6 April 2017

The Registrar
PO Box 2351
WELLINGTON, NZ 6140

Sent via email: registrar@comcom.govt.nz

Dear Sir/Madam,

Re: Submission by Youi NZ Pty Limited to the Commerce Commission on Vero Insurance New Zealand Clearance Application to acquire Tower Limited

We refer to the notice by Vero Insurance New Zealand (Vero) dated 2 March 2017 seeking clearance from the Commerce Commission to acquire Tower Limited (Tower), and the Commission's statement of preliminary issues in relation to that notice dated 16 March 2017. Youi NZ Pty Limited ('Youi') welcomes the opportunity to comment on Vero's notice.

Background

By way of background, Youi[1] is a registered general insurance company which underwrites its own policies. Youi's products currently include Vehicle (Car, Motorcycle and Caravan & Trailer), Home (Buildings and Contents) and Watercraft.

Vero, through its affiliation with Suncorp Group Limited (Suncorp), and Tower both supply personal and commercial insurance, including in the market segments that Youi offer such as domestic house and contents, private motor vehicle, and private pleasure craft.

[1] Youi is a wholly owned subsidiary of Youi Holdings Pty Ltd, which in turn is a subsidiary of OUTsurance International Holdings Pty Limited which is part of the Rand Merchant Investment Holdings Group (RMIH), a large international insurance services provider.

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As a market participant in the personal insurance sector within New Zealand, Youi wish to make a formal submission in relation to Vero's proposed acquisition of Tower.

Summary of submission

In summary, Youi has concerns on the proposed acquisition as it considers it would result in Vero having a large percentage of market share in the general insurance market in New Zealand which would

(a) lessen competition by increasing Vero/Suncorp's ability to exercise market power when buying products (for example, collision repair services, home contents item replacement, etc.);

(b) allow Vero to exercise significant pricing power to firstly squeeze out new entrants through aggressive pricing and subsequently allow prices to consumers to rise; and

(c) reduce innovation in product design and customer service and further entrench substandard practices.

Youi's recommendation

It is Youi's recommendation that the Commerce Commission decline Vero's application to acquire Tower on the basis that the proposed merger will have, or would be likely to have, the effect of substantially lessening competition in the general insurance market in New Zealand.

Reasons for position

1. Increased Barrier to Market entrants

Whilst a consolidated market may, on the surface, appear to present opportunities for new entrants, the extent of consolidation may in fact have different consequences.

Youi has already identified examples of this type of behaviour by larger insurers in the existing market, such as using cross subsidies from classes of business or regions which a new entrant does not participate in to fund losses in the classes of business that a new entrant does offer. Further scale and marginal efficiencies gained by these insurers is likely to exacerbate this current situation.

2. Undue Pressure created by wider Supply Chain Networks

Existing larger general insurers already spend prolifically and have created extensive supply chain networks consisting of dedicated service providers. This proposed acquisition is likely to further increase the numbers of service providers captured by these networks, which places further pressure on procurement capabilities of other market players. The merged entity may also have an incentive to depress prices paid to suppliers to a level below the competitive price. Also, by selectively dealing with suppliers and establishing their own supply network, independent suppliers (such as family repair shops) may be possibly excluded from the market. The likely effect of this may be industry bodies being entirely focussed upon the needs of these major market players; as opposed to those of consumers and substandard customer service being provided.

3. Reduced Product and/or service innovation

Youi was the first new entrant to the New Zealand market in decades. Youi's entry has coincided with some market incumbents providing new services to the market. These services have been available within the Australian arm of those incumbents for some time, but were not innovative, by world standards. However, until that time these companies had not previously seen a need to introduce them to the New Zealand market. It is arguable, the pressure of Youi's entry incentivized the introduction of these new services. This is a strong example of increased competition leading to a change in the market. Where there are no new entrants joining a market, less incentive exists to change existing practices.

Further market consolidation could therefore result in a reduced drive for product or service innovation which will ultimately lead to poor consumer outcomes. In the longer term, Youi also considers consumers might be paying higher or more expensive premiums for insurance cover due to lack of competition and choice.

4. Capita/ advantages

It would also appear that a significant market barrier already exists for any new general insurance market entrant which is to possess a Financial Strength Rating (FSR). Whether intended by the RBNZ's solvency standards or not, customers perceive a lower rating to be inferior. Indeed, holders of a higher rating draw attention to the rating of a competitor, where that rating is lower than their own to create doubt. For a new entrant, it is therefore desirable to have the highest rating possible.

To achieve a suitable FSR, one which would be unlikely to be referred to by a competitor as being inferior, a new market entrant requires considerably more capital, well over and above prudential requirements. This excessive capital requirement reduces the opportunity for potential entrants and directly benefits market incumbents. This is further accentuated should larger insurers use their vast capital resources to fund a pricing position in such a way that the capital required by a new entrant is quickly depleted.

5. Concentration Risk

With further market consolidation, a significant risk exists that one or both major insurers elect to limit cover in certain areas (e.g. highest risk earthquake or flood areas) thereby restricting members of the public accessing insurance cover. A healthy market with wider competition is unlikely to see this type of unilateral change.

These larger insurers in the market both tested the limits of their catastrophe reinsurance cover in the 2010/11 earthquakes. The existence of the Australian arm on that occasion meant that financial security was sustained. However, further consolidation increases the risk that these companies do not have sufficient resources to be able to deal with an earthquake that again tests the limits of their cover. New Zealand tax payers may again be called upon to meet a significant insolvency — yet for such a large market participant the quantum could of much higher magnitude than that witnessed in 2011.

Conclusion

Youi is unable to comment regarding the extent to which intermediaries such as banks are likely to act as a competitive constraint on the merged entity or other related issues.

Youi considers this acquisition will potentially create an even more significant barrier to entry for new general insurance entrants into the New Zealand market. Further consolidation in a smaller market, by word standards, will mean the scale advantage of the larger insurers will allow more ability to apply considerable pressure on any new industry entrant.

Youi is overwhelmingly opposed to this proposed acquisition due to the aforementioned reasons and it welcomes an opportunity to discuss these concerns in more detail with the Commerce Commission.

Yours sincerely

Frank Costigan
Deputy CEO