



INDEPENDENT CONSUMER AND COMPETITION COMMISSION

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DETERMINATION

**APPLICATION FOR CLEARANCE OF THE
ACQUISITION OF HEATH LAMBERT (PNG) LIMITED**

BY

MARSH (PNG) LIMITED

DETERMINATION

Background

Parties and Acquisition Proposal

This Determination relates to the application by Marsh (PNG) Limited (**Marsh**) for Clearance of its proposed acquisition of Heath Lambert (PNG) Limited (**Heath Lambert**) pursuant to Section 81 of the Independent Consumer and Competition Act 2002.

Marsh has been operating in Papua New Guinea (PNG) for over twenty six years and is one of the six (6) insurance brokers operating in PNG, specializing in large corporate clients dealing mainly with risk management services. Marsh is owned by Marsh (Australia) Ltd 52%, Melanesian Trustees 26% and H.R. Kila & Associates 22%.

Heath Lambert has been in the PNG insurance market for over fifty years and specializes in small- medium size enterprises dealing mainly with traditional insurance policies such as fire, marine and property. The shareholders of Heath Lambert are the Lambert Group (Australia) 79%, POSF 20% and Estate Edith Tracey 1%.

In March this year, Marsh (Australia) Ltd acquired Heath Lambert (Australia) Limited which also gave Marsh an interest in Heath Lambert (PNG) Limited resulting in the current application for clearance by the Commission of the merger in PNG.

If clearance were granted, Marsh and Heath Lambert would merge into one operating company in PNG incorporating all existing share holders of Marsh and Heath Lambert. Marsh (Australia) Ltd has also indicated it would sell down its shareholdings in Heath Lambert to allow POSF to increase their shareholding in the proposed new entity from 4 per cent to 10 per cent. The proposed shareholding would be as follows:

Shareholding of Marsh

Shareholders	Nationality	Percentage of Shares
Marsh (Australia) Ltd	Australia	52%
POSF	Papua New Guinea	10%
Estate Edith Tracey	Papua New Guinea	0%
Melanesian Trustees	Papua New Guinea	21%
H.R. Kila & Associates	Papua New Guinea	17%
Total		100%

Application for Clearance

Marsh has lodged an application for clearance of the proposed acquisition of Heath Lambert (PNG) Limited pursuant to Section 81 of the ICCA Act, Sub-section (3) of which provides that the Commission must within 20 days make a determination on whether or not to grant clearance of the proposed acquisition.

The application was lodged on 10th August 2004, and the Commission was to have made a determination on this application by 30th August, 2004. However, at the request of the Commission for further information and as per the provisions of section 81(5) of the *ICCA Act 2002*, the Commission now has until 15th September, 2004, to make a determination on this application.

Elements of a Clearance

Marsh applied for a clearance of the proposed acquisition under Section 81 of the *ICCA Act 2002*. Section 81(3) of the Act provides that the Commission shall:

- (a) if it is satisfied that the acquisition will not have, and will not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, give a clearance; or
- (b) if it is not satisfied that the acquisition will not have, and will not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, decline to give a clearance for the acquisition.

In order to arrive at the decision whether to grant a clearance or not, it is necessary to assess the competition effect of the proposed merger in the market.

The market

By way of background to the market, the insurance brokers act as insurance consultants to or agents of buyers of insurance policies by negotiating on their behalf with the insurance companies.

Insurance brokers, who are required to be licensed by the Insurance Commissioner, place their business with seven (7) insurance companies that are also licensed to underwrite business in PNG. These insurance companies are: American Home Assurance Company, QBE Insurance (PNG) Ltd, Pacific MMI Insurance Ltd, Mitsui Sumitomo Insurance Company, Tower Insurance, Workers Mutual Insurance (PNG) Ltd and the National Teachers Insurance Ltd. Persons seeking insurance may deal

directly with insurance companies without going through an insurance broker, though in practice it appears that the vast majority (about 95%) of insurance business in PNG, at least as far as commercial insurance by firms and businesses is concerned, is transacted through insurance brokers.

The acquisition is to be assessed on its effect on competition in the relevant market which is defined in Section 45 (2) of the Act as:

“...a reference to a market in the whole of Papua New Guinea for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them, including imports”.

In its application the applicant submits that the relevant market is the broking market but segments it into two sub-markets. The high end of the market deals with the high risk or big business clients and the low end deals with the small traditional risk insurance and individual clients (see Table below). Marsh suggests that it controls the great bulk of the high end of the market, with Heath Lambert also having some high end clients, while the other insurance brokers are predominantly involved in the low end of the market. Those brokers are; AON Risk Services, Asia Pacific Insurance Brokers, South Pacific Insurance Advisory and Kanda International Insurance Brokers. At the time of making this assessment, the Insurance Commissioner had licensed a new broker, Insurance Partners (PNG) Limited, which is understood to be a member of an international consortium, the Willis Group.

Table on Revenue Bands

Revenue Band	Heath (PNG) Ltd	No. of Clients	Marsh (PNG) Ltd	No. of Clients
Less than K10,000	700,987	823	756,682	658
K10,000-K100,000	2,417,065	7	2,952,919	86
K100,001- K200,000	312,680	2	1,436,817	10
K200,001-K500,000	624,751	2	1,865,123	7
K500,001 Plus	1,282,792	1	3,511,222	3
Total	4,436,801	835	10,516,663	757

While the Commission would agree that the relevant market in this case is the insurance broking market, it is irrelevant to segment this market into that of the high and the low ends of the market. There is little or no barrier to the broker with a large business or corporate client base also servicing the small clients and indeed individual customers, or, a broker with small client base doing likewise in servicing big corporate clients.

In addition, there is no clear distinction between the “high end” and the “low end” – what about middle sized businesses, where do they fit in? In any event, small or medium enterprises may have a need for sophisticated,

“high end” insurance products, while some large enterprises may, by the nature of their business, need only simple, “low end” insurance products. It is therefore the Commission’s view that the total insurance broking market as a whole is a relevant market in this case, not a high end or low end insurance business market.

Marsh seems to accept that insurance broking is a different market from insurance services generally, and it is agreed that this distinction is appropriate. While there may be competition to some extent between insurance brokers and insurance companies dealing directly (discussed below), the services provided by insurance brokers are distinct from those services provided by insurance companies.

It is therefore considered that the relevant market in this clearance application is the whole insurance broking market in Papua New Guinea.

The Effect on Competition

The insurance broking market is reasonably concentrated with six participants only, but more particularly with two of those participants having two thirds of the market between them, as indicated in the following table.

The table below shows the market share in terms of placements (figures supplied by Marsh).

Insurance Premium Placements for 2002

Form of Placement	Amount of Premium	Share of Market
Direct Placement	12,491,659.00	5%
Marsh (PNG)	117,175,017.00	52%
Heath Lambert (PNG)	33,232,323.00	15%
AON,SPIA & APIB	59,888,521.00	28%
Total Broker & Direct	K222,787,520.00	100%

The above table shows that in 2002, Marsh had a 52 per cent of the market share compared to Heath Lambert 15 per cent and the other brokers put together making 28 per cent. The remaining 5 per cent was through direct placements with insurance companies.

The merger between Marsh and Heath Lambert, if approved, would give the merged entity a market share of about 67% (assuming no post merger loss of business), which produces a highly concentrated market, even allowing that there are four (soon to be five) other competing brokers. In ordinary circumstances that would give Marsh a high degree of market power, with the potential effect on competition that would have.

Arguments advanced by the Applicant

In arguing that its high market share would not allow it to dominate the market, and thus adversely affect competition, the applicant advanced the following:

- (1) That the insurance industry is governed by legislation through the Office of the Insurance Commissioner. Business in PNG can only be placed with insurance companies or brokers that are licensed by the Insurance Commissioner to transact insurance or broking business in PNG. Overseas and unlicensed brokers are precluded from transacting business in PNG. However, insurance brokers may place business overseas due to lack of capacity in the local market or where there is a price advantage.
- (2) A dominant market share does not give any competitive advantage to Insurance brokers because they do not set the prices of insurance premiums rather it is the insurers or insurance underwriters who set the prices based on:
 - Re-insurance cost (based on international trends);
 - Claims experience of a particular product and class of insurance;
 - Risk profile of each individual exposure; and
 - Internal insurance company underwriting philosophies and strategies.
- (3) Insurance brokers merely use their market strength, knowledge and skill to get the cheapest possible premium with the most extensive cover for their clients.

The applicant also claims that the prices vary from one insurance company to another and therefore the more market strength a brokers has the more leverage they can apply to insurance companies to get cheaper prices and extensive cover for their clients.

The applicant also highlights in its submission that brokers like Marsh and Heath Lambert are remunerated by “brokerage” or “commission” paid by the insurance companies for businesses placed with them. The brokerage rates are generally set by insurance companies and are standard for all insurance broking companies.

In these circumstances, it is the applicant’s submission that competition in the market will not be affected as a result of the proposed merger.

Views from Industry Participants and Others

Views were also sought from industry participants as well as other interested parties and these are summarized as follows:

Kanda International Insurance Brokers & Consultants and **QBE Insurance (PNG) Limited** submitted their views which in general agree that the merger should be allowed to proceed on the grounds that:

- Competition for small to medium size brokers will be enhanced;
- Prices are not determined by brokers;
- Heath Lambert clients now have access to world wide networking benefits; and
- The net gains to consumers outweigh any lessening of competition in the market.

AON Risk Services expressed their support for the merger to avoid congestion in the market that would lead to smaller brokers being squeezed out.

Asian Pacific Insurance Brokers also did not oppose the merger but cautioned that it could have potential negative effect on the consumers through:

- Hike in insurance premiums across the market;
- General insurers dominating the market;
- Declining service standards;
- Sub-standard products being delivered;
- Dictatorial tactics will be evident in the market; and
- There will be less competition, a hike in premiums and declining service standards.

The Office of the Insurance Commissioner raised objections to the merger on the grounds that:

- The bulk of the insurance premiums are placed through brokers and that the insurance industry is broker driven; and
- There would be concentration of expertise in one entity.

After careful assessment of the above, the Commission's position on the arguments and claims raised are as follow.

(1) Regulation of industry by the Insurance Commissioner

To the extent that the industry is regulated, this could act as a constraint to entry of new insurance companies or broking companies and therefore, would affect competition in the market. While under normal circumstances this may be so, the licensing of

new brokers appears to be based on prudential criteria, not on any desire to artificially limit the number of brokers. The fact that a new entrant has been licensed recently in addition to the 5 existing brokers indicates that regulation of the industry is not necessarily a barrier to entry by new competitors and does not constrain competition.

(2) *Dominant market share does not give competitive advantage to brokers as prices are set by insurers and not by brokers*

Market share is a good indicator of market power and many customers and potential customers will perceive, rightly or wrongly, that the applicant's far greater market share will give Marsh an advantage in dealing with insurance companies. As a result, customers are more likely to choose the applicant over the other smaller brokers in minding their insurance interests. By the same token, the applicant will have greater leverage in negotiating best premiums for clients and insurance companies will be reluctant to lose the applicant's business. This scenario is possibly heightened by the fact that 95% of insurance is arranged through brokers in PNG.

While this may be the likely scenario under normal circumstances, the information that is available would suggest otherwise. There are seven insurance companies and seven brokers, including the new entrant, giving insurance buyers a wide choice in securing the best premium rates with better and wider insurance coverage in PNG. There is evidence of consumers changing their brokers, and there is no evidence of the existing brokers being against the proposed merger. This may reflect the fact that Heath Lambert already holds a large part of the market. Indeed there is recent anecdotal evidence of five clients who have recently moved from Marsh to AON and South Pacific Insurance Advisory (although this could not be confirmed).

The same reasoning and arguments are valid for the applicant's claim on prices being set by the insurers. The leverage it has due to its size would under normal circumstances influence prices in negotiating with insurance companies. (Of course those lower premiums would ultimately benefit consumers anyway.) However, here again, the choices available to the consumer are such that competition is likely to be heightened. This is particularly so in view of the fact that most Chief Executive Officers of competing brokers are former employee of either Marsh or Heath Lambert and have good inside knowledge about the insurance business and, the fact that brokers only have 12 months at the most to retain clients.

With respect to the views from other industry participants and others, only the Insurance Commissioner has raised some serious objection to the

proposed merger. Unfortunately and with due respect, the objection was not substantiated in terms of factual information. Indeed, the claims of a monopoly and therefore, substantial lessening of competition in the market run counter to the recent licensing by the Insurance Commissioner of another international broker to enter the market.

Statutory Factors taken into account in Assessing Competition

In addition to the assessment of the arguments by the applicant and others, in assessing the post acquisition effect on competition in the market, Section 69(5) of the *ICCC Act 2002* sets out a number of non-exclusive factors to be taken into account.

(a) The actual and potential level of import competition in the market

The sourcing of insurance services is regulated by the Insurance Commissioner through legislation and the ICCC would agree with the applicant that the actual and potential level of import competition is not at issue here. However, the Commission notes that it is possible for new entrants to come into the industry, and as is demonstrated by the recent decision by the Insurance Commissioner to licence Willis, it is possible for these new entrants to come in from overseas. Thus, they potentially have the expertise, skill base and financial resources to enter the market in competition with the existing players including a player who holds potentially over 60% of the market. Thus, from this perspective import competition is relevant and is a potential constraint on adverse monopolistic practices by the existing incumbents.

(b) The Nature and Effect of Barriers to Entry to the Market

The applicant submits that prior to 2001 there were only three (3) brokers in the insurance industry; Heath Lambert, Marsh and AON Risk Services. In 2001 and 2003, the office of the Insurance Commissioner licensed Asian Pacific Insurance Brokers, South Pacific Insurance Advisory and Kanda International Insurance Brokers respectively. As indicated earlier, there is now a further new entrant and this, the applicant submits, is evidence of the fact that there are no barriers to entry for any new broker wishing to enter the PNG market.

The Commission would agree that the entry of a new international broker is evidence of the ease with which new brokers can enter the market and the potential that new entrants can be offshoots of existing significant international broking firms.

(c) Number of Buyers and Sellers in the market.

The buyers of insurance products in the market in effect comprise the whole population of PNG from individuals to large corporate clients. But due to the nature of the industry, there are effectively seven suppliers of insurance products and six brokers including the new entrant making it a very competitive or 'super competitive market' according to Kanda International Insurance Brokers. The Commission would agree that there is a high level of competition in the market, although some of the insurance companies and brokers specialize in certain parts of the market. Nevertheless, there is both the potential for new entrants and a diverse range of services that are being sought after to support a vibrant competitive industry. In terms of the broking part of the industry, this vibrancy of competition has been demonstrated by the entry of several new brokers to the PNG market in recent years.

(d) Degree of Countervailing power in the market

The ability for customers to exercise countervailing power is very limited. While some customers or potential customers are large enterprises whose premium payments may be large enough to give them some countervailing power that would be rare. The ability of those large customers to source their insurance requirements offshore gives them some (limited) countervailing power.

On the supply side, one or two of the seven insurance companies may be large enough to exercise countervailing power by resisting demands for special deals, and of course Marsh claims that those companies set rates without having lower rates forced on them by powerful brokers.

Overall countervailing power is low.

(e) Likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices and profit margins

The applicant claims that it is the insurance companies and not the insurance brokers that set the price of insurance products and therefore Marsh will not be in a position to increase its profit margin or prices. On the contrary, it claims that the merged entity is more likely to offer cheaper premiums and a better insurance cover because of its newly acquired buying strength and extensive market knowledge which it can use to negotiate on behalf of its clients cheaper insurance premiums, better insurance cover or both.

The Commission disagrees with the applicant's claim on margin increase. Marsh is in a position to squeeze insurance companies for higher commissions and will be even more able to do so after the merger. However, that pressure may also produce lower premiums, which means that consumers stand to benefit from the merger. Brokers may not have a direct say in the cost of product but with the leverage that Marsh has and the economies of scale it is able to achieve as a result of the merger, it is more likely, in the long run, to increase in its profit margins through higher commission income and/or reduction in its average operational costs.

(f) Extent to which substitutes are available or are likely to become available in the market

There is one direct substitute available – insurance purchased directly from the insurance companies by the customers. While the level of direct dealing in the insurance market in PNG is very low at present, about 5%, the possibility of cutting out brokers by dealing direct must be taken into account, particularly if Marsh were to try to force insurance companies to pay it larger commissions, in which case the insurance companies may decide to respond by discounting premiums for customers who deal with the insurance companies directly.

(g) Dynamic characteristics of the market including growth, innovation and product differentiation.

While the industry is regulated by the Insurance Commissioner which may constrain new entry and growth in the industry, recent experience in a significant expansion in the number of brokers in the last couple of years suggests the market is quite dynamic.

(h) Likelihood that the acquisition would result in the removal from the market of a sustainable, vigorous and effective competitor

The acquisition by Marsh of Heath Lambert, the second largest broker in the market, must, to some extent at least, result in the removal of a competitor. However, there may be some validity in the claim by Marsh that, due to the differences in their client base, Heath Lambert is not a competitor of Marsh in all areas. But the claim by Marsh that Heath Lambert is not a competitor and therefore, the merger can not possibly result in the removal of a sustainable, vigorous and an effective competitor from the market, significantly overstates the situation.

(i) Nature and Extent of Vertical Integration in the market.

While it is not clearly spelt out in the applicant's submission, the Commission is of the view that vertical integration is not at issue here. None of the six insurance brokers appears to be associated with or controlled by companies providing insurance or reinsurance.

(j) Other factors

While the acquisition would give Marsh a very high market share, it already has in excess of 50% of the market anyway. The likelihood of Marsh using its market power for anticompetitive effects would perhaps not be much greater with a 67% market share than with 52%. The experience in the market to date, with the doubling of market participants in the last few years, and the lack of opposition by those competitors to the merger, suggests that the potential anticompetitive effect of the merger may not be as great as might otherwise be expected.

There appears to be vigorous competition in the market at the moment and another new competitor, perhaps with some international support, should ensure that competition remains strong.

The main opportunity for Marsh to exercise its increased market power after the merger would appear to be to increase pressure on insurance companies to reduce premiums, which is a positive benefit for consumers.

Summary and Conclusion

To grant a clearance under Section 81(3) of the *ICCC Act 2002*, the Commission must be satisfied, on the basis of the facts given, that the acquisition will not have, and will not be likely to have, the effect of substantially lessening competition in a market. The only test is the competition effect of the acquisition in the market.

This requires analysis of the competition effect in the relevant market. Section 45(2) of the *ICCC Act 2002* defines the relevant market as;

“a reference to a market in the whole of PNG for goods and services as well as other goods and services that as a matter of fact and commercial common sense, are substitutable for them, including imports”.

The applicant defined the relevant markets as the high and the low ends of the broking market depending on the magnitude of risks handled and covered, such that that it (Marsh) is more predominant in the upper end while Heath Lambert operates at the lower end of the market.

The Commission rejects this definition of the relevant market. The relevant market is the insurance broking market as a whole in which Marsh, Heath Lambert and the other brokers all compete.

While the acquisition will increase Marsh’s existing large market share to about two thirds, there are a number of factors which mitigate against a conclusion that the acquisition would result in a substantial lessening of competition. These factors include:

- The market appears to be fairly strongly competitive at the moment, notwithstanding Marsh’s existing strong market position;
- The barriers to entry are low, and new players have entered the market in recent times;
- Marsh can most readily exercise its enhanced market power to force premiums down, to the benefit of consumers rather than to any competitive detriment;
- Countervailing power is of little effect;
- Marsh should not be able to significantly and sustainably increase prices but may increase its profit margins;
- The capacity to avoid brokers and deal directly with insurers should constrain undue increases in commissions or margins;
- While overall revenue in the market may be stable, the market structure is relatively dynamic, with increased numbers of competitors;
- Competitors and suppliers (insurers) are largely supportive of the acquisition, apparently not feeling threatened by the increase in Marsh’s market power; and
- While the acquisition may well result in some lessening of competition, it would not appear to amount to a substantial lessening of competition.

Decision

In view of the above factors and considerations, the Commission is satisfied that the acquisition of Heath Lambert by Marsh (PNG) Limited will not have, and will not be likely to have, the effect of substantially lessening competition in a market and hereby grants clearance for the proposed acquisition to proceed pursuant to Section 81(3) of the Independent Consumer and Competition Act 2002.

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Thomas Abe
Acting Commissioner

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Paul Baxter
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Chris Gideon
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