Statement of Preliminary Issues
IAG / AMI
25 January 2012

Introduction

1. On 20 December 2011, the Commerce Commission (Commission) received an application from IAG New Zealand Limited (IAG) seeking clearance to acquire certain business assets of AMI Insurance (Operations) Limited (AMI). The public version of the application can be accessed on the Commission’s website at:

   http://www.comcom.govt.nz/clearances-register/detail/749

2. This Statement of Preliminary Issues outlines the key competition issues the Commission currently considers 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 the Commission’s assessment of the application for clearance progresses. Therefore, the issues highlighted in this Statement of Preliminary Issues are in no way binding on the Commission.

3. The Commission invites interested parties to make comment on the likely competitive effects of the proposed merger.

Relevant Parties

The Acquirer – IAG New Zealand (Holdings) Limited (IAG)

4. IAG is a wholly owned subsidiary of Insurance Australia Group Limited, a large Australian general insurance company. In New Zealand, IAG offers general insurance products (including domestic home, contents and motor vehicle insurance, and commercial insurance) under the ‘State’ and ‘NZI’ brands.

The Target – AMI Insurance (Operations) Limited (AMI)

5. AMI is a large general insurance company which primarily offers home, contents, and motor vehicle insurance products. AMI operates in New Zealand only.

The Transaction

6. As a result of the 2010 and 2011 Canterbury earthquakes, AMI incurred significant insured losses which required it to enter into a capital support arrangement with the New Zealand Government in order to continue operating. AMI determined that the best course of action was to seek an external investor in AMI.

7. Under the terms of the proposed acquisition, any of AMI’s liabilities resulting from the Canterbury earthquakes will be transferred to a company owned by the Crown. IAG will purchase the remaining assets of AMI and also provide claims management and administration services for claims arising from the Canterbury earthquakes.
Analytical Framework

8. In the context of an application for clearance, the Commission must consider whether or not an acquisition substantially lessens competition. The first step of the Commission’s analytical framework is to determine the relevant market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target where aggregation of market share may arise from the acquisition. The Commission then considers the relevant products and geographic regions that constitute close substitutes from both a customer’s and a supplier’s point of view.

9. The Commission uses a forward-looking type of analysis to assess the degree of any potential lessening of competition in the relevant market or markets arising from a proposed acquisition. Therefore, the next step is to establish the two hypothetical future scenarios:

9.1 With the acquisition in question (the factual); and

9.2 in the absence of the acquisition (the counterfactual).

10. The impact of the acquisition on competition is then viewed as the difference between those two scenarios.

11. The Commission analyses the extent of competition in each relevant market for both the factual and counterfactual scenarios, in terms of:

11.1 existing competition – the degree to which existing competitors compete and their ability to expand production in the event that the combined entity raises prices;

11.2 potential competition – the ability of businesses to readily enter the market and thereafter expand, given an inducement to do so;

11.3 the countervailing market power of buyers – the potential for a business to be sufficiently constrained by purchaser’s ability to exert an influence on price, quality and/or terms of supply; and

11.4 coordinated behaviour – whether the acquisition would enhance the ability of market participants to collude either tacitly or explicitly.

12. A comparison of the extent of competition in the relevant markets both with and without the acquisition enables the Commission to assess the degree by which the proposed acquisition might lessen competition. If the lessening is substantial the Commission may not give clearance to the proposed acquisition.

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Preliminary Issues

13. The proposed acquisition would result in aggregation of market share in three insurance product categories: domestic house, domestic contents, and domestic motor vehicles.

14. The Commission considers that its consideration of the proposed acquisition will focus on the following areas:

Market Definition

15. In respect of market definition, the Commission will consider there are separate underwriting and retail insurance markets.

16. The Commission will also assess whether other related markets such as windscreen or motor vehicle repairs are relevant to the proposed acquisition.

Existing Competition

17. IAG submits that the merged entity would continue to face strong competition post acquisition from existing insurance companies and from banks. In addition, IAG submits that customers have a large amount of choice and face little difficulty in switching between insurance providers.

18. The Commission understands that no New Zealand bank offering general insurance products underwrites its own policies. Instead, it will resell a product of an insurance company. The Commission will assess whether or not banks are able to provide competitive constraint as a result of this relationship.

Potential Competition

19. IAG submits that the conditions of entry into insurance markets are not so onerous as to deter entry by credible alternative competitors. Specifically, IAG submits that entry could occur in several ways:

   19.1 New entry by the major banks moving into underwriting their own insurance products.

   19.2 Expansion by either existing international insurance companies into New Zealand, or by existing New Zealand based insurers moving from commercial to domestic insurance.

Next Steps

20. In line with the Commission’s Merger and Acquisitions Clearance Process Guidelines (available on the Commission’s website at www.comcom.govt.nz), the Commission has established a draft timeframe for consideration of the issues and IAG’s application for clearance. An extension of time has been agreed to by the Applicant such that the Commission should make its final decision by 29 February 2012. However, this timeframe could change. To keep abreast of possible changes to
timing and to find relevant documents, visit the Clearance Public Register on the Commission’s website at:

http://www.comcom.govt.nz/clearances-register/

21. As part of its investigation, the Commission will identify the parties it believes will provide the best information to help it assess the preliminary issues identified above. The Commission will be contacting those parties over the next few weeks.

22. The Commission invites submissions from any other parties who consider they have information relevant to the Commission’s consideration of this matter. If you wish to make a submission, please send it to the Registrar, at registrar@comcom.govt.nz with the reference IAG / AMI in the subject line of your email, or The Registrar, PO Box 2351, Wellington 6140 by 4pm on Tuesday 7 February 2012. Please clearly identify any confidential information contained in the submission and provide contact details.