EN

Case No IV/M.1101 - HERMES / SAMPO / FGB - FCIC

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REGULATION (EEC) No 4064/89
MERGER PROCEDURE

Article 6(1)(b) NON-OPPOSITION
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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 19.5.1998

PUBLIC VERSION

MERGER PROCEDURE
ARTICLE 6(1)(b) DECISION

To the notifying parties

Dear Sirs,

Subject: Case No IV/1101 - Hermes/Sampo/FGB - FCIC
Notification of 5.2.1998 pursuant to Article 4 of Council Regulation N° 4064/89

1. On 5.2.1998**,** the Commission received a notification of a proposed concentration pursuant to Article 4 of Council Regulation (EEC) No 4064/89 by which the undertakings Hermes Versicherungsbeteiligungs GmbH ("Hermes"), Insurance Company of Finland Ltd. ("ICF") and the Republic of Finland, through Finnish Guarantee Board ("FGB") will establish a joint venture, the Finnish Credit Insurance Company ("FCIC").

2. The notification was declared incomplete on 17.2.1998 according to Article 4 of Commission Regulation (EC) No 447/98. The parties provided additional information first on 9.3.1998 and, on the second occasion, on 15.4.1998. After the receipt of the second letter the notification became effective within the meaning of Article 4(2) of Commission Regulation (EC) No 447/98.

I. THE PARTIES

3. The Allianz subsidiary Hermes is a German credit insurer active in the following business areas: domestic and export credit insurance, capital goods insurance, consumer credit insurance, guarantee insurance and fidelity/loss of profit insurance.

4. The Sampo wholly-owned subsidiary ICF is a Finnish credit insurer. ICF is engaged both in credit insurance as well as reinsurance.

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5. FGB is a Finnish state-owned export credit agency. It provides small and medium-sized domestic enterprises with export credit insurance and political risks coverage.

6. FCIC will be engaged in credit insurance and, to some extent, reinsurance. The parties intend to transfer their respective Finnish credit insurance businesses into the joint venture. However, it should be noted that FGB will transfer only marketable risks to the joint venture while non-marketable risks will remain in FGB. FGB's engagement in the joint venture may be explained by an effort of the Finnish State to adjust its short term credit insurance business to the Commission's recent notice[1] which has as its objective to exclude short-term credit insurance from public support measures. It is against this background that FGB appears to reorganise its marketable short-term credit insurance operations within the joint venture.

II. THE OPERATION

7. The proposed transaction will result in Hermes, ICF and FGB establishing a joint venture, FCIC, within the meaning of Article 3(1)(b) of the Merger Regulation.

Joint control

8. The parties will exercise joint control over the joint venture. Each party will hold 33.3% of the share capital of the joint venture. The Board of Directors will comprise 6 persons and each party will nominate 2 members to the Board. The appointment of the Board's chairman rotates annually between the parties. Matters which require unanimous shareholder approval include the appointment of the Managing Director, the approval of the business plan and the budget. Consequently, the joint venture will be jointly controlled by Hermes, ICF and FGB.

Full function on a lasting basis

9. The joint venture will have an initial staff of 10 people. All central functions related to the credit insurance business, such as risk information gathering, risk evaluation and premium calculation will be dealt with by the joint venture. The joint venture will also take care of its own marketing and customer service.

10. The parents will offer the joint venture supporting functions on arm's length basis. Sampo will assist the joint venture in some administrative services such as accounting. Furthermore, the joint venture will make use of Sampo's actuary, required by law in Finland, since the services of the actuary are not needed in day-to-day business.

11. Hermes will offer the joint venture its credit information reports and analyses on arm's length basis since, according to the parties, any credit insurer will have only limited local resources for gathering credit risk information on the market itself. There is, however, no exclusivity requirement imposed on the joint venture to use

[1] Communication of the Commission to the Member States pursuant to Article 93 (1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance, JO C 281, 17.9.1997, p.4.

Hermes's credit information services but credit information is readily available on the open market and the joint venture is free to acquire such information from any third party.

12. For the above reasons the joint venture will be a full function joint venture, established on a lasting basis.

Absence of coordination

13. The parties say that they will transfer their respective marketable risks businesses in the Finnish market to the joint venture and that only FGB will continue to be active in covering non-marketable risks. Marketable risks relate to short-term credit risks on trade within the Community and with certain countries outside it. As opposed to marketable risks which are considered "commercial", non-marketable risks comprise both export credit risks with countries outside the EEA, Australia, Canada, Japan, New Zealand, Switzerland and USA as well as all political risks[2].

14. Sampo Group, through its subsidiary Industrial Insurance Company, will remain active in the fidelity and computer frauds insurance. Since neither Hermes nor FGB are active or intend to start providing insurance cover on this market, no cooperation aspects need to be considered. The parties do not, however, exclude the possibility that there may be overlaps between the activities of FGB and Hermes, on one hand, and the joint venture, on the other hand, on the Finnish market. The parties maintain, however, that this overlap, if any, would be *de minimis*. Moreover, the parties say that FGB's remaining business as a state export credit agency for the coverage of non-marketable risks does not constitute insurance business as such because it would not be profitable for private credit insurers.

15. To date, it has been relatively safe to assume that underwriting non-marketable risks has, to a large extent, been left to state export credit agencies. However, the market is evolving and that private insurers are increasingly interested in covering also non-marketable risks. There are indications that increasing international competition is driving private insurers to extend their risk portfolio to non-marketable risks. The investigation carried out by the Commission shows that some private credit insurers already underwrite political risks for "good" clients, on a case by case basis. According to third parties covering political risks can been seen as an asset for the insurer. For instance, underwriting political risks may have image advantages, and rating companies also give better rankings for insurers that provide cover also for non-marketable risks.

16. It can be argued that with its expertise and financial resources Hermes, after having gained vital access to the evolving Finnish market through the joint venture, could move to underwriting non-marketable risks also in the Finnish market and, thus, be on the same market with FGB. However, the state export credit agencies have traditionally focused on the export activities of small and medium sized companies' (SMEs) and take into account additional political considerations, such as

[2] Communication of the Commission to the Member States pursuant to Article 93 (1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance, JO C 281, 17.9.1997, p.4.

stimulating SMEs' growth and internationalisation efforts and promoting employment. In the event Hermes should start covering also political risks in the Finnish market, it is questionable whether Hermes would target the same segment of companies. Third party comments suggest that more attractive alternative for Hermes would rather be insuring large, international companies that favour insurers with sufficient capital base and capacity to provide cover for international risks.

17. Finally, the parties say that the joint venture will not, from the outset, be involved in insuring non-marketable risks. The parties do submit that the line of business of the joint venture may be extended later. While it cannot be excluded that the joint venture would underwrite non-marketable risks in the future, at the moment it appears hypothetical given *inter alia* the size of the start-up personnel, the starting capital and the gross premium income expectations of the joint venture.

18. A related issue regarding possible coordination between the joint venture and the parent companies is the fact that Hermes will reserve the right to underwrite marketable risks for international groups including a Finnish company in case the joint venture is not able to do this. The parties argue, however, that this will not restrict competition since coinsurance between the joint venture and Hermes will be carried out on a case by case basis and addresses only a rather singular occurrence. According to the parties there exist several conditions which stipulate when Hermes can accept to underwrite marketable risks. First of all, Hermes can submit such an insurance offer only when requested by such group ("passive sale"). Second, Hermes will have to notify the Board of Directors of the joint venture and, only in the event that the joint venture is not able or willing to make a quotation, Hermes can accept to underwrite the risk.

19. The parties claim that this clause will provide safeguard against a situation where the joint venture is unable to provide insurance cover to a particular customer and would be in danger of losing the client to a competitor. The parties believe, however, that the risk taking capacity of the joint venture will increase over time and the clause will lose relevance in the near future.

20. On the basis of the above, it can therefore be concluded that the joint venture will not be cooperative.

<u>Conclusion</u>

21. For the above reasons, the transaction is a concentration within the meaning of article 3(2) of the Merger Regulation.

III. COMMUNITY DIMENSION

22. Hermes, ICF and FGB have a combined aggregate world-wide turnover in excess of ECU 5,000 million (Hermes ECU 459.440 million, ICF ECU 5.559 million and FGB ECU 32.569 million). Each of them has a Community-wide turnover in excess of ECU 250 million (Hermes ECU 408.629 million, ICF ECU 5.559 million and FGB ECU 32.500 million), but they do not achieve more than two-thirds of their aggregate Community-wide turnover within one and the same Member State. The notified operation therefore has a Community dimension, but does not constitute a cooperation case under the EEA Agreement, pursuant to Article 57 of that Agreement.

IV. COMPATIBILITY WITH THE COMMON MARKET

23. The parties have overlapping activities mainly in credit insurance. According to the parties the joint venture will, within the scope of its financial capacity, also practice reinsurance. The parties explain, however, that it is customary in the insurance business that the insurers of the same insurance sector give reinsurance on a reciprocity basis and, accordingly, all market players in credit insurance also offer reinsurance of credit insurance risks. Nevertheless, the parties say that reinsurance will form only a negligible share of the joint venture's credit insurance activities and, therefore, do not consider reinsurance as a relevant product market.

1. Relevant product market

24. According to the parties the relevant product market is thecredit insurance market. The parties divide credit insurance into three distinct classes, 14, 15 and 16, and sub-divide the classes as follows: Class 14 includes domestic and export credit insurance, consumer credit insurance and capital goods credit insurance; class 15 comprises guarantee insurance; and class 16 relates to fidelity/loss of profit and business interruption insurance[3]. According to the parties the relevant segment in this case comprises only class 14 risks as defined above, because the joint venture will be active only on this segment.

25. The Commission has considered the credit insurance market in three previous decisions. Both in *IV.M.812 - Allianz/Vereinte* and *IV.M.813 - Allianz/Hermes* the Commission took a demand-side position that life and non-life insurance could be segmented into as many product markets as there are types of different risks. Subsequently, in *IV.M.813 - Allianz/Hermes* the Commission identified the following segments of credit insurance: "delcredere" insurance (including domestic and export credit insurance and capital goods insurance); consumer credit insurance; guarantee insurance; and fidelity insurance. Credit insurance in general offers protection for suppliers of goods and services against insolvency of a debtor or extended late payments whereas fidelity insurance and computer fraud insurance cover internal risks deriving from illicit actions committed by employees of the insured.

[3] This subdivision is based on First Council Directive of 24 July 1973 on the co-ordination of laws, Regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life insurance, JO L 228, 16.8.1973, p. 3.

26. In its decision *IV/M.1082 - Allianz/AGF* the Commission divided the “delcredere” insurance policies into domestic credit insurance, export credit and capital goods insurance. The Commission concluded that both domestic and export credit insurance protect the policy holder against the insolvency of the client, and the only difference between the two different types of insurance is the location of the risk insured. Export credit insurance can be further divided according to the kind of risk covered (see above section II, point 13). Capital goods insurance covers insolvency risks deriving from the purchase of installations and factories in the home market and abroad.

27. In *IV.M.813 - Allianz/Hermes* the Commission concluded that, from the supply-side perspective, the credit insurance companies could cover all types of risks and, consequently, defined one credit insurance market incorporating all the above mentioned risks. However, in *IV/M.1082 - Allianz/AGF* the Commission examined the “delcredere” market as one separate product market due to its special characteristics, such as the requirement of extensive knowledge of the markets, investments and human resources.

28. In the present case the parties argue that bank guarantees should be considered credit insurance because, especially on the Finnish market, the majority of the guarantees are given out by banks rather than insurers. In addition, the parties argue that factoring may increasingly be substituted for class 14 credit insurance as defined above and is a potential competitor for credit insurance.

29. In *IV.M.813 - Allianz/Hermes* the Commission investigated whether services offered by banks should be regarded as substitutes for credit insurance. The Commission held that, although some products offered by banks are beginning to enter the market as potential competitors to credit insurance, due to their particular characteristics and prices these products are not yet sufficiently developed to substitute credit insurance products as such but are supplementary in nature. An investigation carried out by the Commission in the present case also confirms that bank guarantees are not, in general, considered as direct substitutes to credit insurance.

30. However, for the purposes of this decision it is not necessary to exactly define the market because, in all alternative market definitions considered, effective competition would not be significantly impeded in the EEA or any substantial part of that area.

2. <u>Relevant geographic market</u>

31. According to the parties the relevant geographic market is Finland. The parties base their argument on two previous decisions: In *IV.M.813 - Allianz/Hermes* the Commission concluded, *inter alia*, that the market entry takes place mainly through national subsidiaries and assumed that the relevant geographic market in that particular case was national. Also in *IV.M.812 - Allianz/Vereinte* the Commission concluded that the market was national.

32. On the other hand, in both *IV.M.812 - Allianz/Vereinte* and *IV.M.813 - Allianz/Hermes* the Commission recognised the fact that there are indications of the internationalisation of the credit insurance market. However, in *IV.M.812 -*

Allianz/Vereinte the Commission found that, despite the fact that the market is opening up especially for industrial customers, the market structure, distribution, customer preferences and national legislation dictate that the market is national.

33. In *IV/M.1082 - Allianz/AGF* the Commission recognised the fact that markets are becoming increasingly European in scope because of the liberalisation process in the European insurance markets, the world-wide re-insurance structures and the growing internationalisation of the business. The Commission noted that especially multinational corporates require a wider geographical scope in terms of servicing their group-wide operations from a single source. On the other hand, the Commission took notice also of the fact that "delcredere" market has a national dimension, too. This can be seen in the fact that small and medium sized companies usually seek credit insurance with domestic companies. Policies are mainly contracted on a local basis because of the need of information on the business of the insured, the financial situation of the customers and the local economic structures. The Commission concluded that there are elements to support both international and national geographic market definition, but for the purposes of the decision the definition was left open.

34. There are clear indications in the present case that the market is evolving and there is an increasing number of foreign insurers who offer insurance policies to Finnish policy holders, also cross-border. However, the fact that Hermes is seeking a local alliance in the Finnish market is in line with the Commission's previous findings and indicates that market entry may still require operating together with a local player.

35. However, for the purposes of this decision, the relevant geographic market can be left open because, in all alternative geographic market definitions considered, effective competition would not be significantly impeded in the EEA or any substantial part of that area.

V. ASSESSMENT

A. Impact of the operation at the European level

36. Hermes has activities in all European countries, except Greece. ICF has activities only in Finland. FGB covers marketable risks in Finland and non-marketable risks in Finland but, to a minor extent, also in Germany and Sweden. However, as the joint venture will not underwrite non-marketable risks, FGB's activities in Germany and Sweden do not affect the overall market shares on these markets. Following this, it may be concluded that the operation will not strengthen or create a dominant position as a result of which effective competition would be significantly impeded on these markets.

B. Impact of the operation at the national level

37. As stated above, all three notifying parties have overlapping activities in Finland. According to the parties a particular feature in the Finnish credit insurance business is the role of captive insurers, who play an important role in the Finnish credit insurance market. Captive insurers can be divided into two groups: (i) normal captives and (ii) bank captives. Normal captives, the parties

say, refer to insurance companies that form part of a large industrial group and exclusively cover risks borne by members of this group. On the other hand banks, according to the parties, can balance their credit risk through taking out an insurance and thus reduce their capitalisation requirements.

38. The parties identify three normal captive insurers in Finland: Pankavara,which is controlled by Enso Group; Garantia, which is controlled by 9 pension funds; and Dairies' Mutual, which is owned by some 60 dairies' cooperatives. The only bank captive is Mutual Insurance Company of Cooperative Banks, which is owned by about 250 cooperative banks.

39. According to the parties only one insurer, Pankavara, has been created for captive use in a strict sense. The parties base this argument on the fact that Pankavara is under the direct control of another company (Enso Group), while the other three companies are not. The parties argue, therefore, that the premium income of Pankavara should not be taken into account when calculating market shares while the premium income of the other three captives should be included in such calculations.

40. The investigation carried out by the Commission shows that Pankavara provides insurance cover only to the Enso Group and has no possibilities to underwrite risks to third parties. Accordingly, Dairies' Mutual provides credit insurance only to Valio and it's shareholders, cooperative dairies, and Garantia provides guarantee insurance only to pension related investors. Mutual Insurance Company of Cooperative Banks underwrites risks only to its member banks.

41. Captive production should, according to the normal economic practice, be excluded from the market share calculations. However, the investigation suggests that while the captive insurers operating in the Finnish credit insurance market are themselves restricted as to the choice of their customers, their customers appear to be somewhat free to seek insurance coverage on the open market. A tentative conclusion may therefore be drawn that, from the demand side, both captive and non-captive insurers compete, at least to some extent, for the same customers. Given this, it appears that captive insurers operate, at least partly, on the same market as non-captive insurers.

42. On the basis of the above, market shares will be examined both including and excluding the captive insurers and the bank guarantees in the following:

a) <u>Class 14 insurance, including captives</u>

43. When class 14 credit insurance is considered, captive insurers hold, according to the parties, an estimated [..][4] (bank captives [..][5] + Pankavara [..][6]) of the total of the market in Finland. ICF is the second largest credit insurer with a [..][7] stake of the market, Pohjola holds [..][8] and FGB [..][9] of the market. Other

[4] Confidential information, between 70 - 80%
[5] Confidential information, between 70 - 80%
[6] Confidential information, between 1 - 5%
[7] Confidential information, between 5 - 10%
[8] Confidential information, between 1 - 5%

foreign companies have a combined market share of [..][10] whereas Hermes's share of the total market is less than [..][11]. When taking all the captive insurers into account, the combined market share of the parties is less than [..][12]. The exclusion of Pankavara would not have any significant impact on the market shares.

b) Class 14 insurance, excluding captives

44. In the event that all captive insurers would be excluded from the market share calculations, the parties' combined market share would rise to [..][13]. The next largest credit insurer would be Pohjola with [..][14] of the market. Other Finnish insurers would have a combined share of [..][15] and the foreign companies jointly [..][16].

c) Class 14-16 insurance, including captives

45. When considering a wider product market definition, that is, classes 14-16, financial institutions offering bank guarantees have, according to the parties, [..][17] of the market. Captive insurers hold [..][18] of the market (bank captives [..][19] + Garantia [..][20] + Pankavara [..][21]), Pohjola, foreign insurers and others respectively [..][22], and FGB [..][23]. The combined market share of the joint venture would, according to this scenario, be less than [..][24].

d) Class 14-16 insurance, excluding captives

46. If all captive insurers were to be excluded, financial institutions offering bank guarantees would hold [..][25] of the whole of the market. Pohjola would have a [..][26] stake, other Finnish insurers would have jointly [..][27] and the foreign insurers [..][28] of the market. The combined market share of the joint venture would be less than [..][29].

e) Class 14-16 insurance, excluding captives and bank guarantees

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[9] Confidential information, between 1 - 5%
[10] Confidential information, between 5 - 10%
[11] Confidential information, < 5%
[12] Confidential information, between 10 - 15%
[13] Confidential information, between 40 - 50%
[14] Confidential information, between 10 - 20%
[15] Confidential information, < 5%
[16] Confidential information, between 30 - 40%
[17] Confidential information, between 50 - 60%
[18] Confidential information, between 20 - 30%
[19] Confidential information, between 20 - 30%
[20] Confidential information, between 5 - 10%
[21] Confidential information, between 1 - 5%
[22] Confidential information, < 5%
[23] Confidential information, < 5%
[24] Confidential information, between 1 - 5%
[25] Confidential information, between 80 - 90%
[26] Confidential information, between 1 - 5%
[27] Confidential information, between 1 - 5%
[28] Confidential information, between 1 - 5%
[29] Confidential information, between 5 - 10%

47. As discussed above, the Commission has tentatively suggested that services offered by bank, such as bank guarantees, should be considered supplementary products to credit insurance rather than substitutes. If, therefore, also bank guarantees were to be excluded, the joint venture's market share would rise from approximately [..][30] to [..][31].

C. Conclusion

48. Based on the above, it can be observed that the joint venture may reach relatively high market shares if the captive insurers and bank guarantees were to be excluded from the calculations. However, market shares alone do not necessarily indicate dominance but there are other considerations to be taken into account.

49. In particular, the liberalisation of the insurance market in the European Union has rendered the previously national markets more open to intra-community competition and set about a considerable amount of reorganisation and regrouping among the European insurers. The changes taking place in the European market can be seen clearly also in the Finnish credit insurance market where the present operation reflects the general reorganising in Europe. It is therefore important to consider the market shares in the context of a rapidly changing market. Following this, while the joint venture could reach a market share up to [..][32] it should be noted, first of all, that at the same time the joint venture's most important competitor Pohjola has teamed up with the German insurer Gerling Speziale Kreditversicherung-AG ("Gerling"), which is likely to strengthen Pohjola's ability to compete.

50. The changes prompted by the opening of the Finnish market can be seen particularly in that the activity of foreign credit insurers has increased relatively fast during the past few years: between 1994-1997 foreign credit insurers have increased their market share from 1-2% to 20-30%, depending on the relevant market. Several foreign credit insurers have also recently announced plans to underwrite credit insurance business in Finland (e.g. BG Garanti, Zuricher Versicherung).

51. This considerable increase in the number of foreign credit insurers witnesses reasonable possibilities to enter the Finnish market. The foreign credit insurance companies' entry to the Finnish credit insurance market has happened both by establishing branch offices but also by brokering which, in particular, appears to be a viable medium for market entry. The Commission noted in its decision IV.M.759 - *Sun Alliance/Royal Insurance* that the existence of broker channels of distribution remove some of the cost and difficulty of establishing independent channels of distribution. The same advantages apply also to the entry to the Finnish market, and it may be noted that Finnish legislation does not e.g. require a license for cross-border insurance that takes place through a broker.

[30] Confidential information, between 5 - 10%
[31] Confidential information, between 30 - 40%
[32] Confidential information, between 40 - 50%

52. The investigation suggests that the Finnish credit insurance market is lucrative for especially large European credit insurers because of the fact that there is demand in Finland for credit insurance with sufficient capital base. However, the local credit insurance companies tend to operate on a smaller scale and are not frequently able to meet the large, export driven industry's insurance demands. Third party comments confirm the assertion that the smaller Finnish credit insurance companies need to regroup in order to present a competitive offer to these large customers.

53. The rapid increase in the number of foreign credit insurers also indicates that the market is relatively immature and that there is basis for growth. Compared to the other European countries the market penetration in Finland is low. The parties estimate that, at present, only about 7% of domestic receivables and 23% of export risks are insured which, according to the parties, is due to the fact that only large Finnish exporters use credit insurance while SMEs are not accustomed to covering these risk to the same extent. Both the notifying parties and third parties expect the market to grow rapidly in the next few years.

54. Another important notion as regards the development of credit insurance markets in general is the fact that the boundaries between different insurance products and product groups appear to be moving. As already discussed above, private insurers have started moving to the non-marketable risk sector which used to be the exclusivity of the state export credit agencies. Another example is the products and services offered by banks which may be potential substitutes to some credit insurance products in the near future. The delimitations of different groups of credit insurance may therefore be outdated within the near future and the market positions of the players different.

55. Based on the above, the market share of the joint venture as calculated in any alternative market definitions does not seem to be indicative of a dominant position, given the presence of another strong player on the market, the evidence of increasing competition from foreign credit insurers, the present low penetration of the market and potential new substituting products.

VI. CONCLUSION

56. For the above reasons the Commission has decided not to oppose the notified operation and to declare it compatible with the common market and with the functioning of the EEA Agreement. This decision is adopted in application of Article 6(1)(b) of Council Regulation (EEC) No. 4064/89.

For the Commission