AIG Insurance New Zealand submission on application to Commerce Commission by Vero Insurance New Zealand Limited (Vero) for clearance of Vero's Proposed Acquisition of Tower Limited (the Proposed Acquisition)

AIG seeks confidentiality for sections in [ ]

1 Executive Summary

1.1 AIG is concerned about the potential impact to consumers of the Proposed Acquisition on personal products markets for domestic buildings, contents and private motor vehicles (**HCMV market**).

1.2 AIG is also concerned about the potential impact to consumers and suppliers in the markets for provision of windscreen repair services and collision repair services. AIG also believes this will potentially extend to include home repairs and the supply of building materials, particular in the event of natural catastrophe.

1.3 The Proposed Acquisition will result in a high concentration of market share in the HCMV market in IAG ([ ]%) and Vero ([ ]%), with a combined concentration of circa [ ]%. Tower currently is the most significant competitive constraint in the HCMV market on Vero and IAG with a market share of ([ ]%). The Proposed Acquisition would lead to further concentration of the HCMV market.

1.4 Increased market concentration makes new market entry and competitive offerings from existing players more difficult, all to the detriment of consumers. By way of example, Youi currently only accounts for a very small share of the HCMV market and its products do not compete strongly with Vero, Tower or IAG. Having to compete in a further concentrated market would further undermine the ability of smaller players like Youi and new market entrants to compete.

1.5 Acquisition will also establish conditions that substantially increase the potential for Vero and IAG to coordinate their behaviour (directly or indirectly) and collectively exercise market power, to the detriment of customers.

1.6 Should the Proposed Acquisition proceed, AIG believes the level of concentration will effectively create institutions that present significant systemic risk and are therefore too big to fail.

1.7 Vero's application to the Commission contains statements that are diametrically opposed to its previous submissions on the IAG/Lumley merger, which was submitted to the Commission only three years earlier. AIG believes Vero's revised position is not supported or justified by changes in the market.

1.8 The Commission cannot therefore be satisfied that the test for granting clearance is met.

2 Proposed Acquisition will result in highly concentrated markets

A. Combined general insurance market (commercial and personal lines)

2.1 Analysis of the combined market share information in Table 1 of Vero's application (based on premium revenue) indicates:

2.1.1 IAG will continue to hold 45% market share for the combined general insurance market;

2.1.2 Vero, which has the second largest-market share after IAG will move from 25% to 30% market share post-acquisition;

2.1.3 the next largest market share after the merged Vero/Tower entity will be QBE with only 7% of the combined general insurance markets;

2.1.4 at present the three largest firms in the combined general insurance markets (IAG, Vero and QBE) hold combined market share of 77%; and

2.1.5 post-acquisition, IAG and the merged Vero/Tower entity will have a collective share of the combined general insurance market of 75%, and when adding, QBE (at 7%) the three largest insurers in the combined general insurance markets (IAG, Vero and QBE) hold combined market share of 82%. No other insurer will have a market share of more than 3%, and in many cases it will be substantially smaller.

2.2 On these market share figures for the combined general insurance market, the proposed transaction significantly exceeds the Commission's market share and concentration indicators. Accordingly, compelling reasons must exist to grant the clearance.

2.3 Further details of annual market share for general insurers are contained at **Appendix 1.**

B. Personal insurance markets

2.4 AIG considers that the effect of the Proposed Acquisition would be even more acute in the personal insurance markets and specifically the HCMV market.

2.5 [ ]:

	Gross Written Premium	Percentage
Domestic Building	[ ]	[ ]%
Domestic Contents	[ ]	[ ]%
Private Motor	[ ]	[ ]%
Earthquake: Domestic	[ ]	[ ]%
Travel: Outbound Leisure	[ ]	[ ]%
Marine Hull: Private	[ ]	[ ]%
	[ ]	

2.6 Accordingly, the total annual premium for the HCMV market makes up approximately [ ] of all personal lines business, thus making HCMV the core offering of any personal lines insurer.

2.7 In terms of apportioning market share between insurers, AIG is unable to obtain detailed numbers due to commercial restraints. Accordingly, below we set out what we consider to be our best estimates of the HCMV market.

Insurer	Commercial (%)	Personal Lines (%)	Total GPW[1]	Total Personal Lines	Total HCMV Market	HCMV Market Share
IAG[2]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]%
Vero AA[3] Combined	[ ] [ ]	[ ] [ ]	[ ]	[ ] [ ][4] **[ ]**	[ ]	[ ]%
Tower	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]%
Others				[ ]	[ ][5]	
				[ ]	**[ ]**	

2.8 We estimate that "Others" are constituted as follows:

Insurer	Total GPW	Notes	HCMV Market Share
FMG	[ ]	[ ]	[ ]%
Youi	[ ]	[ ]	[ ]%
MAS	[ ]	[ ]	[ ]%
Capacity providers and others	[ ]		[ ]%

2.9 The Proposed Acquisition will therefore result in a much more highly concentrated HCMV market than at present, with the HCMV market becoming dominated by two companies, IAG at [ ]% and Vero at [ ]%. The result is an effective duopoly controlling circa [ ]% of the HCMV market in New Zealand.

2.10 The cumulative effect of the acquisition would be to lead to a greater concentration in both the combined general insurance market and HCMV market with a significant reduction in the amount of competition in both. Vero argues that the increase in market share would be small, and less than the increase in IAG's market share that occurred when IAG acquired Lumley. However, the combined market figures on which this statement is made hide the impact of the transaction significantly. Vero and Tower both have a stronger presence in the HCMV market, such that even the absolute increase in Vero's market share will be significant.

[1] Source: ICNZ Members Ranking: Annual Gross Premiums Written
[2] Extrapolated from IAG investor report 1H2017: https://www.iag.com.au/sites/default/files/Documents/Results%20%26%20reports/1H17_Investor%20Report%20-%20FINAL.pdf
[3] Extrapolated from Suncorp half year results ended December 2016: http://www.suncorpgroup.com.au/sites/default/files/fm/documents/Investor%20Relations/Financial%20results/HY17%20Results/HY17%20Presentation%20and%20Data%20Pack.pdf
[4] [ ]
[5] [ ]

2.11 The Commission's approval of the IAG/Lumley merger does not mean that it should approve Vero's application.

2.12 Vero claims in its application that the market share information it has provided overstates its market shares, because it is based only on premiums to ICNZ members. However, ICNZ members do include almost all the participants' in the personal products markets, such that AIG considers that the ICNZ premium information is a good indication of market share in the HCMV market.

2.13 The test for clearance of an acquisition is that the Commission must be satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market. With the impact of the Proposed Acquisition on market share, AIG submits that the Commission would need some strong evidence in order to be convinced that this test is met.

3 Competitive dynamics of the markets

Relevant markets

3.1 This submission focusses on the HCMV market and related buying markets. In Vero's application these are described as:

3.1.1 **Personal products markets**

(a) Domestic house and contents

(b) Private motor vehicle

3.1.2 **National buying markets**

(a) Auto-glass and windscreen repair/replacement services

(b) Collision repair services

3.2 AIG considers that the two personal products markets above should be regarded as a single market (the HCMV market). This is because the policies in these two areas are almost universally sold as a package with multi-purchase discount. It is also not commercially feasible for an insurer to offer only one of these mainstream personal product lines and seriously compete (the exception being truly specialty sub-products such as "modified auto" and "high net-worth home and content", which do not have a large market profile).

3.3 If, however, the Commission takes the approach of treating domestic house and contents and private motor vehicle as separate markets, it needs to recognise:

3.3.1 the significant extent to which those policies are bundled;

3.3.2 the need for an insurer to offer each individual product line in order to gain market share; and

3.3.3 the barriers that exist to entry and expansion in a market.

Overview of the competitive situation in the personal products markets

3.4 As noted above, the personal products markets are dominated by IAG (and its related brands) and Vero/AA. As noted above, those two companies together currently have a [ ]% share of the HCMV market, increasing to [ ]% if the Proposed Acquisition proceeds. Vero is the second largest provider in that market, and IAG's largest competitor.

3.5 These two companies offer a wide suite of products and in IAG's case, across several brands. They have well-known brands and strong marketing presence. They have wide-ranging arrangements with providers of motor vehicle repair, towage, windscreen and parts providers, and with contents replacement providers, building repair services, materials, and loss adjusters.

Conditions of entry and expansion

3.6 Vero's clearance application states that "*Suncorp considers that the barriers to entry in both the commercial and personal insurance product markets are not significant, as is evidenced by recent entry and expansion in these markets*".

3.7 However, when submitting on IAG's application for clearance to acquire Lumley, Suncorp stated (at page 8):

"The barriers to entry in personal lines insurance markets are higher than those claimed by IAG in its application and found by the NZCC in IAG/AMI. This is demonstrated by a lack of entry into the direct personal lines markets in the last 17 years. Instead, during that time (and indeed very recently) a number of parties have exited the market. The entry barriers primarily relate to increased regulatory barriers, the importance of pricing experience as a result of the Canterbury earthquakes and the requirement for scale to reduce reinsurance costs. In addition, the insurance market in New Zealand is relatively mature, with little growth in customer numbers expected in the near term [for example, 93% of motorists have car insurance (source ministry of transport vehicle insurance report Dec 2009)]. Accordingly, the only way for a new entrant to succeed is to take market share from an existing player."

"While these barriers can be overcome to an extent, a new entrant is likely to stick to niche areas rather than enter organically on a broad scale. Large international insurers would be able to obtain better returns by focusing resources in other countries. Furthermore, the proposed transaction would further disincentive entry given IAG's enhanced scale and ability to sustainably target new entrants with low prices or targeted offers."

3.8 At page 9, Suncorp stated:

"Pricing/claims experience is an important factor in personal lines, particularly H&C. The Canterbury earthquakes gave rise to a wealth of information for existing insurers, allowing existing insurers to very specifically assess risks based on various factors such as soil type, location etc. While new entrants can purchase models allowing assessment of natural perils, these represent a cost not borne by incumbents and would be inferior to the wealth of claims data."

"In Suncorp's view, proprietary knowledge of H&C risks gives incumbents a significant market advantage over new entrants, one that is not easily replicable by new entrants without incurring substantial costs."

3.9 AIG agrees with Suncorp's comments on IAG's application for clearance to acquire Lumley, and considers that the barriers to entry and expansion in the market for HCMV are high and will be even higher if the Proposed Acquisition proceeds.

3.10 In order to enter into the markets in any meaningful way, and to expand, insurance companies need underwriting data in order to understand, properly price and manage the risks in the market. To a point, assumptions can be made and information from other markets can be used to construct pricing models, however in such cases greater risk weighting is required given the nature of the assumptions – which in turn leads to a requirement for higher capital – which in turn leads to a need for higher prices to achieve a satisfactory return on capital.

3.11 Insurance companies can only obtain “in-market” data through experience in a market. The more experience and exposure an insurer has in a market, the better an insurer can understand risk by having access to more accurate information and more accurate pricing. This leads to less assumptions in the modelling – which in turn leads to a requirement to hold less capital – which in turn leads to lower prices while maintaining a satisfactory return on capital.

3.12 The underwriting data is closely guarded by incumbents and not available to competitors. As a result, incumbent insurers already enjoy a significant advantage over new entrants to price and manage risk. Accordingly, new entrants face higher risks in a market until they can obtain greater quantity and quality of underwriting data to make better informed decisions.

3.13 Other factors affecting entry and expansion in the HCMV market are:

3.13.1 Regulatory costs, as noted by Suncorp in its submission on the IAG/Lumley acquisition.

3.13.2 Establishing and resourcing a satisfactory claims service. There is only a relatively small pool of experienced staff in New Zealand. Incumbent insurers are in a better position to recruit and retain staff.

3.13.3 Marketing, communication and advertising costs. Entry and expansion into the personal products markets needs to be supported by consumer advertising. This is costly, takes time to develop and there are large economies of scale to be gained. In the consumer space, in particular, marketing and communication teams are needed with a range of expertise (eg digital, on-line, traditional media) and to deal with media enquiries. These need to be built in order for a new entrant to gain market share.

3.13.4 Securing competitive pricing on repairs, towage, windscreen, parts, contents replacement, building repair services, and loss adjusters. Incumbents are in a position to achieve better pricing.

3.13.5 The need to offer a full suite of HCMV products, as discussed above in paragraph 3.3.

3.13.6 Experience working with EQC, and related systems. Incumbents have gained valuable experience and configured their systems for working with EQC following the Kaikoura Earthquake and the new processes for handling claims under the EQC Memorandum of Understanding.

3.13.7 Incumbents are better able to respond in the case of large natural catastrophe events through their ability to control the repair network (both home and auto), secure materials and additional contractors and effectively prioritise home repairs to the detriment of new entrants.

3.14 Having two companies, Vero and IAG, dominate the New Zealand consumer market in an even stronger way than at present would significantly deter new competitors from entering the market. Those companies, due to their market position, are able to respond to new entry by lowering prices, but still maintain an acceptable return, when those price levels might not provide an adequate return for other insurers. It is also worth noting that a new entrant is likely to take longer to become profitable than the 2 year period estimated by the Commission in the IAG/Lumley decision. Evidence in support of this can be seen from the performance of new entrant Youi.

3.15 AIG notes that in its decision to grant clearance to IAG’s acquisition of Lumley, the Commission was fairly brief in its analysis of the barriers to entry in the markets, for personal insurance products. The Commission focussed only on a new entrants ability to provide underwriting services for banks, and stated (at page 21): “*After speaking to* *several insurers that do not currently provide underwriting services to banks, we are satisfied that there are likely to be insurers that have the ability and intention to bid for bank tenders.*" However, AIG does not consider that new entry is reasonably likely for the reasons discussed in paragraphs 3.34 to 3.45 below.

3.16 There is also a considerable difference, in terms of the impact on the potential for new entry into the market as a result of 4 larger insurers reducing to 3 (in the IAG/Lumley decision) and from 3 larger insurers reducing to 2 (as would result from the Proposed Acquisition). With only two market players, the opportunity for customers, distributors and vendors to have meaningful choice in the market place is significantly reduced. Each of Vero and IAG would know there is no further meaningful market share to be gained due to anti-competition concerns and as a result, each would be focused on extracting the optimal economic rents allowable by their comfortable duopoly.

Tower

3.17 Of the other participants' in the HCMV market Tower is the third largest provider of insurance. It is therefore a significant competitor to Vero and IAG, and realistically the only existing participant in that market able to challenge those companies for market share. It is a significant, well-resourced and established insurance company focused on personal lines insurance.

QBE

3.18 QBE is a significant operator in the commercial insurance products market but AIG considers that its participation in the HCMV market (if at all) is very small.

3.19 Vero's application states that QBE has only recently entered the personal products markets, through brokers. AIG understands, however, that QBE is only doing so as a provider of capacity on broker- led products. This is where a broker (such as Aon) develops an insurance product, where there is a lead insurer and various following companies, who provide the capacity. The typical split might be say 60% of cover from the lead insurer, with the capacity providers taking the rest.

3.20 The lead providers in the HCMV market are typically IAG/ Vero or Tower, who have the internal resources and market understanding to price and support the insurance contracts and deal with claims. The capacity providers, in comparison, provide none of the infrastructure or support for the product. They are, in essence, a "silent partner" – contributing economic capacity but nothing else. They do not provide a competing product which consumers can purchase.

3.21 As a result, the providers of capacity cannot be considered to provide a meaningful constraint on competition with insurers that have fully invested in the systems and services necessary to allow full entry into a market and that engage with customers.

3.22 In any case, QBE's entry into this part of the market is anticipated to have occurred through intermediaries, is recent, and will have resulted in minimal market share and will not translate into any significant competitive threat to either Vero or IAG.

Youi

3.23 While Youi's entry into New Zealand has attracted attention, Youi is not yet a significant challenger to Vero's or IAG's market position or a meaningful constraint on their actions.

3.24 Youi has spent significant amounts on advertising and associated start-up costs as it seeks to build a credible alternative to IAG, Vero and Tower. Despite that significant spend, Youi has only been able to gain a market share of [ ]% of the HCMV market.[6]

3.25 It is not credible for Vero to claim, as it does in its application, that at this level of market share, Youi is a major competitor.

3.26 Furthermore, Vero's claim is also not credible when Youi's policies, marketing approach and place in the market are examined. Youi's product offering is based on a different approach to IAG, Vero and Tower. In AIG's view, Youi starts with the proposition of a very basic insurance cover, and invites customers to buy upwards for additional cover. The effect is to offer a base policy which is cheaper but comes with narrower coverage/ more limitations/ higher excess or combinations thereof. By contrast, neither IAG, Vero or Tower offer a product where the cover can be reduced to the lowest level which Youi is prepared to offer.

3.27 In its first year of operating (2014), Youi made a $2.4 million loss. In its second year of operating (2015), Youi made a $14.8 million dollar loss. In its third year of operating (2016), Youi made an $11.06 million dollar loss.[7] AIG considers it likely that Youi will continue to make a loss in its fourth year of operation and for the foreseeable future. The ability to incur these losses while building a competitive franchise further emphasise the challenges of new entrants in to the New Zealand consumer insurance market.

3.28 Recent issues arising under the Fair Trading Act have also impacted Youi's reputation in the market and it is likely this will affect its ability to win or retain customers in the short term.

3.29 Youi is therefore in a challenging position in the market and its long-term future in New Zealand remains uncertain. [
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FMG and MAS

3.30 In paragraph 6.19, Vero lists FMG and MAS as competitors whom Suncorp "competes with vigorously". In Vero's submission on the IAG/Lumley acquisition dated 21 February 2014, Vero states:

> *"FMG operates in a niche, servicing almost exclusively rural customers. Neither FMG's marketing, nor it's pricing, are in any way aimed at attracting non rural customers. Accordingly, in Suncorp's view, FMG does not pose a significant constraint on IAG's pricing and will not do so post acquisition."*[8]

> *"[MAS] represents a very small part of the overall insurance market, and accordingly does not impose any real competitive constraint on IAG. In Suncorp's experience, MAS does not compete hard on price, but rather tends to differentiate itself based on the claims services that it provides (as professionals tend to be more sensitive to this aspect of competition). This suggests that IAG increasing its prices is unlikely to lead to any significant degree of switching to MAS and MAS should not be included as a relevant constraint in the Commissions analysis."*[9]

3.31 FMG, as New Zealand's leading rural insurer, does not market its products to urban consumers. A non-rural consumer does not, and would not, purchase FMG insurance to cover their home, contents and/or car. FMGs household contents insurance, for

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6 [ ]

7 Extracted from publically available financial statements

8 Page 5, Submission of Suncorp Group Limited on IAG's proposed acquisition of Wesfarmers' underwriting business 21 February 2014

9 Page 5, Submission of Suncorp Group Limited on IAG's proposed acquisition of Wesfarmers' underwriting business 21 February 2014

example, provides cover for the cost of refilling firefighting equipment, a feature which would be redundant to a consumer living, for example, in Wellington.

3.32 MAS requires consumers to apply for membership, which is only approved to people who have qualifications (predominantly in the medical field) and are high net worth professionals.

3.33 AIG considers that both FMG and MAS continue to be niche providers, and do not impose any significant constraint upon the larger market participants.

Banks

3.34 All of New Zealand's leading trading banks are engaged in the offer of retail insurance to their customers, including HCMV. The insurance is underwritten by insurance companies, which typically provide "white label" insurance products for sale alongside other financial services offered by banks.

3.35 The current arrangements for the offer, sale and distribution of HCMV through banks is as follows:

3.35.1 IAG: ASB, Westpac, BNZ and the Cooperative Bank;

3.35.2 Vero: ANZ and AMP; and

3.35.3 Tower: Kiwibank and TSB Bank.

3.36 These types of distribution arrangements between insurers and banks tend to be long term (3-5 years), and will not always go to tender. When a programme is available for tender, the only insurers who can respond are those who have the infrastructure, underwriting data and reputation necessary to operate the programme to the bank's standards.

3.37 From an insurer's perspective, a bank programme is an attractive means of distributing product (subject to acceptable commission rates). However, as can be seen from paragraph 3.35, these arrangements are highly concentrated amongst the three leading providers of HCMV.

3.38 Vero states that "*a new entrant would only need to win one tender with a large bank in order for entry into New Zealand to be financially viable*". Though it may be correct that winning a tender for a large bank could make entry into New Zealand viable or at least is a major contributor to successful entry, this statement grossly understates the difficulties in winning a tender.

3.39 Banks will not engage with an entity unless it has the proven ability and capacity to deliver, strongly undermining a new entrant's ability to win a tender. At the bare minimum, a new entrant will need to show it:

3.39.1 has sufficient information on the risks in the relevant retail market;

3.39.2 has the resources and processes required, i.e. a claims management team specifically dedicated to bank-brand customers;

3.39.3 is reputationally and financially sound; and

3.39.4 is able to meet the bank's expectations on commission.

3.40 By way of example, AIG supports and has supported various travel insurance programmes operated by banks through their credit card offerings. Whilst AIG could participate in a tender for this type of product, it could not viably tender for HCMV notwithstanding AIG's resources and infrastructure. The same can be said of all other insurers who do not significantly participate in the HCMV market (bearing in mind that the risk appetite of FMG and MAS is not in the general retail market).

3.41 If Vero acquires Tower, all major retail banks will distribute HCMV underwritten by either IAG or Vero. This would be significant concentration on the supply side of the market.

3.42 AIG notes that Vero's application refers to AIG as a supplier of white label insurance to banks (paragraph 8.15(c)). AIG, however, only provides travel insurance products through banks in the consumer space as part of banks' credit card programmes.

3.43 Vero claims that banks have significant countervailing power. AIG disagrees.

3.44 The Commission, in its decision on the IAG/Lumley acquisition, assessed the level of competition for white label insurance in the personal products market, and emphasised that the "*the other major competitors that underwrite personal insurance products for banks are Vero and Tower*" [10]. The Commission stated:

3.44.1 *"While retail banks will not be able to use Lumley as an underwriter/provider of insurance, they will still have (at least) two credible options in Vero (provides services for ANZ) and Tower (provides services for Kiwibank) in addition to IAG should they wish to switch to an alternative insurance underwriter."*[11]

3.45 Vero's proposed acquisition of Tower would further reduce the availability of insurance companies deemed 'credible options' for banks to two players (IAG and Vero), which is inconsistent with the competitive landscape envisaged by the Commission three years ago.

4 [ ]

5 Tower provides a meaningful constraint

5.1 Tower, as the third largest provider in the HCMV market, provides the most meaningful constraint on Vero's and AIG's actions.

5.2 As detailed above, the removal of Tower from the market as an independent insurer will mean that there is much less choice available to customers.

5.3 In its application for acquisition, Vero stated that Tower and Suncorp are not each other's closest competitors and that Tower's business is simply complimentary to Vero's.

5.4 However, in its submission on the IAG/Lumley acquisition three years earlier, Vero stated:

"The Proposed Transaction represents a tipping point towards an anti-competitive market structure. Indeed, in its IAG/AMI decision, the Commission specifically relied on Lumley as a material constraint on IAG noting it (alongside Vero and Tower) as a significant, well-resourced and established insurance company with a trusted and respected brand."[12]

5.5 In its clearance of IAG's acquisition of Lumley, the Commission saw Tower as an important source of competition against IAG.

[10] Page 16, *Re IAG (NZ) Holdings Limited and Lumley General Insurance (N.Z.) Limited* [2014] NZCC 12
[11] Page 14, *Re IAG (NZ) Holdings Limited and Lumley General Insurance (N.Z.) Limited* [2014] NZCC 12
[12] Page 2, Submission of Suncorp Group Limited on IAG's proposed acquisition of Wesfarmers' underwriting business 21 February 2014

5.6 Vero claims that Suncorp's and Tower's personal insurance product offerings are highly differentiated on coverage, service and claims handling and reputation. AIG considers, however, that:

5.6.1 The terms of each companies' policies are substantially the same. For example, Vero and Tower's car insurance product are almost identical, in that the three kinds of cover offered under each policy are comprehensive, third party cover, and third party cover with fire and theft.

5.6.2 Where they are differences between policies those differences are less than the differences between Vero's policies and those offered by Youi and no different in total than the difference between Vero's policies and those offered by IAG, which Vero claims are closer competitors than Tower.

5.6.3 There is no significant overall difference between insurers in terms of claims handling and services – albeit it is a very subjective topic. In particular the introduction of the revised Fair Insurance Code has meant there is now a minimum service standard for all insurers.

5.7 In AIG's view, Tower and IAG are Vero's most direct competitors.

5.8 Vero also submits that:

"Unlike Suncorp, Tower does not participate in the broker market where the vast majority of commercial insurance is transacted. Instead, Tower has limited its commercial offerings to the direct commercial insurance channels (which makes up a small portion of the total commercial insurance markets)."

5.9 Though this statement is made in reference to the commercial insurance market, AIG considers Tower's use of different distribution channels (by offering its services direct to market rather than through an intermediary) in the personal products market and the commercial insurance market does not mean Tower is operating in a separate market to Vero or is not a close competitor to Vero.

5.10 First, consumers searching for home, contents and car insurance online are almost exclusively faced with brand names owned by IAG, Vero or Tower, whose personal insurance products are substantially the same. All companies provide a substantial amount of information about their policies online.

5.11 Second, rather than directing customers to seek a quote directly through its website (as Tower does), Vero instead directs customers to contact a broker on its behalf, with contact details and website available through a search function on Vero's website. This difference in distribution channel does not mean that Tower's and Vero's products do not compete.

5.12 Vero claims that, alongside IAG, Youi is its closest competitor for domestic house, contents and motor. This claim is not credible. As previously noted, there are significant differences between Youi's policies and Vero's and they target different segments of the market. Further, Youi's minimal market share means it would not be a more significant competitor to Vero than Tower at a [ ]% market share.

6 Countervailing Power of Consumers

6.1 In paragraph 8.46 of Vero's application, on the countervailing power of consumers, Vero states: "*Consumers also have the ability to select from a number of insurance providers, and are able to conduct price comparisons easily and quickly, whether by using price comparison websites , or by seeking quotes from individual insurance companies' websites.*"

6.2 This is inconsistent with Vero's earlier position in its submission on the IAG/Lumley acquisition, in which it states:[13]

> *"While the IAG application says the availability of price comparison sites for insurance products is a way of consumers exerting countervailing power over insurers, these are effectively non-existent in New Zealand. While overseas sites offer live quotes based on risk details submitted, information in New Zealand is limited to broad product information or limited historic price relativity."*
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> *"Price comparison sites in New Zealand do not provide a substitute to customers "ringing around", which can take a significant amount of time and can represent a barrier to switching. Further and significantly, given IAG's dominance in the market, any live comparison site would require access to IAG's products and prices in order to be worthwhile. If IAG thought such a site would lead to lower prices it could simply refuse to provide access to this information."*

6.3 The Commission's decision to clear the IAG/Lumley acquisition did not find that customers had any countervailing power.

6.4 AIG submits that Vero, in the application, is pointing to nothing more than the ability of customers to switch products from the merged firm to buying products from a competitor and the possibility that, if a large number of customers switch, this could influence the decisions of the merged entity. This is the normal competitive process, and does not mean that individual customers have countervailing power.

6.5 Individual retail customers do not have any special characteristics (such as those listed at paragraph 3.115 of the Commission's Merger Guidelines) that give them the ability to substantially influence the price the merged firm charges. In particular, no single retail customer purchases enough product, such that they could in any way influence the price that the merged firm would charge.

7 What will happen if the acquisition does not proceed? The counterfactual

7.1 Vero claims that the counterfactual is a scenario "not materially different from the status quo".

7.2 AIG disagrees. AIG considers that the counterfactual is a scenario materially different from the status quo and with a significantly higher level of competition and greater incentives for new entrants to establish and grow consumer insurance businesses in New Zealand.

7.3 AIG considers, if the Proposed Acquisition does not proceed, then:

(a) Tower will potentially be acquired by another purchaser but whose purchase would not raise competition concerns (unless it was IAG),

(b) or remain in common ownership.

7.4 Vero's application, for example, notes that Fairfax Financial has announced its intention to acquire Tower.

7.5 If purchased by Fairfax, Tower will remain in separate ownership, independent of any other current participant.

7.6 The scenario of Fairfax Financial or another independent party owning Tower will likely result in a materially more competitive market structure than if Tower remains

[13] Page 7, Submission of Suncorp Group Limited on IAG's proposed acquisition of Wesfarmers' underwriting business 21 February 2014

under current ownership. The Commission should therefore take that as the counterfactual rather than continuation of the status quo.

8 The anti-competitive effects of the Proposed Acquisition

8.1 AIG considers that the proposed acquisition will have the effect of substantially lessening competition in the markets for HCMV products compared to the counterfactual. Certainly, AIG does not consider that the Commission can be satisfied that the acquisition would not have that effect, the test for granting a clearance.

8.2 AIG considers that, if the acquisition proceeds, the HCMV market will be substantively less competitive than the scenario of Fairfax Financial or another independent party owning Tower, or even of Tower remaining in public ownership.

8.3 The acquisition will remove the constraint imposed by Tower on both the actions of Vero and IAG in the HCMV markets for windscreen repair services and collision repair services.

8.4 Any other new entry is unlikely, if Vero acquires Tower, compared to the counterfactual. AIG considers that the barriers to entry will become harder than at present.

8.5 Both IAG and the combined Vero/Tower entity will be able to act in a much more unconstrained way and raise prices (in the HCMV markets) and lower the prices they pay for windscreen repair services and collision repair services.

8.6 They would also be able to more strongly respond to new entry into the markets in the future, which would discourage such new entry.

8.7 A further impact will be reduced choice for the consumer. An example is evidenced by only offering domestic house (sum insured/ agreed value) products post 2011 Earthquake. A more competitive market has the potential to see insurers willing and able to offer a greater variety of cover.

8.8 The proposed acquisition will also establish market conditions that will provide much greater opportunity compared to the counterfactual for Vero and IAG to act in a coordinated way in those markets and collectively exercise market power.

8.9 AIG submits there is also a broader New Zealand wide concern to be considered. Reducing the HCMV market to two major players will create enormous challenges if either insurer fails for any reason (including mispricing, inadequate reinsurance, systemic operational failure, investment risk and so forth). This is not an unrealistic concern, given:

8.9.1 the events surrounding AMI Insurance’s near collapse following the Christchurch earthquake in 2011 (only prevented by a government bailout and subsequent merger with IAG); and

8.9.2 New Zealand’s heightened risk of natural disasters.

8.10 The concern is that in allowing a concentration of the HCMV markets as proposed, New Zealand will effectively have permitted the creation of two systemically important financial institutions which are too big to fail.

8.11 In turn, the spread of the corresponding reinsurance will be confined to a reduced pool of re-insurers – effectively exposing the HCMV market to greater risk in the event of error by insurers or solvency risk. By contrast, in a market where there are many competitors, the underlying insured risk and associated reinsurance risk is diversified, shielding the overall market from a cataclysmic event should any insurer or reinsurer fail.

8.12 Finally, AIG notes that, in its submission on the IAG/Lumley merger three years ago, Suncorp stated:

"Suncorp considers the Proposed Transaction would result in a substantial lessening of competition, particularly in the New Zealand personal home and contents (H&C) and personal motor insurance markets. IAG already controls well over half of each of the New Zealand personal motor and H&C markets and the acquisition would also see IAG controlling three of the four main banking relationships."[14]

"Even an overall view of the insurance industry demonstrates that New Zealand's market structure is highly unusual in how much of the industry is controlled by the largest player."[15]

"The very high level of concentration in New Zealand that would result from the Proposed Transaction would well exceed those seen in other insurance markets around the world."

8.13 Vero's claim's in its application for clearance are at odds with these submissions, especially as the proposed transaction will result in an even higher level of concentration that the IAG's acquisition of Lumley.

9 Request for conference

9.1 AIG requests that the Commission hold a conference on Vero's application for clearance. Vero's application raises important questions for the insurance sector and consumers, which AIG submits need to be fully considered by Commissioners in a conference. AIG would want to appear at a conference.

10 AIG contact information

10.1 AIG's contact person for this submission is:

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[14] Page 1, Submission of Suncorp Group Limited on IAG's proposed acquisition of Wesfarmers' underwriting business 21 February 2014

[15] Page 5, Submission of Suncorp Group Limited on IAG's proposed acquisition of Wesfarmers' underwriting business 21 February 2014

Appendix 1