Submission on proposed Vero Insurance NZ Ltd acquisition of Tower Ltd to the Commerce Commission NZ

By:

Dr Michael Naylor
Senior Lecturer in Finance & Insurance
School of Business
Massey University
Private Bag 11 222
Palmerston North
021-02779292

All this submission is public

I am opposed to this acquisition proposal for a number of reasons;

1) The market for personal house and contents insurance is already highly concentrated and uncompetitive. The current market structure can be characterised as a duopoly. My figures show that IAG has 50%, Suncorp has 28%, Tower 7%, and FMG 4%. The Herfindahl-Horschman index for the current market is thus 0.335, which is internationally considered to be highly concentrated. A market with a combined Suncorp-Tower would be IAG -50%, Suncorp 35%, FMG 4%, 7 others 11%. This would have an index of 0.375. This would be regarded as failing all overseas competition metrics.

   The above market shares are generous to Suncorp. FMG and MAS cannot be regarded as in the same market place as Suncorp, as they pursue a different customer base. I am not privy to ICNZ figures but sources indicate that within the narrow household H&C sector IAG & Suncorp currently have a combined share of well over 70%. Thus, IAG and Suncorp already dominate, with Tower as their only real competitor. While Tower is a minor player compared to IAG & Suncorp, its combination with Suncorp would leave a duopoly with a combined 85-90% share.

   Market entry has occurred in the life insurance sector, where there is a more spread and dynamic market structure. It is telling to compare the changes in market share and innovation which have occurred in that sector with the stagnation of the H&C sector.

2) Tower is the remaining competitor of any significance and its removal would have a significant adverse impact on the market. This is relevant across both direct and brokered markets, despite Tower's limited presence in the brokered market, as the two markets are competition as far as the household P&C is concerned.

   NZ cost structures are high buy international standards, as are profit margins. Increased competition is required to correct this.

3) A more important issue is that the proposed acquisition would gave a larger impact on the NZ insurance sector than the above comments would indicate. The above comments only relate to static competition, that is the market as it is currently standing still. On top of that dynamic competition issues have to be considered. I am on record as having made statements about the prospects of the world-wide insurance sector in the future with regard to the impact of IT. I am currently publishing a book on the topic, which will establish my position as an international expert in this area.

   Basically, the insurance sector is about to be substantially disrupted by the combination of a number of factors, based on AI intelligent robotic processes and telematics. It is vital for NZ and Australia to be at the forefront of these innovations, and attract the required skills and capital. Failure to do this will have a widespread impact on competitiveness of our insurance sector and related companies within the business ecosystems. This innovation process is very difficult for incumbents like IAG and Suncorp and they will need a number of external impulses to force them to go through the required structural and cultural adjustments.

4) Tower is not in a financial position to remain as a standalone company. It has been heavily impacted by the Cant quake and has not been a dynamic competitor since then. Even before that Tower has been under-investing in its systems and processes for a decade, and its customers have started to notice. Its market share has been reducing, and this has impacted adversely on household H&C market.

   The counter-factual is thus the acquisition of Tower by Fairfax. This brings in an external insurer who has shown substantial dynamic characteristics and innovative impulses. Tower, with the backing of Fairfax, would have the resources, financial, personnel, and IT, to become more competitive and therefore expands its market share, reduce profit margins, and superior customer service. Fairfax has had this impact on the Canadian insurance sector, where it has shaken up incumbents.

   Tower this needs a backer prepared to invest substantial resources, especially in terms of IT systems, CRM systems, and management skill. This would be good for Tower's customers. Vero, post-acquisition, would not the capacities or resources, and would not be under competitive pressure to reform Tower.

5) NZ has the IT skills, regulatory environment, and customer base to become an international leader in InsurTech innovation. The acquisition of Tower by Suncorp would remove any external

impulse for these adjustments, and possibly have a substantial adverse effect on the NZX insurance sector and related companies.

Fairfax has the capacity to bring a higher level of InsurTech to Tower, due to its leading IT systems and financial backing. This should provide an edge of dynamism which the NZ insurance sector is missing, and future proof us against external companies which base their skilled staff abroad.

A vita aspect is that entry needs ort be disruptive. It is well recognized in the Australian market that there is a lack of internal or external disruptors in the insurance sector. Innovations are occurring, but they are hesitant and insubstantial. Disruptive entry will occur – it is better to occur after Australian and NZ insurers have been encouraged to transform by a milder disruptor like Fairfax.

The possible entry of Fairfax in the NZ is thus an event of significance which far exceeds what on the face seems a simple acquisition by a duopolist. I am willing to discuss issues of InsurTech innovation and dynamics in detail with Commission members.

6) There are substantial barriers to entry which exist. Vero's submission mentions YouI as a major competitor. YouI has advertised and invested heavily and yet has only achieved a 1% market share. It is struggling to retain that. YouI's experience shows that the IAG/Suncorp duopoly has been restricting to our market.

   A branch network and a brand-name are still important characteristics for the NZ customer. Tower has those, and thus plays a key role as an entry point for a new competitive player in the market. Without acquisition of Tower, Fairfax may not enter, and the competitive structure will be even more stagnant.

7) Banks do not play a major role in introducing competition into the market. This is because they have relied on IAG & Suncorp to provide, price, and service their products. Any failure of the insurer to service customers well, harms the bank reputation, so they are cautious in partnership choices and are extremely unlikely to use an external insurer has does not have a branch network. This is particularly in areas of claims.

8) The competition which has arisen due to the expansion of QBE and Chubb, has so far been small and confined to the brokered commercial sector. This cannot thus be seen as relevant to the acquisition of Tower by Suncorp, as there is no direct competition.

9) The proposed acquisition by Suncorp would lead to an internationally unique level of market concentration, substantially reduced competition, and stagnation in terms of innovation and customer service. An acquisition by Fairfax would, hopefully, lead to the reverse; reduced concentration, reduced profit margins, improved customer service, and the start of innovation.

   I ask the Commissioners to make this clear to Suncorp.