, private motor vehicle and pleasure craft insurance sold to consumers for private use.

37. Personal insurance products are mainly sold directly to consumers, rather than through brokers. Where brokers sell personal products, this is most often done as part of a package for commercial customers (eg, a small business owner buying insurance for their business and their home), or for personal risks which are hard to place in the New Zealand market.

38. Insurance companies rely on a number of channels to sell personal insurance products directly to consumers, including through retail branches, call centres, insurance agents, and the internet.[12] The two channels through which insurance companies sell personal insurance products of interest in this acquisition are:

    38.1 direct sales to consumers, such as through IAG's State and AMI brands; and

    38.2 sales made via retail banks, such as Westpac, to final consumers (see paras 49-51 for further details).

39. Historically, insurers relied upon branches and agents to sell their products, but more recently, call centres have increased in importance. While the internet does not appear to be a major distribution channel at present, technological advancements and trends in other markets suggest that internet selling of insurance is likely to only increase in the future.

Commercial insurance products

40. The second category is commercial insurance products. These include a variety of insurance products designed to protect a business, regardless of its size, from unforeseen events, such as fire, theft, property damage and third-party liability. These products include insurance to cover commercial property (material damage and business interruption), commercial motor vehicle, and marine cargo.

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12 We estimate that 80-85% of personal insurance is sold directly to final customers.

41. Some customers buy commercial insurance as a bundle (ie, all their risks are insured together), while some buy individual products.

42. Compared to personal insurance products which are mainly sold direct to consumers, commercial products are mainly sold via brokers. The ICNZ estimates that 85% of commercial products are sold by brokers.[13]

Insurance underwriting/underwriters

43. Insurance underwriting is the process an insurer undertakes to evaluate, accept or reject insurance risk. An insurance underwriter is the person who is responsible for underwriting an insurance contract. An insurance underwriter can also refer to the insurance company assuming the risk under an insurance contract. [14]

Reinsurance

44. Reinsurance is the insurance purchased by insurers to mitigate their own financial risks. Insurers use it to offset some of their financial risk by, in effect, buying insurance from another insurer, the reinsurer. The reinsurer then assumes some of the original insurer's liability in the event of a major catastrophe. The object of reinsurance is to indemnify the original insurer against loss that they may sustain in their capacity as insurers.

Impact of Canterbury earthquakes

45. In September 2010 and February 2011, the Canterbury region experienced major earthquakes that resulted in significant damage and loss of life. The latest Treasury estimates have put the insurance losses arising from the Canterbury earthquakes at $40 billion.[15]

46. The claims resulting from the earthquakes and the higher perceived risk of earthquakes in New Zealand have had a dramatic effect on all companies providing insurance in New Zealand. In particular, the earthquakes have led to:

    46.1 insurance companies facing considerably higher reinsurance costs as they renew their insurance programmes following the Canterbury earthquakes;

    46.2 most insurers moving from providing total replacement to a capped sum insured cover for property;

    46.3 increased premiums; and

    46.4 the withdrawal of some insurance underwriters from the market or a reduction by some underwriters in the geographic or product coverage, particularly in respect of property (eg, since the Canterbury earthquakes,

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13 *ICNZ Insurance Handbook A Short Guide to the General Insurance Industry in New Zealand* at p.22.
14 Ibid at p. 56.
15 http://www.nbr.co.nz/article/christchurch-quake-cost-rises-10b-40b-bd-139278.

Zurich has withdrawn from underwriting catastrophe cover south of Hamilton).

47. However, IAG contends that the insurance market is now largely operating as it was prior to these disaster events and is returning to "business-as-usual competitive trading conditions."[16]

48. As a direct result of the Canterbury earthquakes, the Reserve Bank of New Zealand has issued new regulatory requirements for insurance entrants, effective from 2016. The requirement is for insurers to have sufficient capital reserves to meet a 1:1,000 year insured event in New Zealand as compared to a 1:250 year event in Australia.

Role of banks in the sale of insurance in New Zealand

49. New Zealand's trading banks are active in retail insurance markets. Banks resell or distribute a range of personal insurance products (including house, contents, and motor vehicle policies) as an adjunct to other financial services they sell through their branch networks.

50. None of the banks currently distributing insurance products in New Zealand underwrite the policies they sell. Instead, the banks contract with an underwriter to distribute the underwriter's product. In some instances the products the banks offer are standard policies re-branded with the bank's logo, with the banks receiving a commission on the sales the bank makes. However, some banks [ ] have a much greater involvement in the design of the product and receive a share of profits as well as a commission.

51. All of the claims management services are carried out by the underwriting company.

Theories of harm

52. The proposed acquisition could substantially lessen competition through:

   52.1 unilateral effects that would be likely to result from the proposed acquisition increasing IAG's market power in certain personal or commercial insurance products such that it could profitably increase price above competitive levels, or reduce quality below the level that would prevail without the merger; or

   52.2 IAG profitably depressing prices paid to suppliers of collision repair services, auto-glass replacement/repair and other similar purchasers to a level below the competitive price in those markets.

Market definition

53. Market definition is a tool that can provide a framework to help identify and assess the close competitive constraints a merged firm would likely face. Determining the relevant market requires us to judge whether, for example, two products are

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16 IAG Application at [10.1].

sufficiently close substitutes as a matter of fact and commercial common sense to fall within the same market. 17

54. We define markets in the way that best isolates the key competition issues that arise from the merger. There may not be a bright line that separates those products that are within a market from those outside that market. In reality, a product may compete more closely (ie, be a closer substitute) with some products, than with others. This is particularly the case in the provision of insurance, which comprises various differentiated products and, as such, makes it difficult to clearly define markets.

55. What matters is that we consider all relevant competitive constraints, and the extent of those constraints, on different products. For this reason, we may also consider products which fall outside the market but which may still impose some degree of competitive constraint on the merged firm.

Summary of the relevant markets

56. We consider that the relevant markets for the purposes of considering this application are the national markets for the insurance of:

56.1 domestic house and contents;

56.2 private motor vehicles;

56.3 private pleasure craft;

56.4 commercial motor vehicles;

56.5 commercial property (including material damage and business interruption);

56.6 various forms of liability (including commercial liability);

56.7 commercial hulls;

56.8 marine and air cargo; and

56.9 other commercial products (eg, contract works and engineering).

57. As a result of the potential overlap in the supply of various personal and commercial insurance products, including the supply of private and commercial motor vehicle insurance, we also consider the following related buying markets:

57.1 collision repair services; and

57.2 other buying markets, including auto-glass replacement and windscreen repair services.

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[17] Section 3(1A) of the Act.

Supply-side substitution

58. The merging parties submitted that while not all insurers offer the same range of personal and commercial products, there is fluidity in the capacity to offer such products and all insurance products should therefore be considered as one broader market.

59. We typically group products together for consideration in one product market if:

59.1 the products are substitutable from a supply-side perspective;

59.2 the competitive dynamics for all the products are the same; or

59.3 the products are sold as a system.

60. We do not consider that insurance firms could easily, profitably and quickly switch between supplying different insurance products. As such, we will consider the insurers' ability and incentive to switch between offering different insurance products in our discussion of entry and expansion. This is primarily because:

60.1 a sizeable investment in infrastructure needs to be made when moving from providing commercial products to directly providing personal products as direct selling requires outlets and technological systems that can capture larger volumes of data;

60.2 insurers are restrained in their capacity by their ability to secure reinsurance and, therefore, by their risk profile. Insurers seek to spread their risk. For instance, an insurer that is already relatively exposed to a certain type of risk, such as property insurance in Canterbury, may not be able to secure capacity (after its own or the reinsurers' assessment of exposure) for additional risk in this area and so may not be able to supply in this area;

60.3 insurers tend to purchase an insurance book (a client list and current risk) rather than expanding organically; and

60.4 we have not seen sufficient evidence of switching between insurance products on the supply side to indicate a single market.

Grouping of product markets as 'personal' and 'commercial'

61. Although each of the insurance products are separate from a demand-side perspective, we have considered the competitive effects in some of the personal and commercial insurance products collectively. This is because the competitive effects in some of these groups are largely the same. In particular, we have separately considered the competitive effects of personal insurance products sold to banks and pleasure craft insurance. All other personal insurance products we have considered in aggregate. In the case of commercial insurance products, we have separately considered insurance products for cars, insurance for heavy vehicles and commercial insurance for SMEs when sold in bundles. All other commercial products we have considered in aggregate.

Personal insurance

Product markets

62. In assessing the competitive effects of the proposed acquisition in relation to personal insurance products, we have adopted the markets considered in the *IAG/AMI* decision.[18] In addition, given the aggregation in private pleasure craft insurance, we have included private pleasure craft as a personal insurance product.

63. Insurance companies typically provide a full range of personal insurance products. These products are typically either standard term or customised products for the final customer. We consider that there are separate markets for the provision of the following personal insurance products:

    63.1 domestic house and contents;

    63.2 private motor vehicle; and

    63.3 private pleasure craft.

Functional market

64. As discussed, insurers use a number of distribution channels to sell insurance products to final consumers. In personal insurance, insurers primarily sell insurance either directly to the public or re-sell through banks (under the bank's own brand). Little personal insurance is sold through brokers.

Geographic market

65. Previously, the Commission has considered the personal insurance product markets to be national in scope.[19]

66. All of the main participants, including the merging parties, Vero/AA Insurance and TOWER are offering personal insurance products throughout the country. Therefore, we consider that there is no reason to depart from a national geographic market for the purpose of considering this acquisition.

Commercial insurance

Product markets

67. As in personal insurance, some general commercial insurers provide a full range of commercial insurance products (eg, IAG, Lumley and Vero). However, there are also insurance companies that either focus on, or specialise in, certain commercial product lines (eg, ACE provides a range of commercial property and liability products but does not currently provide commercial motor vehicle insurance).

68. Consistent with our assessment of personal insurance, the Commission considers that there are separate markets for the provision of:

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

19 Ibid at [38].

68.1 commercial motor vehicle insurance;

68.2 commercial property insurance;

68.3 liability insurance;

68.4 commercial hull insurance;

68.5 marine cargo insurance (including air cargo); and

68.6 other commercial insurance products.

69. For the purpose of our analysis, we make no distinction between rural commercial insurance products and other types of commercial insurance. This is because of the difficulty in obtaining a precise description on what is specifically covered by 'rural' insurance as opposed to standard commercial insurance products that are sold to rural-based customers. Therefore, rural commercial insurance has been treated as part of the commercial insurance products markets.

70. Within each market above, the products are highly differentiated and vary by the terms of the insurance contract, including the extent of coverage. The product markets above could be further delineated by type of customer and type of risk. We have considered that a distinction may be drawn between small and medium sized businesses (SMEs) and corporate customers, although a bright line between these types of customer is difficult to identify. Rather than drawing such a bright line, any particular competition concerns, including the closeness of competition between the merging parties and their competitors, in regard to SMEs is considered in the competition analysis below.

71. Similarly, we consider that for the purchasers of commercial motor vehicle insurance a distinction could be made between purchasers of insurance for individual commercial vehicles, operators of small car fleets, the operators of large car fleets, and heavy motor vehicle operators.[20] This suggests the different categories of commercial motor vehicle insurance might fall into discrete markets. However, again rather than drawing a bright line distinction, we propose to consider this matter from a closeness of competition perspective in the competition analysis.

Functional dimension

72. Commercial insurance is primarily sold by insurers through brokers, but also directly to final customers.

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[20] For instance, we understand that SMEs could purchase commercial motor vehicle insurance directly from insurance companies such as State (IAG) and TOWER. Alternatively, SMEs could purchase such insurance through a broker, in which case the options can include NZI (IAG), Lumley, Vero and QBE. For fleet car and heavy motor vehicle operators, the options include NZI, Lumley and Vero, and may also extend to self-supply.

Geographic dimension

73. All of the main participants, including the merging parties, Vero and QBE, are offering commercial insurance products throughout the country.[21]

74. Like the personal products markets, we have considered the competition impacts of the proposed acquisition on national markets.

Related markets

75. We have also identified a number of buying markets that are likely to be affected by the proposed acquisition. Our primary focus has been on collision repair services, where concerns have been raised by industry participants.

76. Given that the merging parties compete for the acquisition of such services, we consider the following related markets:

    76.1 collision repair services; and

    76.2 other buying markets, including auto-glass replacement and windscreen repair services.

With and without scenarios

With the acquisition

77. With the acquisition, IAG would acquire 100% of the shares in Lumley.

Without the acquisition

78. Absent the acquisition, we consider that the current level of competition is likely to prevail. This accounts for two likely future scenarios: Wesfarmers retaining Lumley, or Wesfarmers selling Lumley to a buyer not requiring clearance.[22]

Competition Assessment – Personal insurance products markets

Summary

79. This section assesses the likely competitive impact of the acquisition on personal insurance products markets.

80. As noted previously, there are two major channels through which insurance companies sell personal insurance products: direct sales and sales made via retail banks. However, insurance companies and banks compete with each other for direct sales of personal insurance products. We have considered the competitive effects of the acquisition through each of these channels.

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21 Zurich has advised us that it does not provide natural catastrophe cover for properties south of Hamilton. However, as we explain in our competition analysis, we have not relied on Zurich as a constraint in the commercial property market and therefore do not consider it is necessary to define regional geographic markets for commercial insurance products.

22 Commerce Commission *Mergers and Acquisitions Guidelines*, July 2013, at [2.40].

81. Lumley has only a very limited involvement in the direct sales of personal insurance products to the public, and sales to the public through brokers. Instead, Lumley's participation in the personal insurance products market is largely as the underwriter/provider of Westpac's, and to a lesser extent, SBS's, and HSBC's insurance products, and as a potential underwriter/provider of insurance products for other banks. Therefore, our analysis has focussed on the impact of the acquisition on the banks and the alternatives they would have without Lumley being present.

82. In summary, we are satisfied that, post-acquisition, IAG is unlikely to be able to profitably increase prices above, or reduce quality below the levels that would prevail without the acquisition.

    82.1 Lumley has only a very minor existing involvement in the direct sale of personal insurance products and we have seen no evidence to suggest that would change in the future absent the acquisition. It follows that the acquisition will not result in any material change to those parts of the markets.

    82.2 While retail banks will not be able to use Lumley as an underwriter/provider of insurance, they will still have (at least) two credible options in Vero (provides services for ANZ) and TOWER (provides services for Kiwibank) in addition to IAG should they wish to switch to an alternative insurance underwriter. Other insurers may also be available to bid for bank contracts (see para 115 for further details).

    82.3 Raising prices (or lowering quality) to banking customers would be a high risk strategy for IAG, particularly given the size of the contracts being awarded by those banks.

Existing competition

83. Table 1 provides estimated market shares for the major insurers that underwrite personal insurance products.

Table 1: Estimated market shares for personal insurance products

		House and contents	**Motor vehicles**	**Pleasure craft**
Party		% Market share	% Market share	% Market share
IAG	Direct	[		
	through ASB	[		
	through BNZ	[		
	through Co-operative Bank	[		
	Total IAG	[		
Lumley	Direct	[		
	through Westpac	[		
	through SBS/HSBC	[		
	Total Lumley	[		
	Merged entity	[		
Vero	Direct	[		
	Through AA Insurance	[		
	Through ANZ	[		
	Total Vero	[		
TOWER	Direct	[		
	through Kiwibank/TSB/ANZ/Other	[		
	Total TOWER	[		
Lloyd's		[		
Allianz		[		
Others (including FMG)		[		
	Total	100	100	100

Source: IAG application.

Note: TOWER's estimated market shares include ANZ legacy customers (ie, those ANZ customers who decided to remain with TOWER when Vero won the ANZ banking contract in 2009).

Limited overlap in direct sales of personal insurance products

84. As shown in Table 1, the acquisition would result in little material change for personal house and contents and private motor vehicle insurance products sold directly to customers. This is because Lumley, being predominantly an intermediated insurer, has a very limited involvement in direct sales, and we have no evidence to indicate that, absent the acquisition, Lumley is likely to change its approach. In particular, for domestic house and contents insurance, Lumley accounts for only a small share of the market through direct sales ([ ]%), while Lumley's share for private motor vehicles through direct sales is also small ([ ]%).

85. In contrast, IAG derives a much larger share of its revenue from personal insurance products that are sold direct to consumers, with about [ ]% of its combined GWP revenue for house and contents and motor vehicle insurance earned in this way.

86. Given the low levels of aggregation in the direct sales of domestic house and contents and private motor vehicle insurance, we do not consider this channel any further. However, as noted previously, banks and insurers compete for customers in the direct sale of these insurance products

Small increase in overlap in sales via banks

87. The acquisition would result in a relatively small increase in market share in the underwriting of personal insurance products to banks. Lumley currently underwrites for Westpac,[23] SBS and HSBC. Lumley's sales through these channels account for relatively small shares of domestic house and contents insurance ([ ]%), and of private motor vehicle insurance ([ ]%).

88. IAG also underwrites for a number of banks, including ASB and BNZ. The other major competitors that underwrite personal insurance products for the banks are Vero and TOWER.

89. While Lumley's market share in underwriting to bank customers is low, should banks consider Lumley as a competitive alternative when considering the renewal of their insurance underwriting contracts, Lumley's market share will understate its competitive importance.

90. The competitive effects of the merger for the underwriting of personal insurance products for banks are considered further below at paragraphs 93 and following.

A greater overlap in pleasure craft insurance

91. For pleasure craft, Lumley's market share is greater than for other personal insurance products at [ ]%. However, we consider that IAG would continue to face

[23] Lumley earns [ ] of its personal insurance products' premium income from its relationship with Westpac, which currently accounts for approximately [ ]% of Lumley's personal products insurance business [ ].

competition post–acquisition from Vero, and to a lesser extent from Lloyd's, Allianz and other smaller players in the market, including FMG. QBE also provides pleasure craft insurance.[24]

92. Given the level of existing competition that is likely to prevail post-acquisition, we do not consider that the acquisition would result in a substantial lessening of competition in the pleasure craft insurance market.

Overlap in sales through banks

93. Table 2 sets out the relationships between the major underwriters of personal insurance products and the retail banks pre- and post-acquisition.

Table 2: Relationships between underwriters and retail banks for personal insurance products

Underwriters	Retail banks Pre-acquisition	Retail banks Post –acquisition
IAG	ASB BNZ Co-operative Bank	ASB BNZ Co-operative Bank Westpac SBS HSBC
Lumley	Westpac SBS HSBC	-
Vero	ANZ	ANZ
TOWER	Kiwibank TSB	Kiwibank TSB

94. As shown in Table 2, IAG currently holds two (ASB and BNZ) of the five major bank contracts. The acquisition would result in IAG acquiring a third major bank contract, the Westpac contract, along with the contracts for two smaller banks, SBS and HSBC. The other two major bank contracts would be held by Vero (for ANZ) and TOWER (for Kiwibank).

95. The acquisition removes a provider of underwriting services – Lumley – to the banks. Whether this would likely result in a substantial lessening of competition by reducing the competitive pressure and resulting in an increase in prices, or a reduction in services compared to the situation without the acquisition, depends on:

    95.1 whether the banks currently consider switching their underwriting service providers such that the acquisition would mean the removal of Lumley as a competitive alternative; and

[24] Telephone call with QBE (20 February 2014).

95.2 if such switching would occur, whether the banks have enough remaining competitive options such that there is unlikely to be a substantial lessening of competition.

96. We consider each of these issues in turn below.

97. However, we first note the relationship between the price paid by banks for underwriting services and that paid by final customers. We are concerned with both any detrimental change in the contractual terms faced by the banks for re-selling insurance products as well as any change in the price of the insurance products themselves.

The banks are price sensitive

98. Banks are price sensitive. Price sensitive customers are more likely to seek alternative suppliers if faced with a price increase than absorb a price increase. Similarly, a price increase is less likely to be a profitable strategy for an insurance company if its customers are price sensitive and switch away.

99. As re-sellers, regardless of the merger's impact on commissions or any other terms, banks could simply pass through any increase in the price of insurance products. Whether such pass-through is likely will depend on how the pass-through would impact the banks' own competitiveness in the market for the sale of personal insurance products to final customers.

100. The merging parties submit that banks will bargain aggressively on the prices and terms of the insurance products underwritten by insurance companies, with their primary concerns being on the premium relative to the wider market in any of their price point discussions.[25] That is, banks will seek to understand where their pricing sits in comparison to direct, bank and broker offerings as they strive to maintain relative market levels for price, coverage and customer service.

101. This was confirmed by the banks. The banks told us that the pricing, quality and service of the insurance products that they re-sell were crucial factors as customers will identify the product with the bank's own brand. They also said that their insurance products are aimed to fit within the wider portfolio of products sold by the bank and directed at customers who tend to purchase multiple banking products.

102. In addition, we have found evidence that customers are more likely to switch away from banks supplying insurance products than from an insurance company that supplies insurance products directly. That is, the churn rates for insurance products are higher in the banking distribution channel than in direct insurance sales.[26] This

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25 [ ].

26 [ ]

provides further support for our view that banks are constrained by competition at the downstream level and that they are unlikely to be able to pass through any price increases of personal insurance products to their final customers.

103. Given the competition the banks face in the re-sale of insurance products, as well as the suite of banking products they sell in conjunction with insurance, we do not consider it likely that they would simply pass-through any increase in insurance premiums. Rather they are likely to attempt to negotiate not only favourable contractual terms for themselves, but also favourable insurance prices for their customers.

Do banks consider alternative underwriters?

104. We next consider whether banks can cost-effectively switch underwriters, or alternatively, whether switching costs are so high that, once an underwriter is chosen, banks are unlikely to switch. If switching costs were high, then switching underwriters would be unlikely both with and without the merger, and so the merger would be unlikely to result in a substantial lessening of competition.

105. We consider that switching costs are not likely to be so high that banks would not consider switching underwriters. Therefore, we assess the impact of this acquisition on the ability of banks to switch underwriters.

106. Bank insurance contracts come up for tender periodically and not only are non-incumbent underwriters considered, there is also evidence of them being the successful bidder. As examples, ANZ switched from TOWER to Vero following a tender in 2009; HSBC switched from IAG to Lumley following a competitive tender in 2010; and ASB tendered its business in 2011, but decided to retain the incumbent provider IAG. [27]

107. While there are no doubt switching costs, such as information technology integration and residual claims, the fact that there has been some switching suggests these are not prohibitive.

Is the merger likely to result in an SLC to the banks?

108. As noted above, Lumley's market share in underwriting of personal insurance products might understate their competitive importance in regard to the banks.

109. When competing for banks' tenders, underwriters are engaged in a bidding market. In such markets, rivals compete *for* the market rather than *in* the market, and therefore for the right to be the selected supplier rather than for sales. In these markets even relatively few competing suppliers can produce highly price competitive market outcomes, particularly where:[28]

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27 [ ]

28 For further information see the OECD's 2006 policy roundtable document on "Competition in bidding markets" available at: http://www.oecd.org/competition/cartels/38773965.pdf

109.1 'the winner takes all' – the customer does not contract more than one supplier and so there is a risk of pricing above competitive levels and losing out on the market (the banks retain the customer relationship on termination of the contract);

109.2 competition is lumpy – each 'contest' is relatively large as a proportion of the supplier's total sales. That is, in this case, each bank is relatively important in terms of total sales and therefore the loss of the banking customer would materially impact on profitability;

109.3 the price tendered to one customer does not affect the firm's prices to other customers – successfully winning a contract with one bank through a lower price does not mean that the insurer has to lower its prices to other banks, making the insurer more willing to compete aggressively for any one particular contract; and

109.4 there is no 'lock-in' or significant incumbency advantage.

110. Bank tenders appear to be characterised by all but the last point, and as discussed in the previous section, any incumbency advantage is not determinative since competitive tendering and switching do occur. The incentive to gain considerable market share for a set period ("winner takes all") when such contracts do in fact arise ("lumpy contracts") can be strong motivators for continued competition even with a reduced number of competitive options. Not only are bank contracts conducted on a "winner takes all" basis, they also represent a [ ] proportion of the revenue Vero and TOWER each earn from the sale of personal insurance products.

111. In terms of this acquisition, Lumley provides underwriting services to Westpac. The issue then to determine is whether Westpac has options if IAG sought to increase prices/decrease quality post-acquisition. While Westpac advised us that its relationship with Lumley is longstanding,[29] based on our assessment of the Westpac/Lumley contract, Westpac could switch provider relatively quickly should it wish to.[30]

112. Furthermore, as discussed above, Westpac could turn to Vero and TOWER as alternative options. Both are credible providers which have existing relationships with banks. The costs to Westpac in doing so would be no greater than the costs it

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29 [ ]

30 [ ]

would have faced in switching away from Lumley previously if Lumley had sought to increase prices/decrease service quality.

113. More generally, and thinking about Lumley as a potential competitor for other banks' business, we consider that retail banks will continue to retain sufficient alternatives in the market. There are three credible alternative providers – IAG, Vero and TOWER – who can compete for bank tenders.

Potential entry into personal insurance products markets

114. In addition to considering the ability of banks to switch to an existing insurance underwriter, we have investigated the possibility of a new entrant competing to provide personal insurance products to banks, and/or for the banks to undertake their own underwriting.

115. After speaking to several insurers that do not currently provide underwriting services to banks, we are satisfied that there are likely to be insurers that have the ability and intention to bid for bank tenders.[31]

116. However, in regard to banks underwriting their own insurance products, we have found that while the parent companies of certain Australian-owned local banks are currently underwriting their own personal insurance lines, [ ][32] [ ][33]

Commercial insurance products markets

Summary

117. This section assesses the likely competitive impact of the proposed acquisition on the commercial insurance products markets.

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31 [ ]

32 [ ]

33 [ ]Further, the Reserve Bank of New Zealand (RBNZ) bank registration policy is that where a bank is a locally incorporated company, to comply with the RBNZ's conditions of registration, a bank must restrict the underwriting of life and general insurance to no more than 1% of the banking group's total consolidated assets. These conditions of registration will normally apply to the New Zealand banking groups of overseas incorporated banks also. Therefore, such conditions may restrict banks, or their subsidiaries, from underwriting insurance to no more than 1% of their total assets.

118. The greatest aggregation from the acquisition would occur in the underwriting of commercial motor vehicle insurance (including heavy commercial vehicles), where IAG would increase its overall market share to over 50% (from around [ ]% to around [ ]%). In addition, we also considered the aggregation arising from the acquisition in the provision of commercial products in bundles to SME customers. These are the areas we focus on in this determination.

119. However, we are satisfied that, post-acquisition, IAG is unlikely to be able to profitably increase prices above, or reduce quality below, the levels that would prevail without the acquisition in either of these areas – the commercial motor vehicle market, or in the sale of commercial products as a bundle to SME customers – or in any other commercial product markets. As such, we are satisfied there is unlikely to be a substantial lessening of competition. This is because of:

119.1 competition from existing insurance providers, such as Vero;

119.2 the ability and incentive for some existing insurance providers, including QBE, to expand in the affected product/customer segments of the markets;

119.3 the constraint provided in some circumstances from offshore providers (eg, insurance provided through Lloyd’s); and

119.4 the range of options available to insurance brokers, who are the major sellers of commercial insurance lines, including domestic and overseas providers.

Limited overlap in a number of commercial insurance markets

120. The acquisition will result in limited aggregation in a number of commercial insurance products markets. Table 3 provides estimated market shares for the commercial insurance products assessed during the investigation of this acquisition.

Table 3: Estimated market shares for the underwriting of commercial insurance products

Insurer	Motor vehicle %	Commercial Property %	Professional Liability %	Commercial hull %	Marine cargo %	Other commercial insurance %
IAG	[					
Lumley	[					
Merged entity	[					
Vero	[					
QBE	[					
AIG	[					
Zurich	[					
TOWER	[					
Allianz	[					
ACE	[					
Lloyd's	[					
Other	[					
Total	100	100	100	100	100	100

Source: IAG application

Note 1: Estimated market shares are provided as a percentage of gross written premiums which IAG has based on ICNZ market data for the year ending June 2013 and IAG's internal analysis.

Note 2: Estimated market shares listed for motor vehicles are for all types of commercial motor vehicles, including cars and heavy motor vehicles. Market share estimates are not available for the individual segments of the market such as heavy motor vehicles.

121. As shown in Table 3, the level of aggregation is relatively small for:

121.1 commercial property;

121.2 professional liability;

121.3 commercial hull; and

121.4 other commercial insurance products.

122. We do not consider a substantial lessening of competition is likely to result in these markets because of:

122.1 the relatively small aggregation that would result from the acquisition for these products,

122.2 the relatively low combined market shares in some markets ; and

122.3 the presence of other significant competitors and their ability and incentive to expand.

123. While the level of aggregation is higher for marine cargo insurance, we also do not consider a substantial lessening of competition is likely because of:

123.1 the presence of a number of other general or specialist insurance providers, including:

123.1.1 Vero, which has been identified as one of the top three participants in the underwriting of marine cargo insurance (the others being IAG and Lumley);[34]

123.1.2 other smaller participants, including Zurich and QBE, which offer marine cargo insurance; and

123.2 the ability of some end users to place marine cargo insurance with overseas insurers or with Lloyd's.

Impact of the acquisition on the commercial motor vehicle insurance market

Overview

124. Commercial motor vehicle insurance products are highly differentiated, both in terms of the type of risk covered and the categories of customers. Therefore, the risks involved with insuring, for instance, a fleet of cars differ from the risks of insuring a fleet of trucks. Similarly, each of the customer categories has a different risk profile, which in turn may influence customer choice.

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34 [ ]

125. IAG has argued that there is a single commercial motor vehicle market, noting for instance that the supply of heavy motor vehicle insurance is not markedly different from the supply of general commercial motor vehicle insurance. For instance, IAG noted that a separate internal team for heavy motor vehicles is not required.[35]

126. However, for the purpose of analysing the proposed acquisition, we note that each of the market participants has different strengths, so we consider the different categories of commercial motor vehicle from a closeness of competition perspective. We consider commercial insurance products for cars separately from insurance products for heavy commercial vehicles (which we define to cover trucks and trailers, buses and heavy equipment, such as the heavy machinery used in the construction, forestry and agricultural sectors).

Commercial motor vehicle insurance

127. This section covers the supply of motor vehicle insurance products for cars (non-fleet and fleet vehicles). IAG has stated that it uses 'vehicle' insurance products for insurance of up to 14 cars, while 'fleet' products are used to insure over 15 vehicles.[36] It estimates that 40% of the commercial motor vehicle market relates to fleets.[37]

128. Non-fleet and small fleet customers have the option of purchasing their motor vehicle insurance requirements directly from State (IAG), TOWER and FMG, or may choose to buy such insurance via a broker. If a broker is used, customers can place their insurance through NZI (IAG), Lumley, Vero, and QBE.

129. Large fleet clients, as noted by IAG, tend to use insurance brokers because of the greater complexity of their overall insurance needs.[38] In addition, we understand that specialist and/or offshore insurance providers/markets may provide an additional option for buyers of fleet and non-fleet vehicles.

130. Table 4 provides estimated market shares for the major insurers providing underwriting for general commercial motor vehicle insurance.

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35 IAG's Response to Commission's Letter of Issues at [47].

36 IAG's Response to the Commission's request for documents and information (21 February 2014) at [36].However we note that some insurers define non-fleet differently.

37 IAG Application at [18.6 (c)].

38 IAG response to the Commission's request for documents and information at [37].

Table 4: Estimated market shares for commercial motor vehicle insurance products for the year ending June 2013

Competitor	$m (GWP)	% Market share
IAG	[	
Lumley	[	
Merged entity	**[**	
Vero	[	
Zurich	[	
QBE	[	
Allianz	[	
FMG	[	
TOWER	[	
Lloyd's	[	
MAS	[	
Others	[	
Total	[ ]	100

Source: IAG application

131. IAG and Lumley are two of the three largest participants in this market. The other major underwriter and provider of such insurance is Vero, with QBE, Allianz and Zurich having smaller market shares. TOWER and FMG also underwrite general commercial motor vehicle insurance, but unlike the other insurers mentioned that sell through brokers, TOWER and FMG sell directly to commercial customers.

132. IAG submitted that there are a number of vigorous competitors in the commercial vehicle insurance market, including Vero, Allianz, QBE and Zurich.[39] [40]

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[39] IAG Application at [18.6 (c)].

[40] In particular, IAG has identified [ ]

133. Lumley is also of the view that the commercial motor vehicle market is competitive.[41]

134. We are satisfied that Vero would remain a strong competitor in this market, and we consider there are unlikely to be any insurmountable obstacles to prevent it from expanding. Vero has confirmed to us that it is one of the major competitors in this market.[42] Other parties we have spoken to have also identified Vero as a major competitor in this market.[43] Naturally, however, any expansion would require Vero to consider its risk profile to ensure that its portfolio is sufficiently diverse to support growth in the commercial motor vehicle insurance market.

135. In addition, we are satisfied that QBE, which has been expanding its presence, will continue to provide an effective constraint on IAG. QBE, as a large global insurer, has the ability and incentive to expand in the event IAG were to attempt to raise prices or lower customer quality. This is supported by information provided by QBE showing that [ ][44]

136. Other parties we have spoken to also consider that QBE is an aggressive competitor in this market.[45]

137. We are also of the view that Allianz, Zurich, TOWER and FMG will remain as viable options for some purchasers of commercial motor vehicle insurance products.[46] However, because of recent changes to how Allianz and Zurich conduct their

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[41] For example, Lumley states that commercial motor vehicle insurance is a very competitive sector of the insurance market with several insurers participating, [ ]

Lumley also considers that [ ]

[42] Meeting with Vero (21 February 2014).

[43] For example [ ] has identified Vero as one of the four major participants in the commercial motor vehicle insurance market.

[44] QBE has stated that:

[ ]

[

[ ] and

[ ]

[45] For example, [ ]

[46] Zurich advised us that [ ]

businesses, they may not be able to offer commercial motor vehicle insurance to the full range of purchasers, even if IAG were to raise prices or reduce quality. For instance, Allianz's decision to concentrate on corporate customers now means that it is likely to be less willing to underwrite for SME customers.[47] Nevertheless, any given range of purchasers would continue to have sufficient options for their commercial motor vehicle insurance requirements.

138. Finally we have found that some purchasers of commercial motor vehicle insurance, such as fleet car operators and corporate customers, may have scope to:

138.1 self-insure, either fully or by capping their exposure above a certain limit,[48] or

138.2 use brokers that have access to Lloyd's and other global markets, such as Crombie Lockwood's Offshore Markets Placement Limited (OMPL), which as a Lloyd's coverholder, has access to the Lloyd's market.[49]

139. However, we are unable to place significant weight on either of these options as constraints in this market. This is due to a lack of available evidence to indicate the extent to which parties opt to self-insure, as well as our understanding that offshore facilities tend to be used to place higher risk insurance. In any event, we do not consider it is necessary to rely on either of these options given the constraints from existing competitors mentioned above.

Barriers to entry/expansion

140. We consider that barriers to entry into commercial insurance are not negligible. For instance, Zurich purchased an existing commercial motor book in 2007 to enter the commercial vehicle insurance market rather than growing organically.[50] We have been told that the commercial motor vehicle market is mature and so growth could be more difficult. Evidence that entry is not straightforward has been provided by insurance companies that we consulted during the investigation of this acquisition.[51]

141. In contrast, we consider that expansion is likely to be less onerous, although there can be limitations for some underwriters to expand to avoid having too much exposure to risk in any one insurance product. That said, evidence indicates that because of the "short tail" nature of commercial vehicle insurance, the risk implications of expansion in this area are not as great as it is for some other insurance products.[52] Further, [ ] has informed us that following the Canterbury

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47 [ ]

48 IAG provided the example of [ ];

49 [ ].

50 Telephone call with Zurich (11 February 2014).

51 [ ]

52 Telephone call with [ ](2 May 2014).

earthquakes, insurers have moved towards the commercial motor vehicle market due to there being little catastrophe risk in this product line.[53]

142. We consider that the expansion of QBE in recent years across a range of insurance products, including commercial motor vehicle insurance, shows that over exposure in specific insurance products can be managed and is unlikely to be an obstacle to growth for this company. We acknowledge that not all insurers are positioned to expand.[54] The opportunity and expected profitability of expansion will depend on the particular fact situation of each insurer, and their individual risk appetite.

Heavy commercial vehicle insurance

143. While the acquisition would result in overlap in the heavy commercial vehicle insurance segment, we consider that the presence of other general and specialist insurers as shown in Table 5 would continue to provide competition post-acquisition.

Table 5: Competitors in the heavy commercial motor vehicle segment

Insurer	Comments
Vero	• Identified by insurers and brokers as an existing competitor.
Allianz	• Specialist insurance underwriter through its subsidiary Global Transport and Automotive Insurance Solutions (trading as Motor & General).
QBE	• Identified as an insurer that competes in heavy vehicle motor insurance.
Zurich	• Identified by insurers and brokers as a competitor in heavy vehicle motor insurance.
FMG	• Identified as an insurer that has begun to compete in the heavy vehicle motor segment for rural customers.

Source: Industry participants.

144. The merging parties have submitted that like the general commercial motor vehicle lines, the supply of heavy commercial insurance lines is competitive. Both parties have provided information illustrating how customers tender insurance contracts in

53 Interview with [ ]
54 For example, and as noted above, [ ].

this segment, and that such tenders are competed for strongly by a range of competitors.[55]

145. We are satisfied that Vero and Allianz are strong competitors in the underwriting of insurance for heavy commercial vehicles and will continue to provide an effective constraint post-acquisition. This is supported by information from industry participants. Allianz confirmed that it is a competitor in this segment.[56] Even Multisure Limited, which has raised concerns about the impact of the acquisition, has identified Allianz as having a broad appetite for heavy motor vehicle insurance.[57]

146. In addition, Zurich and QBE are also active in the heavy motor vehicle segment. [58] FMG has also been identified as another insurer that has been competing for contracts for rural customers. [59]

Impact of the acquisition on commercial insurance products for SMEs

147. During our investigation, insurance brokers advised us that SME customers often require a range of commercial insurance products, and that insurers often prefer to supply such products in a bundle. Moreover, placing SME customers' requirements

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[55] IAG stated it:

[ ]

[ ].

Lumley submitted that:

[ ]

[ ]; and

Vero is another competitor with [ ].

[56] [ ].

[57] Submission from Multisure (21 February 2014). Multisure is a transport and contracting consultancy.

[58] In particular, we note that:

Zurich, has stated that while [ ];and

[ ].

[59] Telephone call with [ ] (2 May 2014).

for property, liability, and vehicle insurance (and potentially personal insurance) with a single insurer is often considered the most cost effective.[60]

148. However, brokers have informed us that the only insurance providers that can currently bundle these products (ie, provide the spectrum of products) for SME customers are NZI (IAG), Lumley, Vero, and QBE.

149. Brokers have expressed concern that the acquisition would reduce the number of insurers able to provide the requisite bundle of commercial insurance products to SMEs from four to three, therefore enabling IAG to increase prices and/or reduce the quality of its services post-acquisition.

150. However, we are satisfied that this is unlikely.

What is a SME?

151. For the purposes of our analysis, it is not necessary to reach a firm view on what constitutes a SME. Instead, what is most important is whether or not an ultimate customer buys its commercial insurance cover in bundles such that they have a more limited range of competitive alternatives as a result of this acquisition.

Do SMEs buy risks as a bundle?

152. The evidence provided by brokers, such as [ ], supports the proposition that SMEs tend to place various risks with one insurer.[61]

Are there only four providers that provide the range of commercial products suitable for SMEs?

153. Table 6 below summarises our assessment of the ability and willingness of New Zealand underwriters to underwrite general commercial insurance, and potentially personal insurance products to SME customers.

60 In some cases the broker would need to place all of the client's risk with a single insurer in order to meet minimum premium thresholds.

61 For instance, as at February 2014, [ ]% of [ ]active commercial clients were placed with a single insurer. [ ]

Table 6: Summary of major commercial insurance providers and their ability and willingness to underwrite/provide insurance for SME customers

Insurer	Commercial lines available to SMEs	Limitations on SME offerings
IAG	Motor vehicle, property, liability, personal	No apparent limitations
Lumley	Motor vehicle, property, liability, personal	No apparent limitations
Vero	Motor vehicle, property, liability, personal	No apparent limitations
QBE	Motor vehicle, property, liability	Not involved in farming/rural or personal insurance products. Minimum premium level set at $1,500.
Allianz	Motor vehicle, property	Has reduced its coverage following the Canterbury earthquakes, and has moved its focus on corporate clients (with minimum asset values of $20 million or more for property/liability cover).
AIG	Property, liability	Reasonably broad appetite within the SME segment for property/liability categories of risk. Does not currently provide motor vehicle insurance.
Zurich	Motor vehicle, property, liability	Does not write natural catastrophe cover for properties south of Hamilton. Has increased minimum premiums to $20,000. [ ]
ACE	Property, liability	Does not currently provide any SME property and liability products. No existing involvement in underwriting commercial motor vehicle insurance. Minimum asset value is currently $20 million for material damage/business interruption cover. [ ]
FMG	Agribusiness, personal and commercial insurance, primarily for rural customers	Only available by direct sale.
TOWER	Property, business interruption and liability	Only available by direct sale.

Source: Information provided by insurance providers, brokers and from publicly available sources.

154. On the basis of the information in Table 6, we agree with brokers that there are currently four major underwriters that supply SMEs with the full range of general commercial insurance products: IAG, Lumley, Vero and QBE. However, we note:

154.1 AIG would provide an option for some SMEs for property and liability products; and

154.2 FMG and TOWER also offer some commercial insurance products that are sold directly.

155. Other providers, such as Zurich, Allianz and ACE, do not offer adequate insurance cover for SMEs due to geographic restrictions, minimum client asset values, and/or limited insurance product offerings. Rather, such insurers tend to either focus exclusively on corporate customers (eg, Allianz and ACE), and/or provide a more restricted geographic coverage (eg, Zurich in respect of property insurance), thereby removing them as a suitable option for SMEs.

Competitive constraint on IAG post-acquisition?

156. IAG submitted that SMEs will continue to have a range of competitive options available post-acquisition when obtaining cover for general commercial insurance products. Indeed, IAG believes SMEs have the "best of both worlds" in accessing direct and indirect insurance offerings. In particular, IAG:

156.1 identified a range of insurers that either provide insurance indirectly via brokers, including AIG, Vero, QBE, Allianz (through Aon's Client Placement Facility) and OMPL, as well as directly, including through TOWER and FMG;

156.2 identified QBE as a [ ] competitor, TOWER as being strong [ ], AIG as [ ], and Crombie Lockwood's subsidiary OMPL as also being very active;

156.3 [ ] and

156.4 noted the purchase of a bundle of insurance products from a single insurance provider is not required to achieve transaction cost savings. For instance, of NZI and State customers, only [ ]% and [ ]% (respectively) purchase three types of insurance from the same brand.[62] Additionally, IAG noted that minimum premium thresholds are not material.

157. Wesfarmers similarly has stated that there are a range of options available to brokers to meet the requirements of SME customers, which are not necessarily confined to placing the insurance needs of SMEs with a single provider. These include:

157.1 a broker bundling its SME customer risks;[63]

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62 IAG's response to the Commission's Letter of Issues (at [42].

63 Wesfarmers states this can be achieved by separating out an individual SME's insurance needs into its constituent parts (ie, liability, property, motor vehicle, etc) and amalgamating these separate risks with other SMEs and placing these separate risks with individual insurers. [

157.2 a broker using offshore capacity to cover all of a SME's risks. For example, Wesfarmers noted that Crombie Lockwood can obtain such access through its subsidiary OMPL; [64] and

157.3 the scope for two single underwriters to enter a partnership arrangement to offer a "full product line" package to SMEs.

158. In our view, the initial question is whether the two remaining alternative providers of SME commercial bundles – Vero and QBE – have the incentive and ability to expand their existing offerings in the event IAG attempted to increase prices or reduce service post-acquisition.

159. Our view is that they have both the ability and the incentive to do so. This is sufficient to satisfy us that there is unlikely to be a substantial lessening of competition.

159.1 In relation to Vero, it has an existing strong presence in the underwriting of commercial insurance products, including to SME customers. All brokers we spoke to identified Vero as one of their three major underwriters of commercial insurance products, including for a range of bundled insurance products to SME customers, the others being IAG and Lumley. For instance, Vero accounts for [ ]% of Crombie Lockwood's SME business, placing it [ ] to IAG.[65] Other brokers we consulted also identified Vero as one of their major providers of commercial (and personal) insurance products.[66]

159.2 In relation to QBE, we consider that the evidence provided by QBE [ ] shows that it is likely to provide an effective constraint on IAG.[67] It has already demonstrated that it is an aggressive competitor in the commercial motor vehicle insurance market and that, as a large global insurer, it has the potential to expand its commercial offerings, including into the SME customer segment, to fill the gap left by the removal of Lumley.

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64 Wesfarmers has stated that OMPL can [ ]

65 Letter from Russell McVeagh at Figure 3, page 24.

66 For example, [ ].

67 [ ]

160. Furthermore, we agree with the merging parties that brokers have an important role to play in exercising competitive constraint in this segment by shopping around for the best deal for their clients.

161. Clients themselves would still have access to other underwriters of commercial insurance, including TOWER and FMG, which supply directly.

Barriers to entry/expansion

162. As discussed, we consider that barriers to entry into commercial insurance products are not negligible, and the underwriting of a bundle of commercial insurance for SMEs is no different. For example, investment in IT systems would be required and given the high volume/low margin nature of supply to SME customers, any entrant is likely to need to be of a sufficient scale.[68]

163. In contrast, we consider that it is likely to be less onerous for an existing market participant to expand their existing presence. As with commercial motor vehicle insurance, the opportunity and expected profitability of expansion will depend on the particular fact situation of each insurer, and their risk appetite, but we consider that some insurers are so positioned.

164. We consider that QBE's growth in the underwriting of a bundle of commercial insurance products demonstrates expansion is feasible. At the same time, we note that certain companies, such as Allianz, have withdrawn from underwriting insurance products for SMEs.

Competition assessment of the acquisition in buyer markets

165. We have considered the competitive impact of the acquisition in a number of markets where IAG and Lumley compete to buy services. These included collision repair services, windscreen repair/replacement services, vehicle salvage services and claims adjustment services.

166. We found that there would continue to be sufficient competition for windscreen repair/replacement, vehicle salvage and claims adjustment services, and the acquisition would be unlikely to strengthen the buying power of IAG in these markets post–acquisition such that a substantial lessening of competition is likely to result. This is because in these buyer markets, competition would continue to be provided by alternative insurance providers, including Vero/ AA Insurance and TOWER.

167. Therefore, we are satisfied that the acquisition would be unlikely to substantially lessen competition in those markets, and we have not considered those markets further in these reasons.

168. The remainder of this section discusses the effect of the acquisition on collision repair services.

68 Telephone call with [ ]

Market for the provision of collision repairs

169. We have received a number of submissions regarding IAG's existing position and practices in the collision repair market. These submissions suggested that:[69]

169.1 non-insurance work makes up around 20% of collision repair work, and collision repairers rely on insurance generated work to remain in business;

169.2 the hourly rates IAG pays collision repairers holds the cost of collision repairs to a "minimum";[70] and

169.3 IAG is placing greater demands on its network of approved repairers to purchase expensive equipment and expand staff training levels without compensating for such investments.

Our framework for assessing buyer power in mergers

170. A merger between competing buyers could lessen competition if it increases the merged firm's ability to profitably reduce prices it pays to suppliers below the competitive level for a significant period of time. The result may be that suppliers could no longer cover their supply costs and so withdraw supply from the market. In this case that may reduce the number or capacity of, for example, collision repairers in, and collision repair work conducted in New Zealand. However, for the reasons outlined below, we do not consider such an outcome is likely.

Our competition assessment of the acquisition

171. We do not consider that the removal of Lumley from the collision repair market is likely to strengthen IAG's buyer power to such an extent that a substantial lessening of competition is likely to result. This is because:

171.1 IAG is unlikely to be in a position to decrease prices from existing levels since over 50% of the remaining market share for all collision repair work would be accounted for post-acquisition by alternative insurance companies. In particular Vero/AA Insurance would hold the next largest market share after IAG [ ]% and various other insurers, including TOWER and FMG, would have smaller shares.[71]

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69 For example, see the submissions from the Motor Trade Association (18 February 2014), Crash Repairers' Association (27 February 2014). Suncorp Group Limited also expressed concerns in its submission dated 21 February 2014 that the proposed acquisition would strengthen IAG's existing strong control over the crash repair services market.

70 Collision repairers are concerned that the hourly rates set by IAG ($41- $51) are already well below the amount required to run a modern collision repair business, which the Crash Repairers' Association (CRA) estimates to be $90 per hour. Submitters also indicated that crash repairers are currently forced to accept the rates (and other terms and conditions) offered by IAG and that the situation is likely to be exacerbated by the acquisition.

71 IAG estimates that its existing annual spend in the purchase of collision repair services would increase from about [ ]% to about [ ]% post–acquisition (see IAG Application at [28.2] and Annexure 8.)

171.2 In addition, non-insured work is estimated to account for around 20% of the total collision repair market.[72] This work, which is unaffected by the acquisition, would remain available to collision repairers.

171.3 Insurers are incentivised to keep prices they pay for collision repair services at competitive levels, but at the same time must maintain good quality repair services to compete in the private and commercial motor vehicle insurance markets described earlier in these reasons. If they do not, then insurers risk customers switching to alternative insurance providers. We consider it unlikely that IAG would have the incentive to depress prices post-acquisition below competitive levels because any consequent reduction in the quality of repair work would likely cause IAG to lose insurance customers.

[72] We previously estimated that non-insurance work makes up approximately 20% of sales in the collision repair market (see IAG (NZ) Holdings Limited and AMI Insurance (Operations) Limited [2012] NZCC 6 at [101.1]). This figure accords with information from industry sources, including CRA, which stated that CRA members are responsible for around 80% of the insurance collision repair market (see CRA's submission to the Commerce Commission on IAG/AMI (12 February 2012).

Determination on notice of clearance

172. We are satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

173. Under section 66(3)(a) of the Act, the Commerce Commission determines to give clearance for IAG (NZ) Holdings Limited to acquire 100% of the shares in Lumley General Insurance (N.Z.) Limited.

Dated this 6th day of May 2014

Dr Mark Berry
Chairman