



**INDEPENDENT CONSUMER & COMPETITION COMMISSION**

**DETERMINATION**

**APPLICATION FOR ACQUISITION OF ALLIANZ'S NEW ZEALAND  
LIMITED'S 50% SHAREHOLDINGS IN PACIFIC MMI LIMITED**

**BY**

**MOTOR VEHICLE INSURANCE LIMITED**

Application Lodged Date : 6<sup>th</sup> of December 2007

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**TABLE OF CONTENTS**

- 1. Background.....3*
- 2. Acquisition proposal.....3*
- 3. Application for clearance.....4*
- 4. Elements of a clearance.....4*
- 5. Facts & Contentions in support of the application.....5*
- 6. Views from Industry Participants & Others.....5*
- 7. Insurance Industry Characteristics.....7*
  - 7.1 Market Share*
  - 7.2 General Insurance*
  - 7.3 Life Insurance*
  - 7.4 Reinsurance*
- 8. Commission Assessment.....11*
- 9. Effects of Competition in the market.....13*
- 10. Statutory Factors taken into account in Assessing Competition.....16*
- 11. Summary and Conclusion.....22*
- 12. Decision.....23*

## **1. Background**

### ***1.1 Parties to the Acquisition Proposal***

This Determination relates to the application by Motor Vehicle Insurance Limited (MVIL) for Clearance of its proposed acquisition of Allianz New Zealand Limited's (Allianz) 50 percent shareholdings in Pacific MMI Insurance Limited (PMMI).

***Motor Vehicle Insurance Limited (MVIL)*** – MVIL is a statutory authority established under the *Motor Vehicles (Third Party Insurance Act) (Chapter 295)*. By virtue of its Act, the company is State owned and has a statutory monopoly in the provision of motor vehicle and driver registrations, including compulsory third party (CTP) motor vehicle insurance in PNG; thus it is a declared entity under Part III of the *Independent Consumer and Competition Commission Act 2002* (the “ICCC Act”) for regulation purposes.

***Allianz New Zealand Limited (Allianz)*** – Allianz is part of the Allianz Group which is one of the largest and most well known insurance and financial service providers in the world. It represents an international network of strong brands with first-class products, and brings together the expertise of specialists in property and casualty insurance, life and health insurance, asset management and banking.

Allianz currently has subsidiaries in more than 70 countries including PNG, with over 162,000 employees and 60 million customers. The current application relates to its New Zealand subsidiary.

***Pacific MMI Insurance Limited (PMMI)*** – PMMI is a national insurance company operating throughout Papua New Guinea and the Pacific Region. It was established in 1998 through a joint venture between MVIL and Allianz. The Joint Venture took over the insurance portfolio previously operated by the Niugini Insurance Corporation - a state owned company established under the *Insurance Corporation Act 1977*.

Pacific MMI is a registered general insurance company under the *Insurance Act 1995* (the “Insurance Act”), and a registered life insurance company under the *Life Insurance Act 2000* (the “Life Act”). The company provides a range of personal, commercial and corporate insurance products through selected Insurance Brokers, Business Partners, and directly to the Public. Its product ranges include medical, motor vehicle (ie: comprehensive motor vehicle insurance cover but not compulsory third party insurance cover), personal accident, group plans for special affinity and special interest groups, and life insurance, mortgage protection, term life and workers compensation.

## **2. Acquisition Proposal**

The acquirer (MVIL) submitted that it presently holds 50 percent shares in PMMI. Since Allianz is desirous in selling its shareholding, MVIL has exercised its pre-emptive rights under the Constitution of PMMI to acquire that shareholding.

The applicant also submitted that its current interest in PMMI is for investment purposes

and that it has in the past received significant return on its investment. It therefore wishes to increase its return on investment and is of the opinion that the proposed price for the balance 50 percent shareholding is reasonable in all of the circumstances. It claims that the MVIL Board had resolved to approve the transaction and approval from its trustee; the Independent Public Business Corporation has been obtained.

### **3. Application for Clearance**

On 6 December 2007, MVIL lodged its application for clearance of the proposed acquisition of shareholdings in Pacific MMI pursuant to Section 81 of the ICCA Act. The Commission is required to make a determination on whether or not to grant clearance of the proposed acquisition within 20 days of receipt of the application. The Commission was therefore to have made a decision on 26 December 2007.

However due to requests for confidentiality and the unavailability of certain information, the Commission requested further information from the applicant pursuant to Section 81(5). Consistent with this provision of the ICCA Act, the determination date of 26 December 2007 has been extended by the duration of the period the applicant took to respond and provide the requested information to the Commission. Consequently, the determination date is extended by a further 44 days to 23 March 2008.

### **4. Elements of a Clearance**

MVIL applied for a clearance of the proposed acquisition under Section 81 of the ICCA Act. Section 81(3) of the ICCA Act provides that the Commission shall;

- *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*
- *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 for the Commission to decide whether to grant a clearance or not, it is required to assess the competition effect of the proposed acquisition in the relevant market. The detailed discussion is outlined in section 9 of this report.

### **5. Facts & Contentions in support of the application**

In arguing that the share acquisition will not have or would not be likely to have the effect of substantially lessening competition in the market, the applicant made two main claims.

First, since MVIL is not a general insurer, the acquisition of the balance 50 percent shareholding in PMMI will not mean that there is an amalgamation of one general insurer with another thereby lessening the number of general insurers in the market but rather, the

acquisition will simply mean that MVIL will become the 100 percent owner of PMMI.

Second, the applicant submitted that the acquisition would not affect the current arrangement where PMMI's general insurance business will remain in its present form. Subject to certain reviews, MVIL intends to maintain the current management staffing and company business plan of PMMI.

In addition, MVIL submitted that the market is highly competitive due to the nature of products being offered to insurance buyers and the role of insurance brokers; and so insurers compete predominantly on price.

## **6. Views from Industry Participants and others**

The Commission sought views from selected stakeholders, including suppliers of insurance, users of insurance products, and other relevant government agencies such as the Department of Treasury and the Office of Insurance Commissioner. Their views are presented below.

- 6.1. ***Budget Rent-A-Car*** – stated that it did not wish to oppose the acquisition, and that it is not possible to say if the move will have any effect on its general insurance needs, or needs of any of its group partners. Its insurance decisions are based on commercial realities at the time, taking into account an insurer's ability to provide and service the correct product for its needs, at the most reasonable cost.
- 6.2. ***Hertz Leasemaster Limited*** – Hertz rent-a-car does not have any comments to make on the proposed takeover of Allianz New Zealand's shareholding in PMMI by MVIL. They have good relations with both companies.
- 6.3. ***PNG Motors*** – PNG motors does not have any objection to the granting of the Clearance by the Commission.
- 6.4. ***Mitsui Sumitomo Insurance Co. Limited*** – Mitsui Sumitomo Insurance Company Limited has no objection in respect of MVIL's acquisition of shares in PMMI.
- 6.5. ***Asian Pacific Insurance Brokers Limited*** – Whilst mindful of the possibility of what impact a future deregulation of the compulsory third party insurance might have on MVIL as an insurance entity, from a purely investment point of view standpoint, they do not foresee the acquisition would weaken competition. In fact to the contrary, they believe that insurance would become more competitive and affordable to the consuming public.
- 6.6. ***South Pacific Insurance Advisors*** – They see that the acquisition of shares in PMMI by MVIL does not reduce the number of underwriters in the PNG market, and so competition should in theory at least, not be affected in any way.

- 6.7. ***National Teachers Insurance Limited (NTIL)*** – NTIL sees MVIL’s proposed acquisition as a bold move to enable them to have a 100% national controlling interest. It submitted that this move would more than replace the vacuum left by the Governments’ sale of what used to be Niugini Insurance Corporation ten (10) years ago. The move would ensure the retention of premium income (monies) and profits onshore which could be made available for borrowing through the normal banking system, for the creation of new jobs and wealth for the country. The move would also create a stiffer and freer competition amongst industry players especially for national business interests.
- 6.8. ***American Home Assurance Group*** – They have no objection to the acquisition taking place, and their view is that the impact on competition would be negligible.
- 6.9. ***Pacific Re Ltd (Pacific Re)*** – Pacific Re expressed that the purchase of the 50% shareholding by MVIL from Allianz, will not reduce the level of competition that currently exists within the insurance industry in PNG. The purchase of shareholding by MVIL, will not, in their view reduce active competition that currently consumers enjoy from the purchase of products from the general insurance industry. They state that the initiative is a positive move for the industry, for the insuring public and for the economy, in that PMMI, will become a 100% owned by Papua New Guinea, once the process is completed.
- 6.10. ***Tower Insurance (PNG) Ltd*** - Tower does not see the proposed acquisition by MVIL of the remaining 50% shareholding in PMMI as substantially lessening competition within the general insurance market in PNG. It has no objections to the proposed acquisition.
- 6.11. ***AON Risk Services (PNG) Limited*** – AON expressed the view that there will not be any significant competitive impact on the general insurance industry due to MVIL’s acquisition of Allianz’s 50% share in PMMI provided that MVIL do not make any major changes to the current management and operations of PMMI and allow it to continue operating the way it currently do.
- 6.12. ***Pacific MMI*** – The target (PMMI) does not believe that there will be any lessening of competition in the general insurance market due to the shareholding of the company changing.

It submitted that there are at present eleven (11) insurers of general insurance business in the PNG insurance market. MVIL is not included in those eleven, on the basis that it undertakes compulsory third party insurance business only. MVIL is a single line/class insurer that does not compete in the general insurance market. The market is highly competitive which was borne out by the recent ICCC Review on the General Insurance Industry completed only months ago. It stated that the review found that competition is due predominantly to price, the impact of insurance brokers on the market, and the nature of service/product being offered to the insurance buyer.

In addition, it stated that in respect of reinsurance with Allianz Reinsurance Asia Pacific Limited (ARAP), PMMI will continue with its current reinsurance arrangements. This reinsurance programme does not preclude it from sourcing reinsurance from other providers. It also added that PMMI introduced more competition to the marine insurance market in PNG in 2006 by the introduction of reinsurance arrangements with Zurich Australia Insurance Limited who underwrite part of its marine reinsurance programme in conjunction with ARAP. PMMI therefore contests any suggestion that the acquisition would result in the lessening of competition in the general insurance market. It submitted that management of the company is deliberately and effectively placed in the hands of independent experts, and the Board is independent. It advanced that these facts will not change.

It further submitted that pursuant to the provisions of the *Motor Vehicles (Third Party Insurance Act) (Chapter 295)* and the Insurance Act, MVIL is a licensed insurer to carry on general insurance business but is limited to compulsory third party insurance only.

- 6.13. **Office of Insurance Commissioner (OIC)** – The OIC submitted that there are no material issues of competition concerns with the purchase of shares in PMMI. This is because PMMI will remain in the market place and compete with other insurers as usual. In addition, it submitted that a number of prudential/regulatory issues concerning the parties have been resolved with the Office of the Insurance Commissioner.
- 6.14. **Department of Treasury** – Treasury notes the ICCC review into the general insurance industry in 2007 which reports that the industry is relatively competitive. It also notes the proponent's claim that the acquisition will not reduce the number of participants in the general insurance sector as MVIL participate only in one class of business- the compulsory third party. For these reasons, it expressed the view that the acquisition will not result in a substantial lessening of competition in the insurance market.
- 6.15. **Bank of PNG** – The regulator for the Life Insurance in PNG, the Central Bank informally relayed that it would be concerned if unqualified persons are appointed to the PMMI Board. It advised the Commission that it would formally raise this concern with PMMI and MVIL.

## 7. Insurance Industry Characteristics

The Commission notes that the PNG insurance market comprises of two main categories or segments, Life and Non-Life Insurance. The latter is usually termed general insurance market.

During the review into the general insurance industry undertaken by the Commission in 2007, it was identified that the general insurance industry in PNG comprises of four main types of participants: Reinsurers, Insurers, Insurance Brokers and Loss Adjustors.

The PNG insurance industry consist of one (1) local reinsurer, twelve (12) general insurers (including MVIL), five (5) life insurers, six (6) licensed insurance brokers and five (5) licensed loss adjustors. The Commission identified in the general insurance industry that while most of these insurance industry participants are subsidiaries of international insurance companies and insurance brokers; Pacific Re is the only firm in the industry that is 52 percent owned by the PNG Government through MVIL, with the balance of the shares held by other industry participants.

The Commission notes from the Company Extract of Pacific Re Limited that the industry participants which own the remaining shareholding of 48 percent include QBE Pacific Insurance Limited, QBE Insurance (PNG) Limited, Tower Insurance (PNG) Limited, American Home Assurance Company, Mitsui and HIH Life Insurance (PNG) Limited. The Commission also notes that whilst all the shareholders are current players in the industry, HIH Life Insurance (PNG) Limited is currently under liquidation.

### **7.1 Market Share**

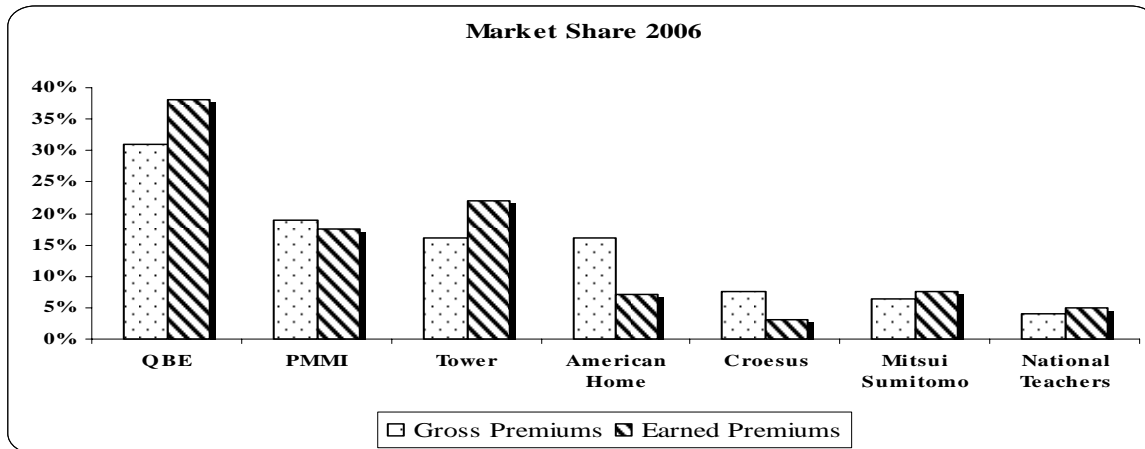
A measure of the market share provides an indication of how well a firm is fairing in the market compared to its rivals who are faced with relatively the same challenges and opportunities. It is therefore often used to determine the competitive strength of the players within the market under consideration.

The Commission understands that compulsory third party (CTP) insurance is solely provided by MVIL and therefore MVIL has a 100 percent market share in the provision of this insurance product within the general insurance market.

In theory, whilst an estimate of a particular insurance product can be deduced relative from the overall market share of all products offered by an insurer based on premiums, this is often difficult to deduce because, as with the normal practice, insurers rarely provide a stand alone insurance cover, instead they usually provide insurance policies collectively in order to be able to offer lower premiums to users of insurance products. Markets share estimates based on premiums for a particular class of insurance cover such as comprehensive motor vehicle insurance would be regarded as commercially sensitive information. Under these circumstances, there was little information available to estimate the market share of specific insurance products.

Notwithstanding this limitation, the Commission noted in its review of the general insurance industry in 2007 the aggregate market share within the general insurance industry. Chart 1 below provides information of the overall position of the leading seven insurers in 2006 based on gross and earned premiums.

**Chart 1: Market Share by gross and earned premiums, 2006 (excluding reinsurance and CTP)**



Source: ICCC Review of the General Insurance Industry in PNG, 2007(reproduced)

The Commission notes that the three leading general insurers in terms of gross premiums in 2006 are QBE, Pacific MMI and Tower. The Commission also notes a similar trend in terms of earned premiums; however, Tower has the second biggest share of the market followed by Pacific MMI. QBE remains the single largest general insurer with close to 40 percent market share.

In the absence of life insurance industry market share data, information before the Commission shows that there are five licensed life insurers within the market competing against each other to provide life insurance products. These products are tailored to meet their client’s needs within the specific market segments each insurer aims to service.

## 7.2 General insurance

Licensed general insurers are entitled to write all classes of insurance products available within the general insurance industry (except for CTP insurance). These products range from the personal line insurance products such as House-owners and House-holders Insurance, Personal Accident Insurance etc; and commercial line insurance products such as Workers Compensation, Public Liability, and Commercial Motor Vehicle insurance.

However, due to a number of factors, insurers normally choose to write only certain general insurance products. These factors include the underwriting criteria that is being employed by the insurance company, availability (or lack) of expertise within the company, and capacity of the insurance company.

Most of the insurance cover classified as high risk is placed offshore due to a lack of capacity within the local market. These include Aviation, Large Marine Hull and Cargo, Industrial Special Risks for large commercial companies, Professional Indemnity and Directors and Officers liabilities.

In terms of the provision of motor vehicle insurance, this class of business is split into two sub-classes; (1) Comprehensive motor vehicle cover and (2) Compulsory third party (CTP) insurance cover.

1. Comprehensive motor vehicle insurance cover provides protection against physical damage or theft of the insured motor vehicle, and also for damage caused by the insured motor vehicle to property of third parties;
2. CTP motor vehicle insurance cover indemnifies a motor vehicle owner against loss resulting from the death of or bodily injury to a third party, caused by or arising out of the use of a motor vehicle.

As discussed, while all other general insurers can provide all classes of general insurance products, the acquirer is restricted by legislation to provide only CTP insurance.

### ***7.3 Life Insurance***

Life Assurance, or life insurance as it is commonly known, relates to the provision of cover for an event that is certain to happen such as death, accidental death or sickness. A life policy is based upon life(s) of the insured or those people named in the policy.

The Commission understands that the broad types of life insurance policies available include; Term insurance policy, Whole life policy, Endowment policy, Money back policy and Annuities and Pension. These broad policies are tailored to meet the specific market and individual circumstances. There is limited information on the extent to which these products are available within the life insurance industry in PNG.

In the PNG insurance industry, the Bank of Papua New Guinea regulates the life insurance segment where there are currently<sup>1</sup> five (5) insurers and three (3) brokers, together a total of eight (8) market participants - licensed under the Life Act. The insurers are Kwila Insurance Corporation, Life Insurance Corporation (PNG) Ltd, Workers Mutual Insurance (PNG) Ltd<sup>2</sup>, Pacific MMI, Capital Insurance Group Ltd. The brokers are AON Risks Services, Asia Pacific Insurance brokers and Marsh (PNG) Ltd.

These insurers underwrite all classes of insurance/assurance products available within the life insurance industry. PMMI is the only industry participant that also holds a general insurance license and therefore operates in both industries.

### ***7.4 Re-insurance***

Reinsurance is a practice by which an insurance company can protect itself against risk of losses by sharing the risk it underwrites with other insurance company. The practice allows a company to assume greater individual risks than its size would otherwise allow, and to protect a company against losses. A company that has a reinsurance program enables it to

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<sup>1</sup> As at 30 April 2007

<sup>2</sup> Currently under liquidation

offer higher limits of protection to a policyholder, than would otherwise be available. In so doing, it provides a competitive hedge for the ceding company, as well as protection for the insurer in the event of a loss.

The PNG insurance market has one domiciled reinsurer – Pacific Re Limited. MVIL has a controlling interest of 52 percent and the remaining 48 percent is owned by the various industry investors.

For the purpose of assessing the clearance application, the Commission is of the view that the relationship between MVIL and Pacific Re warrants consideration. This is relevant in so far as the behaviour or conduct of MVIL and Pacific Re could create a competitive advantage for the operations of PMMI that lessens the competitive constraint on PMMI exerted by other general insurers in the market.

The Commission notes that it is compulsory under the Insurance Act that outwards treaty reinsurance and facultative risks of insurance companies are placed with Pacific Re as the local Re-insurer. Pacific Re is however not obliged to accept all treaties or risks and these can be placed offshore, through an exemption process administered by the Office of the Insurance Commissioner.

## **8. Commission Assessment**

### **8.1 The market**

For the purposes of the ICCC Act, the market is defined under Section 45 (2) 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”.*

Bearing in mind the definition of the market, the Commission would need to identify the relevant market for the purpose of establishing actual and/or potential competition effects in the market.

As noted, the PNG insurance market comprises of two main categories or segments, Life and Non-Life Insurance (or general insurance market), provided under the Life Act and Insurance Act, respectively.

The Commission notes that there are five (5) life insurers and twelve (12) general insurers in the PNG insurance market. For the purpose of the proposed acquisition, the Commission understands that MVIL and PMMI are both licensed by the Office of the Insurance Commissioner as general insurers under the Insurance Act. The Commission also notes that PMMI is a composite insurer in the insurance industry holding both life and general insurance licenses and selling all classes of these products, except CTP insurance. MVIL’s operation in the general insurance industry is restricted under the *Motor Vehicles (Third Party Insurance Act) (Chapter 295)* to compulsory third party motor vehicle insurance only. MVIL does not offer other classes of general insurance products except CTP

insurance of which it has a statutory monopoly.

The Commission understands that competition in the life and general insurance industries focuses on the availability of a range of insurance products, the breath of insurance cover (policy), the premium and the level of services such as speedy claim settlement. In terms of this information, the Commission notes that both MVIL and PMMI offer different insurance products and services relating to motor vehicle risk – compulsory third party motor vehicle insurance and comprehensive motor vehicle insurance. The Commission considers these insurance products to be different because both products have significant differences in the type of risks they are designed to cover. This suggests that these insurance products are not closely substitutable, at least on the demand side.

On the supply side, the Commission considers the high number of participants suggest that there is some competition in the life insurance and general insurance industries due to availability of varying insurance policies, premiums and breath of coverage. The Commission considers however, life insurers do not compete with general insurers because the products on offer are different.

In view of the above, the Commission is required to establish whether the wider PNG insurance market (both life and general insurance) should be considered as the relevant market for the purpose of the proposed acquisition.

The Commission considers that if premiums in the general insurance industry increases, licensed life insurers would not be able to quickly and without significant investment, be able to expand into the supply of general insurance products in response to this price increase because of differences in regulatory requirements. The Commission therefore considers that suppliers of life insurance and general insurance products operate in two separate markets rather than a single wider PNG insurance market.

For the purpose of the clearance application, the Commission considers that CTP motor vehicle insurance cover provided by MVIL is a product of the General Insurance industry and therefore refutes the applicant's claim that MVIL is not a general insurer because it provides a single class/line of business. Moreover, the Commission notes that comprehensive motor vehicle insurance cover which is provided by PMMI and other general insurers, is a product of the general insurance industry since the suppliers, as with MVIL are licensed separately but under the same legislation, the Insurance Act, by the Office of the Insurance Commissioner. In terms of this information, and as discussed under section 7.2 of this report, the Commission notes the commonality of MVIL and PMMI in providing insurance products and services relating to motor vehicles, where both separately offer CTP insurance and comprehensive motor vehicle insurance cover respectively in the general insurance industry.

The Commission therefore considers that the relevant market is the market for the supply of general insurance products.

In addition, the Commission notes that by virtue of Section 36 of the Insurance Act, all licensed general insurers operate within the broader PNG market. Users access insurance products either directly from the insurer or through an insurance broker in PNG, except

under certain circumstances, exemption can be sought for the specific insurance from the global insurance market, via the insurance brokers. Thus, the relevant market is not confined to a particular region, but includes the whole of PNG.

## **9. Effects of Competition in the market**

### ***9.1 Bundling***

The Commission notes the arguments advanced by the applicant that the proposed acquisition will not result in an amalgamation of one general insurer with another thereby lessening the number of general insurers in the market; and that the acquisition would not affect the current arrangement where PMMI's general insurance business will remain in its present form, however will be subject to certain reviews.

In light of this information, the Commission would agree that the acquisition would not necessarily result in the removal of PMMI from the market. The Commission also agrees that the acquisition would result in MVIL owning 100 percent shares in PMMI.

In addition, the Commission is of the view that although MVIL and PMMI are both players in the general insurance market, they are not competitors because of the reason discussed throughout this determination. Thus the Commission considers that competition in the relevant market under the current circumstances where both firms operate as stand- alone entities would not be impacted significantly.

The clearance process requires consideration of what would happen in the future if the conduct for which clearance is sought occurred – the dynamic consideration of the market. The Commission is required to identify and assess the likelihood of potential anti-competitive conduct(s) and/or behavior(s) and the extent to which these may affect competition in the relevant market.

In this regard, the Commission is aware of information relayed in late 2007 by MVIL that it intends to explore the possibility of merging the two firms in future. The Commission considers that this can be achieved via the facility for MVIL to consign the supply of CTP insurance to a third party as provided for under Section 72 of the *Motor Vehicles (Third Party Insurance Act) (Chapter 295)* . The applicant submitted that although competition would be beneficial, entry by a third party under Section 72 is entirely beyond the control of MVIL. MVIL therefore does not envisage potential competition at this stage. Although the Commission sought views from the Independent Public Business Corporation (IPBC), in the absence of any information provided by IPBC, the Commission cannot discount this claim.

The Commission considers that although it may make some sense to spread the risks in terms of CTP claims, MVIL enjoys the profits from being the only CTP insurance provider and therefore PMMI and/or a nominated firm competing against MVIL would mean the premiums will be split. CTP insurance provides guaranteed revenue to MVIL, hence the Commission is of the view that it is unlikely that the State would sell off all its shares or maintain minority shares. This outcome could potentially affect the profitability of MVIL.

The acquisition of PMMI by MVIL as a State entity therefore provides little incentive for divestiture of part of the business where all or part of the State's shares could be transferred to PMMI and/or a nominated entity which would liberalize CTP insurance in the market. In this respect, the Commission is of the view that it is unlikely that a nominated entity would be appointed to provide CTP cover in competition to MVIL.

The Commission nonetheless notes the advantage of spreading the CTP insurance risk and the associated cost savings of joint marketing and considers that where all general insurers or a firm other than PMMI, or an existing general insurer is nominated to provide CTP insurance, this may enhance competition in terms of timeliness in processing claims and possibly lower premiums. The Commission notes that CTP insurance was traditionally offered by general insurers. Whilst undertaking the review into the general insurance industry in 2007, the Commission noted that a number of general insurers have indicated interest to offer CTP cover if the market was liberalized.

In addition, the Commission considers that should PMMI and/or an existing general insurer(s) is nominated to provide CTP insurance, or if MVIL merges its business with PMMI, there is a potential that CTP and comprehensive motor vehicle cover could be bundled and offered as one product. For instance, when a buyer approached MVIL to seek renewal for vehicle registration and pay CTP insurance, MVIL could potentially lower CTP premium on the basis of the buyer signing up with PMMI for comprehensive motor vehicle cover. If discounts are offered on premiums to make the bundling offer attractive, this arrangement would enable MVIL to jointly market CTP and comprehensive motor vehicle cover thereby resulting in potential cost savings to both MVIL and PMMI. This would greatly disadvantage other insurance firms who would not be able to offer both covers in a similar bundle.

In hindsight, the Commission acknowledges that MVIL could easily bundle CTP insurance and comprehensive motor vehicle insurance cover without the proposed acquisition as it currently owns 50 percent of PMMI.

When the Commission queried on this issue in late 2007, MVIL advised that it is mandated to provide only CTP insurance and has no intention to jointly market CTP and comprehensive motor vehicle covers. The Commission does not discount this advice. It notes that while MVIL could easily bundle CTP and comprehensive motor vehicle cover without the acquisition, the applicant would still require the backing of Allianz as the remaining 50 percent shareholder of PMMI. In this respect, the Commission does not discount that the parties have discussed the prospect of bundling in the past and have recognized the potential anti-competitive effect of such an arrangement and rendered the practice risky.

The Commission would be concerned if such an arrangement damaged the competitive process of the general insurance market, specifically in relation to the motor vehicle insurance products. This would give PMMI a competitive edge over other insurers providing only comprehensive motor vehicle insurance.

## ***9.2 Preferential treatment***

In addition, while the proposed acquisition may not remove PMMI as a general insurer, it raises some strategic concerns due to the likelihood of potential preferential treatment accorded to PMMI as a result of its vertical relationship with MVIL as a CTP insurer and majority shareholder of Pacific Re.

The Commission does not discount that Pacific Re could lower its premiums for outwards treaty reinsurance and facultative risks charged to PMMI compared to other insurers. In addition, since Pacific Re is under no binding obligation to accept all reinsurance business, the Commission does not discount that there may be a tendency by Pacific Re to accept certain risks from PMMI and declining these from other insurers. This conduct therefore has the potential to force other general insurers to seek reinsurance abroad at a higher price thus incurring additional transaction cost, than those that might otherwise be available in the local market.

The Commission would be concerned if the parties' future behavior and or conduct would distort the competitive process of the market and disadvantage other general insurers seeking reinsurance from Pacific Re.

## ***9.3 Cross Subsidization***

Another potential anti-competitive concern relates to cross subsidization between MVIL and PMMI, specifically funds flowing from MVIL to PMMI to support anti-competitive premium pricing or other activities which lessen competition in a competitive market. Although the Commission notes the assertion by the applicant that PMMI will remain separate and will be overseen by an independent Board, it does not discount that as the controlling shareholder, MVIL could influence the commercial decisions of PMMI.

The likelihood of MVIL's intervention in the operations of PMMI raises concerns relating to cross subsidization. Particularly, if MVIL were to cross subsidize PMMI post acquisition under circumstances where PMMI faces financial strain of its operations in the medium to long term as a result of increased competition or potentially due to shrinkage in its clientele associated with growing business concerns of the cessation of Allianz as a shareholder partner in PMMI.

The Commission would be concerned if cross subsidization takes place from the regulated to the non-regulated insurance sector.

## ***9.4 Mitigating Factors***

In assessing the actual and potential competition effect of the proposed acquisition discussed above, the Commission observes a number of important factors for consideration which have and may negate the potential competition concerns of the Commission post acquisition.

- (a) Bundling - although the proposed acquisition would allow MVIL to own 100 percent shareholdings of PMMI, this does not necessarily provide an opportunity

for MVIL to consider bundling CTP and comprehensive motor vehicle cover since it has not been done in the past due to the anti-competitive considerations associated with the practice. Should MVIL require its customers to take PMMI motor vehicle insurance as part of its bundling offer and/or provide discount on the CTP insurance, the Commission will consider examining this under Part VI of the ICCC Act to ascertain whether or not the action of MVIL amounts to a contravention of the Act.

- (b) Preferential treatment - the Commission notes that whilst MVIL owns 52 percent shares in Pacific Re, the remaining insurance players own the balance of 48 percent of shares. The Commission does not discount that the likely conduct and/or behaviour by Pacific Re to accord PMMI preferential treatment such as offering lower reinsurance premiums would be protested by other general insurers who hold the balance of shares in Pacific Re. The Commission therefore considers that other competing general insurers such as QBE and Tower would be able to exert some constraint on such potential conduct in the market. In addition, the Commission will consider monitoring and examining such potential behavior to ensure compliance of the ICCC Act.
- (c) Cross subsidization - MVIL operates in a regulated sector of the general insurance industry where the price of CTP insurance is regulated by the Commission. The Commission sets an appropriate price that reflects the efficient cost of providing CTP insurance thereby making sure that MVIL is able to generate appropriate returns.

As part of the forthcoming pricing review applicable to MVIL as a regulated entity, the Commission will likely be putting in place the necessary regulatory arrangements that will set out the rules on ring fencing to ensure that there is no cross subsidizing between MVIL and PMMI which could have the effect of substantially lessening competition.

This regulatory arrangement will assist the Commission to identify the expenditures associated with MVIL's regulated business for the price regulation purposes and thus ensure that expenses incurred by PMMI are recouped only by PMMI from its business in the competitive market. In light of the planned regulatory arrangements, if PMMI reduces the prices of its insurance products to attract customers away from its competitors on the basis of a cross subsidisation on MVIL's total business (CTP and General Insurance and Life Insurance), then it runs the risk of developing financial stress as the Commission will not approve price increases for MVIL associated with inefficient costs of providing CTP cover, so the excess funds needed for anti-competitive cross subsidization will not be available to MVIL.

The ring fencing arrangement would therefore provide insulation to MVIL as a regulated utility from the potential risky activities of an unregulated affiliate.

## **10. Statutory Factors taken into account in Assessing Competition**

In addition to the assessment of the application, the Commission is required under Section

69(5) of the ICC Act to take into account the following statutory matters. These are as follows:

- [a] *the actual and potential level of import competition in the market;*
- [b] *the Nature and effect of barriers to entry in the market;*
- [c] *the number of buyers and sellers in the market;*
- [d] *the degree of countervailing power in the market;*
- [e] *the likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices or profit margins;*
- [f] *the extent to which substitutes are available, or are likely to become available, in the market;*
- [g] *the dynamic characteristics of the market, including growth, innovation and product differentiation;*
- [h] *the likelihood that the acquisition would result in the removal from the market of a sustainable, vigorous and effective competitor;*
- [i] *the nature and extent of vertical, integration in the market.*

In its supplementary submission to the Commission, MVIL addressed these statutory matters.

***[a] The actual and potential level of import competition in the market***

An analysis of the actual and potential level of import competition is vital in assessing whether there are effective constraints on the incumbent firms, posed by imports to ensure competitive behaviour is maintained.

The applicant stated that pursuant to the Insurance Act, the Insurance Commissioner may issue a license to carry on general insurance business. It is therefore possible for additional or new companies to enter the market provided that the requisite capital adequacy and other statutory requirements are met to the satisfaction of the Office of Insurance Commissioner. MVIL propose that there is no restriction on import competition in the market. Nevertheless, market size and return on investment/capital are limiting factors in the potential for other competitors to enter the PNG insurance market.

The Commission notes that MVIL has a statutory monopoly of CTP insurance and therefore import competition is ineligible for this product in the general insurance industry.

In regard to other insurance products offered by the general insurers, the Commission understands that Section 36 of the Insurance Act requires that licensed insurers must insure all risks that are situated in PNG, unless an exemption is granted under Section 37 of the Insurance Act which permits risks to be placed off-shore.

The Commission notes that import competition is likely to be limited to large risks such as large marine hull and cargo and aviation projects which are placed offshore due to the limited capacity of the local market to take on these risks. This information highlights that there is very limited import competition for the supply of other general

insurance products.

***[b] The Nature and Effect of Barriers to Entry to the Market***

Barriers to entry could be anything that makes it difficult for entry into the relevant market.

The applicant submitted that its comments on import competition are equally relevant here. It reiterated that there are at present eleven insurers of general insurance business in the market. Historically, there have been fewer insurers entering the market than insurers which have exited the market. Cases in point include the likes of FAI, HIH, General Accident, GRE Pacific, and Zurich Insurance which was acquired by QBE Insurance. The applicant submitted that the statistics do not preclude the possibility of new insurers entering the market. MVIL further submitted that as part of PMMI's strategic business plan, consideration would be given to entering other markets within the Pacific region in order to achieve growth in the business model.

The Commission notes that in the general insurance industry, there is a significant structural barrier of entry into compulsory third party motor vehicle insurance due to the statutory monopoly protecting MVIL as the sole supplier of this insurance product.

As with barriers of entry regarding the provision of other general insurance products, the Commission established in its review of the general insurance industry in 2007 that, under the Insurance Act, licensing requirements are uniform for foreign and national companies, and are specific to each of the individual industry participants (i.e. reinsurer, insurer, broker or loss adjusters). The licensing process takes between four to six weeks, which is renewed annually with the Office of the Insurance Commissioner.

The Commission also noted in the report that the industry has grown in general terms over the past three years; however, there are areas where new entrants would be required to promote further competition. Consequently, the Commission is of the view that the prudential requirements are not so onerous and there is opportunity for other new entrants to establish themselves in the market and therefore considers that barriers to entry into the general insurance market (excluding CTP insurance) are not significant.

***[c] The number of sellers and buyers in the Market***

MVIL asserted that although there are eleven players in the market, it is not necessarily included as one of those on the basis that it undertakes compulsory third party insurance business only. MVIL is a single line/class insurer that does not compete in the general insurance market.

It further submitted that the market is highly competitive due predominantly to price, the impact of insurance brokers and the nature of product being offered to the insurance buyer. It submitted that these factors do not necessarily prevent the admission of new competitors to the market. Although there have not been any new entrants in recent years, the number of participants in associated industries, such as insurance brokers

(two new indigenous brokers have set up in the last 4 years), have demonstrated that there is sufficient scope and demand within the industry in general.

The Commission rejects MVIL's claim that its own operations should not be included in the general insurance market because it operates as a single line/class insurer. As noted, the relevant market is the market for the supply of general insurance products of which there are twelve licensed insurers operating in this market whilst providing comprehensive motor vehicle cover, amongst other range of general insurance products. MVIL is however the only supplier of CTP insurance in the general insurance market.

***[d] Degree of Countervailing power in the market***

Countervailing power refers to the ability of the buyer(s) or the seller(s) of a product or service to by-pass a particular seller or customer in the supply chain. Where there is potentially only one supplier, the countervailing power of customers may be very small.

The applicant advanced that there is little or no countervailing power within the market. There is however some possibility for insurance companies to exercise some limited countervailing power by providing cover and products at much reduced premiums. However, this would not appear to be commonplace and despite brokers lobbying for lower rates, insurers themselves determine price and product as a direct result of market forces. It further submitted that there is also the avenue that the insurance buyer may place their insurance offshore (under the exemption process) and thereby exercise some countervailing power. That practice is not unusual in this market.

As discussed above, in the general insurance industry, MVIL has a statutory monopoly of CTP insurance and therefore buyers have little or no countervailing or bargaining power (ability to negotiate on price, quality and service arrangement with users).

The Commission also considers that because of the requirement under Section 36 of the Insurance Act, buyers of other general insurance products have little countervailing power from accessing offshore supply because only limited class of general insurance risks are placed offshore.

The Commission is of the view that buyers bargaining power varies from individual clients to corporate clients depending on the volume of their insurance needs and is limited to price (premiums) because insurance products have significant differences in the type of risks they are designed to cover. This is predominantly determined by the insurer.

An individual client with a single or few insurance policy needs would possess little bargaining power compared to a corporate client with wider insurance needs. Large corporate clients such as those in the resource sector, either directly or through brokers are more readily able to switch easily between sellers. Moreover, large buyers exert significant bargaining power on premiums offered by potential insurers.

***[e] Likelihood that the acquisition would result in the acquirer being able to significantly and sustainably increase prices and profit margins***

The applicant submitted that the current business model which has been adopted by PMMI encourages the status quo on pricing to remain. Where a policyholder has a good claims record they are rewarded. Actuarial science is used in the determination of the rates and premiums applied to rating the risk exposures for each class of insurance. Pricing is driven by market forces and as has been demonstrated, the insurance industry is highly competitive. Accordingly, pricing is unlikely to alter due to the shareholders changing.

The Commission notes that PNG insurance premiums for general insurance products are driven by market forces. The Commission has considered this matter in its review of general insurance industry and considers that only CTP motor vehicle insurance pricing is regulated by the ICCC.

In addition, the Commission also considers that there is a high likelihood that buyers would seek insurance with other existing insurers in the market either directly or through brokers should PMMI increase its premiums in general insurance products (excluding CTP insurance), therefore larger competing general insurers such as QBE and Tower can impose competitive constraint on PMMI in terms of its pricing.

***[f] Extent to which substitutes are available or are likely to become available in the market***

The applicant did not adequately address the issues of substitutability in the relevant market.

The Commission considers that there is no demand-side substitutability of insurance products in the general insurance market. As discussed, this is because each insurance product serves a different purpose in terms of risk covered. Therefore, an insurance product cannot be easily substituted for another by buyers. For instance, a buyer seeking comprehensive motor vehicle insurance cover cannot substitute this policy for a marine hull insurance cover because these insurance products serve different purposes and have different applicability and associated risks which are reflected by the premiums.

In contrast, the Commission is of the view that buyers of general insurance products (except CTP insurance) can easily switch between suppliers due to availability of a range of similar insurance products, breadth of insurance cover (policy), premium and the level of services provided by insurers. The Commission therefore considers that there is some supply-side substitutability in the market (except CTP insurance).

***[g] Dynamic characteristics of the market including growth, innovation and product differentiation.***

The applicant submitted that its comments above are relevant when looking at the dynamic characteristics of the market including growth, innovation and product

differentiation. It claims that product innovation by existing insurers is becoming more prevalent. It further claims that as the only composite insurer in the industry holding both life and general insurance licenses and selling all classes of these products, PMMI has been more innovative with product and branding than any other PNG based insurer.

The Commission is of the view that there is limited product innovation and differentiation by MVIL as there is no competition of CTP insurance. Growth in the CTP market is attributed mainly to increase in the demand for CTP insurance.

As with other product in the general insurance market, the Commission considers that there is opportunity for growth through product innovation and differentiation as insurers gradually enhance their capacity to underwrite risks that are currently placed offshore; and tailor insurance policies to capture the insurance need of low to medium income earners.

***[h] Likelihood that the acquisition would result in the removal from the market of a sustainable, vigorous and effective competitor***

The applicant and PMMI refute any suggestion that the acquisition would result in the removal of a competitor from the market. The applicant claims that it intends to maintain its interest in PMMI as a passive investor. It accepts that control over PMMI will be increased; but maintains that MVIL is not a specialist general insurer and management of PMMI is deliberately and effectively placed in the hands of independent experts.

The Commission believes that the 50 percent acquisition of shares in PMMI by MVIL would not result in the removal of a sustainable, vigorous and effective competitor since both MVIL and PMMI are not in direct competition with each other in the product dimension of the general insurance market.

***[i] Nature and Extent of Vertical Integration in the market.***

The applicant advanced that there would be limited (if any) vertical integration in the market. As an insurer, it is limited to provide compulsory third party insurance only. Similarly, it claims that it does not provide any reinsurance cover in respect of general insurance as under its Act, it is restricted to write only one class of insurance - the compulsory third party insurance.

The Commission believes that the proposed acquisition will not of itself; result in a vertical integration between the parties to the acquisition. However, in terms of reinsurance, PMMI as a downstream player will become vertically integrated because of MVIL's operation in the upstream through its shareholdings in Pacific Re.

## **11. Summary and Conclusion**

To grant a clearance under Section 81(3) of the ICC Act, the ICC 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 Commission notes that the acquisition would affect the ownership structure of PMMI in the general insurance market, where both MVIL and PMMI supply distinctively different general insurance products which are not in competition. Consequently, the Commission concludes that the relevant market is the market for the supply of general insurance products.

Whilst the Commission is also aware of possible opportunities for bundling/joint marketing, preferential treatment and cross subsidies between MVIL and PMMI, it is of the view that there are a number of factors that mitigate the likelihood of this from occurring.

The Commission is of the view that its position on the competition concerns discussed above gives a strong signal to the applicant that the Commission will likely be monitoring and putting in place appropriate regulatory arrangement post acquisition, consistent with its regulatory role under the ICC Act and the MVIL regulatory contract.

The Commission is also mindful that there are issues of consumer perception regarding the sustainability and effective management of PMMI in the long term. These concerns relate to the board representation and the prudential requirements of which this responsibility is overseen by the industry regulators – the Office of the Insurance Commission and the Bank of Papua New Guinea. The Commission also notes comments from the Insurance Commissioner and moves by Bank of PNG to ensure that industry regulations are observed.

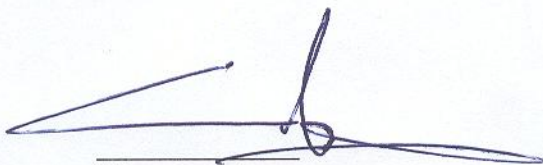
In considering the competition effect in the relevant market, the Commission is of the view that the proposed acquisition would not lead to a substantial lessening of competition taking into account the analysis of the statutory factors as required under Section 69(5) of the ICC Act. The Commission notes the following:

- Post merger, there are relatively a high number of alternative suppliers of general insurance products. Current Government policy allows for only one CTP insurance provider;
- There is little import competition in the market due to regulatory requirements provided for under the Insurance Act. Import competition is confined to very large risk such as Aviation. There is no import competition for CTP insurance allowed under the MVIL Act;
- The nature and effect of barriers to entry to the general insurance market are not onerous and can be overcome (excluding the CTP insurance statutory monopoly);
- There is some bargaining power held (though not countervailing power) due to the role played by brokers in negotiating for insurance covers on behalf of buyers of general insurance products. However, buyers seeking CTP insurance have no bargaining power because the price for CTP insurance is non-negotiable.
- MVIL is unlikely to be able to significantly and substantially increase prices or profit margins from the CTP insurance business to provide advantage to PMMI because the price of CTP insurance is regulated. Other general insurers would be able to exert some price constraints on both parties, especially PMMI due to

- differences in premiums and breadth of insurance cover for other general insurance products;
- There is no demand-side substitutability in the market. However, due to the relatively high number of alternative suppliers of general insurance products, there is supply-side substitutability, except for CTP insurance;
  - Growth in the general insurance market due to product innovation and differentiation is likely, except for CTP insurance where growth is restricted to the growth in vehicle registrations;
  - The proposed acquisition is unlikely to remove from the general insurance market a sustainable, vigorous and effective competitor;
  - The acquisition will add, to some extent, to existing vertical integration in the market through ownership of a general insurance business and a re-insurance business by MVIL.

## 12. Decision

In view of the above factors, analysis and considerations, the Commission notes and gives weight to insurance industry stakeholder's and the Office of the Insurance Commissioner's comments supporting the proposed acquisition; and is satisfied that the acquisition of the 50 percent shareholding in PMMI by MVIL, will not have, and will not be likely to have, the effect of substantially lessening competition in the supply of general insurance products and hereby grants clearance for the proposed acquisition to proceed pursuant to Section 81(3) of the *Independent Consumer and Competition Act 2002*.



**Thomas Abe**  
(Commissioner)



**David Dawson**  
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20<sup>th</sup> March 2008

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