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

Thank you for the opportunity to provide a submission on IAG's proposed acquisition of Wesfarmers' underwriting business (the **Proposed Transaction**). This submission relates to the New Zealand aspects of that transaction, being IAG's acquisition of Lumley General Insurance (N.Z.) Limited (**Lumley**).

This submission is made by Suncorp Group Limited (**Suncorp**). Suncorp is a provider of general insurance, banking, life insurance, superannuation and investment services in Australia and New Zealand. It makes this submission in conjunction with Vero Insurance New Zealand Limited (**Vero**) and AA Insurance Limited (**AAI**). Vero is a wholly owned subsidiary of Suncorp and is a general insurer offering a range of personal, corporate and commercial insurance and risk management products in New Zealand. Suncorp holds a 68% joint venture interest in AAI, with the remaining 32% held by the NZ Automobile Association. AAI is a provider of vehicle and house and contents insurance in New Zealand.

1. Summary of Suncorp's view

Suncorp is concerned by the competition effects of the Proposed Transaction. The Proposed Transaction is the latest phase of a creeping acquisition that will significantly strengthen IAG's already very strong position across the New Zealand insurance industry and in some insurance markets its market shares will increase to over 60%. The Proposed Transaction represents a "tipping point" in insurance markets. It will remove any remaining competitive balance in the market, give IAG substantially increased market power and will substantially lessen competition in relevant insurance markets. The Commission should decline to grant clearance.

Properly functioning insurance markets are of fundamental importance to the New Zealand economy, as demonstrated by the experiences following the Canterbury earthquakes. 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. To allow one party to dominate New Zealand insurance markets in this way creates real risks to the effectiveness of these markets and therefore to the economy as a whole, in circumstances where there are no apparent public (or competitive) benefits arising. In Suncorp's view the Proposed Transaction will allow IAG to exert unilateral market power to the long term detriment of the effectiveness of New Zealand insurance markets, and to the detriment of New Zealand consumers.

Contrary to the position advanced in the application for clearance filed with the Commission by IAG, 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. This is in addition to the significant market shares IAG will hold in some commercial lines insurance products.

Suncorp questions whether the relevant counterfactual against which to assess the Proposed Transaction is, as IAG claims, the status quo. In the absence of the New Zealand aspect of the Proposed Transaction, should the Australian aspect of the transaction proceed, Suncorp considers that the Wesfarmers Group would still be very likely to seek a divestment of Lumley. Such a counterfactual would result in a much more competitive market and a better outcome for consumers compared to the Proposed Transaction, which would see one insurer with immense scale in New Zealand. Suncorp considers that an acquisition of Lumley by another party is a likely counterfactual against which the Commission should measure the competition effects of the Proposed Transaction.

However, measured against any possible counterfactual, status quo or an alternative purchaser, the Proposed Transaction will substantially lessen competition.

The Commission is familiar with personal lines insurance markets in New Zealand having considered them previously including in relation to IAG's acquisition of AMI (***IAG/AMI***). The market conditions (being so shortly after the Canterbury earthquakes and the pressure which insurers were under as a result of those events) were quite different to how they are now. While the Commission ultimately granted clearance to IAG/AMI, in Suncorp's view several of the grounds on which the Commission based its earlier decision do not hold in today's environment and do not apply to the Proposed Transaction, which 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 (para 66).

In Suncorp's view IAG's clearance application does not accurately represent the current state of the market and overstates the degree of competitive constraint that it faces in a number of material respects.

2. Content of this submission

Suncorp considers that the Commission should decline to grant clearance to the Proposed Transaction on the basis of a substantial lessening of competition in key insurance markets in New Zealand. The key reasons for this are set out in the remainder of this submission.

(a) Absent the Proposed Transaction, Wesfarmers would be very likely to sell Lumley as a standalone business.

(b) The Proposed Transaction would further increase IAG's already significant market share in personal lines markets, giving it close to two thirds of the personal motor market and a similar share of H&C. It will also give it control over the majority of major personal lines insurance brands, including three out of the four major bank brands. This would give IAG the ability unilaterally to raise and sustain prices above competitive levels and/or decrease service levels (see sections 4.2 to 4.6 below).

(c) IAG's application overstates the effect of the banks' countervailing power in competitively constraining IAG post-acquisition, both in respect of the likelihood of banks entering the market themselves and their incentives in respect of pricing (see section 5 below).

(d) Conditions of entry into the personal lines insurance markets (at a scale that would act as a real competitive constraint to IAG) are more difficult, and barriers to entry are substantially higher now than were found to exist at the time of the Commission's *IAG/AMI* decision and higher than made out by IAG in its clearance application. The Proposed Transaction will only increase these entry barriers (see section 6 below).

Section 7 discusses a number of additional matters such as effects in commercial lines, Christchurch-specific issues and concerns regarding the effect of the Proposed Transaction on suppliers.

3. Affected markets

IAG has, through creeping acquisitions, established substantial market shares in key insurance sectors that constitute dominance of those sectors. The Proposed Transaction would further strengthen its position in a large number of personal lines and commercial lines insurance markets.

Suncorp broadly accepts the Commission's assessment in *IAG/AMI* that personal lines and commercial insurance markets are quite separate. While that is the case, and Suncorp understands that the Commission will therefore focus on discrete markets, it is important not to overlook the fact that the Proposed Transaction gives IAG the opportunity to leverage certain economies of scale across insurance markets. For example, there is significant cross-over in auto glass and collision repair claims procurement between personal motor and commercial motor that will give IAG even greater market power in motor insurance, both personal and commercial.

As to commercial markets, it is Suncorp's view that market conditions are quite different in those markets (in particular, the countervailing power of brokers and likelihood of new entry) than in markets for personal insurance lines. The competitive harm caused by the Proposed Transaction manifests itself much more clearly in personal lines markets than commercial markets. Accordingly, this submission focuses on personal lines, although also provides some information on commercial markets for the benefit of the Commission.

As to the personal lines markets, Suncorp accepts the Commission's assessment in *IAG/AMI* that the personal lines insurance markets are most appropriately viewed in the context of risk types. On the demand side, consumers cannot substitute between risk types (i.e. they cannot take out automotive insurance to cover H&C). On the supply side, Suncorp considers that there is less substitutability between risk types than is claimed in IAG's clearance application. While there are obviously some overlapping functions between H&C and domestic motor insurance, the risks are assessed quite differently and accordingly demonstrate different market dynamics. Therefore, consistent with the Commission's position in *IAG/AMI,* this submission focuses on separate markets for H&C and personal motor.

IAG's clearance application states (at 12.2) that "Lumley is a fully intermediated insurer" and therefore the Proposed Transaction results in "no overlap in direct business to consumers." In Suncorp's view this misrepresents the nature of the insurance products sold through banks. Banks effectively resell a "white label" product that is developed by the underwriter (with input from the bank). In such circumstances the insurer effectively controls an insurance product that is sold under the bank's brand (and post-acquisition IAG will control the products sold under three of the four main banks' brands). This is in no way akin to products sold through brokers where the brokers compare a range of products from a range of insurers in order to meet specific needs. The banks have a comparatively limited offering from just one insurer.

Given this, and as further outlined below, the Commission needs to assess the competition law issues from reviewing all of the brands of personal lines insurance products that IAG will control post acquisition (regardless of whether those brands are sold directly or via a bank).

4. The Proposed Transaction will substantially lessen competition in personal lines insurance markets

Both the affordability and accessibility of personal lines insurance in New Zealand is, in Suncorp's view, likely to be adversely affected by the Proposed Transaction.

4.1 Likely counterfactual

The applicants refer to the counterfactual as the status quo. Even on the applicants' view of the appropriate counterfactual, a comparison with the status quo highlights the anticompetitive effects of the Proposed Transaction (with IAG further dominating the affected markets). However, in Suncorp's view, the appropriate counterfactual is not the status quo. For the reasons explained below, Suncorp believes that a more appropriate counterfactual is acquisition of Lumley by another insurer. While Suncorp believes that its view of the appropriate counterfactual is more commercially realistic than the applicants' status quo, in any event Suncorp submits that acquisition by another insurer is a likely counterfactual in the sense of *The Warehouse* approach.

Wesfarmers sees strong strategic rationale in divesting its underwriting business, while IAG sees strong strategic rationale in purchasing that business (both in Australia and New Zealand). Accordingly, should IAG be declined clearance in New Zealand, but cleared to proceed in Australia, Suncorp considers it likely IAG would proceed with the transaction but divest the New Zealand business or proceed to acquire only the Australian business. In either scenario, Suncorp considers it likely that the New Zealand business would be available for sale separately. Suncorp cannot see a scenario where Wesfarmers continues to own Lumley beyond the short term given it would be a very small business in the context of the Wesfarmers Group and there would be limited complementarities with Wesfarmers' other New Zealand assets.

Another party acquiring Lumley would result in a much more competitive market structure than a market dominated by a single player, to the benefit of consumers as the other insurers would still remain smaller than IAG, therefore retaining strong incentives to compete against IAG.

While possibly not the only "likely" counterfactual, it is the most competitive outcome of the likely alternatives. Accordingly, the benchmark against which the Commission should assess the competitive effects of the Proposed Transaction is a substantially more competitive market, with insurers competing hard for customers. However, even measured against a counterfactual of the status quo, the Proposed Transaction will substantially lessen competition for the reasons set out in this submission.

4.2 Scale is important

IAG already has substantial scale in personal lines (and in the overall New Zealand non-life insurance industry) from which it should be able to achieve a lower (per unit) cost base than other competing insurers. Accordingly, IAG can achieve good margins by keeping its prices well above its costs because it knows its competitors will not aggressively drop prices and risk sparking a price-war that IAG would be best-positioned to win. While the transaction will further lower IAG's per unit costs (IAG claims that it will achieve substantial synergies of A$140 million per annum from the overall transaction with one third of this arising from lower reinsurance costs), it will not have to pass any of these cost savings on to consumers because competing insurers' costs will remain the same. Accordingly, there will not be an opportunity post acquisition for market forces to drive down prices or improve service quality. More likely, IAG will extract greater margin from its existing customers across most brands, while maintaining comparative (but not aggressively competitive) prices over one or two of its brands in order to maintain customer numbers.

The fact that scale is important in insurance is demonstrated by the graph attached at ***Annex one.*** This graph (prepared by Suncorp from public sources) charts Net Earned Premiums against the Underwriting Result of large Australian insurers. The chart demonstrates that the greater an insurer's total premiums, the greater margin it is able to make between its premiums and underwriting costs. That is, scale provides a better underwriting result (as is demonstrated by IAG's willingness to purchase Wesfarmers' underwriting business and the high value attributed to it). We note that:

- Only the larger Australian general insurers are mapped as small insurers tend to operate in niche markets where the margins can be greater through targeted risk type and customer proposition.

- The outlier on the graph is Wesfarmers but this is to be expected as they are the only one that is part of a larger conglomerate. This means that whilst their insurance premiums are lower, they still get many of the scale benefits of the conglomerate (e.g. distribution reach through Coles stores).

- Suncorp has not produced a similar chart for New Zealand due to the distorting effect of the earthquakes, which are still affecting annual margins due to continual claims reserve movements. However, in essence the principle that scale allows for greater margins also holds true in New Zealand, as evidenced by IAG's expected synergies from the Proposed Transaction.

4.3 Market share estimates

The IAG/AMI transaction created, by a significant margin, the largest player in New Zealand personal lines insurance markets. The Proposed Transaction represents further "market share creep" and will create an even larger player, further dwarfing all competitors and giving IAG substantial unilateral market power.

IAG already holds more than 50% of H&C and personal motor markets, while the Proposed Transaction will take its share of each of these markets to around 60%.

While the market share increment resulting from the Proposed Transaction is comparatively smaller than in IAG/AMI (although still competitively significant), the cumulative effect of IAG's creeping acquisition is to raise IAG's market shares in personal lines to a very high level, giving it significant unilateral market power.

In Suncorp's view if the earlier IAG/AMI transaction fell short of putting IAG into a position where it could exercise unilateral market power, the Proposed Transaction represents a tipping point in the market structure that will reduce effective competition resulting in increased prices and lower service quality. How this unilateral market power will manifest is set out in more detail below.

Further, it should be noted that a market structure of this nature is very different to the make up of insurance markets in other countries. Attached as ***Annex two*** is a bar graph showing the shares of the leading insurers in a number of other jurisdictions. While not split into the relevant markets, 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. In those countries (USA and Germany) where the largest player is substantially larger than the number two, the share of the largest player is less than 10%. Having one insurer control such a high proportion of the insurance markets in New Zealand would make for much less competitive markets than those seen in other countries. Even in Australia, still a small scale market relative to the USA and Europe, there are two strong players in personal lines with a number of additional competitors.

4.4 IAG will dominate brand ownership and could use that to push up prices

Personal lines insurance is primarily sold direct to customers under brands owned by the underwriters or under "white-label" products with brands owned by the banks. Bank relationships effectively give insurers control over the insurance product that is sold under a bank's brand with relevant decisions being made in conjunction with the bank. Intermediated insurance (sold through brokers) represents a small (and decreasing) proportion of personal lines markets. It is primarily directed at more affluent customers and those who bundle personal insurance with small business insurance. Accordingly, for most customers, the relevant competition is between the direct brands, including the bank brands and it is important to consider the impact of the Proposed Transaction on brand ownership in New Zealand.

In doing so, the Commission must consider the actual degree of competitive constraint imposed by the various providers relied upon by IAG. IAG's application (at 16.1) details the players in personal lines insurance in New Zealand, including significant reference to MAS and FMG. However, Suncorp does not view FMG and MAS as providing a significant competitive constraint on IAG (currently or post-acquisition) and considers the ability for those companies to act as a constraining force on IAG is significantly overstated.

(a) **MAS:** As noted in IAG's application, MAS' membership (which is a pre-requisite for insurance cover) is limited to a class of "professionals". Initially this was limited to health professionals, but is now open to professionals in other professions, such as lawyers. However, this represents a very small part of the overall insurance market and accordingly does not impose any real competitive constraint on IAG. In addition, in Suncorp's experience, MAS does not compete hard on price, but rather tends to differentiate itself based on the claims service 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 Commission's analysis.

(b) **FMG**: Similarly, FMG operates in a niche, servicing almost exclusively rural customers. Neither FMG's marketing, nor its 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.

Setting aside MAS and FMG, personal lines insurance in New Zealand is primarily sold under the following insurance company brands[1]:

Brand	Owner
AMI	IAG
State	IAG
AAI	Vero/AAI
Tower	Tower

and the following bank brands:

Brand	Owner
BNZ	IAG
ASB	IAG
Westpac	Lumley → IAG
ANZ	Vero (some legacy customers remain with Tower)
Kiwibank	Tower

As the charts show, post-acquisition, IAG will control half of the best known insurance company brands and three of the four main banks (the Kiwibank share being very small). This allows IAG to combine data across all these brands to put it into a position of significant strength in respect of its market behaviour. Suncorp considers that the Proposed Transaction will aid IAG in being able to increase prices and improve its ability to manipulate pricing across its brands to keep prices up overall while retaining its enlarged customer base.

(a) Personal lines insurance customers are quite "sticky". In *IAG/AMI* the Commission found that 80% to 90% of policy holders do not change insurance providers at their renewal date. There are many reasons why customers tend to stay with an existing insurer. These reasons include inertia, claims history, purchase of insurance as part of a bundle, lack of readily available price comparison services (see section 4.6 below) amongst others.

(b) Ordinarily, price increases are defeated by consumers switching to competing brands, with the associated loss of margin from those who switch. However, IAG, with its dominance in "brand share" will likely be able to recapture a significant number of those customers, (albeit possibly at a slightly lower margin), by manipulating the prices of its other brands. For example, it could designate a brand that it prices more competitively with competing insurers' brands or simply offers attractive introductory offers for that brand in order to recapture more price-sensitive customers. Most customers will shop by brand rather than by underwriter, meaning that if they switch away from one IAG brand, they will not necessarily switch away from IAG altogether.

[1] For completeness, it is acknowledged that there are a number of other smaller insurance providers operating in the New Zealand domestic market. But, most of these are niche players, they generally all have less than 1% share of a market and they would have <u>no</u> ability to constrain IAG.

(c) While IAG's competitors may react to a degree if IAG moves prices upwards, IAG will recognise that other insurers will be constrained by a higher per unit cost, restricting their ability to lower prices on a sustainable basis.

In addition to pricing changes, IAG's increased market power could also manifest itself through "giving less" across the spectrum of the attributes of the product - quantity, quality, service, range, and timeliness. Certainly in the event of a future major claims event, but also arguably in its everyday post-merger offerings, the merger would further increase IAG's ability, at its discretion, to offer a worse claims management experience and to degrade the service and timeliness of the overall customer proposition, to the consumer's detriment.

4.5 The effects are transaction-specific

While IAG already has a significant market share, the Proposed Transaction represents a "tipping point" in personal lines insurance markets, partly because it will control the insurance relationships with three of the four main banks. As set out in further detail below, Suncorp considers that the countervailing power exercised by the banks is substantially overstated in the IAG clearance application. Gaining the insurance relationship across BNZ, ASB and Westpac will allow IAG to push prices up for bank customers without the banks being disadvantaged comparatively (see section 5 below). This will allow IAG to gain greater margins on those customers who remain, while IAG can use its other brands (State or AMI) to capture as many of the switching customers as possible and avoid leaking margin. Accordingly, these anti-competitive effects will be a direct result of the Proposed Transaction.

4.6 Price comparison sites not well established in New Zealand

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 historical price relativity. In addition, the Consumer organisation does not have a wide subscriber base and would reach only a small proportion of the population. Price comparison sites in New Zealand do not provide a substitute to customers "ringing around", which can take significant time and can represent a barrier to switching. Further and significantly, given IAG's dominance of the market, any live price 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. Indeed, Suncorp understands that IAG's policy in Australia is not to provide access to such information. Launching such a site without access to around 60% of the market and five of the nine key brands would not be feasible.

5. IAG's application overstates the role of the banks in personal lines insurance

IAG's application places significant weight on both the countervailing power the banks have in personal lines insurance and the likelihood of entry by banks. Suncorp believes that these constraints are substantially overstated.

5.1 The relationship with banks is more akin to long term partners rather than short term customers

IAG's clearance application and the Commission's decision in *IAG/AMI* relied on banks' ability to switch insurance providers as a key countervailing constraint. However, banks will only switch if incentivised to do so. As the Commission noted in *IAG/AMI*, the key factor that would prompt a bank to switch provider would be poor customer service from a claims management perspective (although as set out below at 5.2, bank switching is less likely now). This suggests that banks might not be particularly price sensitive, provided that their brand does not suffer as a result of appearing clearly more expensive than rival banks. Further, and related to that concern, the claims management service provided to bank-brand customers is generally undertaken by a dedicated team, ring-fenced from the remainder of underwriters' claims management services.

Accordingly, IAG could decrease the quality of its service across other brands as a result of the transaction (see 4.4 above) without affecting service to bank partners.

The bank/insurer arrangement is more complicated than IAG's application suggests. Banks are not customers of insurers, but rather are partners with a say in all relevant decisions. Banks profit from the insurance relationships by taking a commission on policies sold to bank customers and, in some cases, profit-sharing arrangements.

These factors combined suggest that IAG's acquisition of Lumley's Westpac relationship, could well allow it to push up prices. By owning three of the main four banking relationships, IAG can ensure that price increases occur across the majority of the bank channels.

5.2 Banks less likely to switch insurers than two years ago

There are significant infrastructure (as well as contractual) barriers to banks switching providers. Banks and insurers' IT systems have become increasingly integrated as banks offer improved online services to customers, while the difficulties surrounding ownership of the customer base is still fraught.

5.3 Banks are not likely entrants

Banks have not entered the domestic lines markets to date in an underwriting capacity and, for similar reasons as other potential entrants, are unlikely to do so. The New Zealand market is much smaller than the Australian market and would not justify the significant investment in claims handling, systems, pricing/risk data, re-insurance etc (indeed in Suncorp's view, the cost of reinsurance in particular is likely to be a major deterrent to banks entering the underwriting market). Thus, new entry by banks into personal lines insurance is simply not as likely as the applicants suggest.

The underwriting products offered by Australian banks (as referred to in IAG's submission) actually have a very small share of the market and do not appear to act as a significant competitive constraint. Only two of the four major banks in the (much larger) Australian market underwrite (CBA and Westpac and that is mainly done in H&C). These banks have not moved into underwriting insurance in New Zealand and it seems even less likely that if ANZ and NAB do not underwrite in Australia they would start to do so in New Zealand where there is a much smaller market, a higher catastrophe risk profile and specific reinsurance issues to overcome.

6. Barriers to entry in personal lines markets

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 market 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.[2] 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 disincentivise entry given IAG's enhanced scale and ability to sustainably to target new entrants with low prices or targeted offers.

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[2] For example, 93% of motorists have car insurance (source ministry of transport vehicle insurance report Dec 2009) http://www.transport.govt.nz/assets/Import/Documents/Vehicle-insurance-in-New-Zealand.pdf

6.1 Exits from the market

Between 2010 and 2012 the total number of insurers operating in New Zealand fell from 157 to 108. These figures include life insurers and were predominantly at the micro end of the market. They are not insurers who would have had any real ability to constrain IAG. However, the figures are demonstrative of the nature of the personal lines insurance market. It is a market where parties are exiting, not entering. In terms of larger players who have exited:

Insurer	Date of exit	Reasons given for exit
China Taiping	August 2012	Difficulties obtaining reinsurance - reinsurers imposed restrictions that impacted the ability to write business
Ansvar	December 2011	Earthquake losses and difficulty in obtaining future reinsurance
Various	2012	7 small insurers (representing less than 0.02% of the market) exited due to tightened regulations
Western Pacific	2011	Liquidated due to losses incurred from Canterbury earthquakes
Allianz (personal lines)	2011	
Allianz (commercial SME)	July 2013	Focus on large commercial tailored packages only

Source: RBNZ and relevant company statements

The general theme is of smaller players exiting the market leading to consolidation around the margins and no new entrants. It is unrealistic to suggest, as the applicants do, that new entrants will or may enter this market (please see section 5.3 above in relation to potential entry by the banks).

As set out above, there are a variety of reasons for exit, ranging from increased regulatory barriers (the capital requirements have been substantially increased in recent years) to earthquake losses and reinsurance difficulties. This alone suggests that barriers are much higher than claimed by IAG. Further, IAG gaining significant additional scale through the Proposed Transaction as compared to other insurers could well further undermine the financial stability of some other insurers in the market, possibly leading to further market exits.

6.2 Historical pricing and claims experience important

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. Similarly, for non-natural perils, new entrants could reverse engineer incumbents' pricing to obtain a view on risks, but again, this would provide inferior information and result in additional costs.

IAG's application claims that new entrants can easily procure pricing/risk/claims knowledge (19.2). However, none of the examples provided relate to H&C insurance. The *Mike Henry* case refers to travel insurance, while the *Suncorp/Promina* case reference was to personal motor insurance. In addition, these cases were decided prior to the seismic events in Canterbury, which have changed the insurance landscape significantly. 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. This is why entry can be seen in other insurance markets (such as life insurance where the likes of Partners Life has entered organically) but not in H&C.

6.3 Scale important in New Zealand insurance markets

For a small or brand new entrant to New Zealand, the low frequency/high impact of large events in New Zealand make the personal H&C market unattractive without requisite scale. Smaller players do not generally have sufficient scale and risk diversification in New Zealand and this would be even more difficult to achieve in a reasonable time when there is a dominant player like IAG in the market in a position to manipulate its various brands.

For a large overseas insurer looking to expand organically, New Zealand is unattractive due to its small size (in global terms), high catastrophe risk and already highly concentrated market meaning that the large company would likely get a better return and larger growth opportunities by investing elsewhere. In addition, regulatory changes, including the requirement to have 1 in 1000 year catastrophe event reinsurance cover have decreased the attractiveness of the New Zealand market. (It is noteworthy that Suncorp understands IAG has been particularly vocal about opposing this increase in required prudential capital reserves, suggesting that it does indeed have a material effect on an insurer's business.) As a result, there have been no significant entrants in the last few years and a number of high profile exits, as set out above.

Suncorp considers that none of the insurers listed in sections 21.1 and 21.2 of IAG's application are likely entrants into personal lines markets (as set out above, the banks listed in section 21.3 are also unlikely market entrants). Indeed, the application lists Allianz, which has exited from personal lines (with the minor exception of domestic motor insurance through the Protecta brand). Similarly, while New India had a small presence in New Zealand pre-earthquake, Suncorp understands that they reduced activity after the earthquakes and do not appear to be making significant attempts to increase market share.

6.4 Barriers to expansion

While existing personal lines insurers can expand, post the Proposed Transaction there will be relatively few insurers remaining in these markets. Of those that will remain, even fewer currently act as a real competitive constraint on IAG (see section 4.4 above regarding MAS and FMG) and all will lack scale compared to IAG.

Further, contrary to IAG's clearance application, existing commercial insurers would not "expand" into personal lines markets, they would need to "enter" personal lines insurance markets. In doing so, they would face many of the entry barriers described above.

7. Other matters

There are three other matters on which Suncorp wishes to comment:

7.1 Commercial lines

Suncorp considers the Proposed Transaction is most likely to give rise to competitive harm in personal lines. However, it will also result in IAG acquiring a significant market position across commercial lines markets.

As set out above, the market dynamics in commercial and personal lines are quite different, with brokers playing a far more active part in commercial lines markets and a greater number of insurers active (many of which operate in "niche" areas). Brokers offer an additional dimension by playing insurers off against each other and providing a distribution channel to market for smaller insurers.

However, even with these differences, IAG's sizeable share of these markets, combined with their overall size in the insurance industry in New Zealand, could well raise further significant competition issues as a result of the Proposed Transaction.

7.2 **Effects in Christchurch**

The Commission's statement of preliminary issues noted that the Commission may take an interest in whether the Proposed Transaction may give rise to any particular regional issues including in Canterbury. Suncorp considers the potential impact of the Proposed Transaction on claims handling services in that region is a key area that the Commission should consider.

IAG notes in its clearance application (13.3) that service and claims handling are both competitive differentiators between insurance companies. Suncorp agrees with that. Claims management is a key factor in determining the quality of insurance consumer service and levels of customer satisfaction.

In relation to Christchurch, putting EQC to one side, IAG is already the second slowest insurer in settling claims in Christchurch (second only to Southern Response – now owned by the government and dealing with a large volume of claims from AMI). Lumley has a significantly better claims handling record in Christchurch (as of 31 December 2013, IAG had settled 51% of earthquake claims, compared to Lumley's 70%). There has been considerable government, public and consumer concern about the speed and efficiency of the management of insurance claims stemming from the Canterbury earthquakes. The Proposed Transaction will remove a competitor (Lumley) with a better claims handling record and the effect of this is to decrease the competitive tension on IAG to improve its claims handling record in that region. This is a competitive matter which will be to the detriment of insurance consumers with IAG (and Lumley) claims in Christchurch and for any future natural disaster.

7.3 **Repair markets**

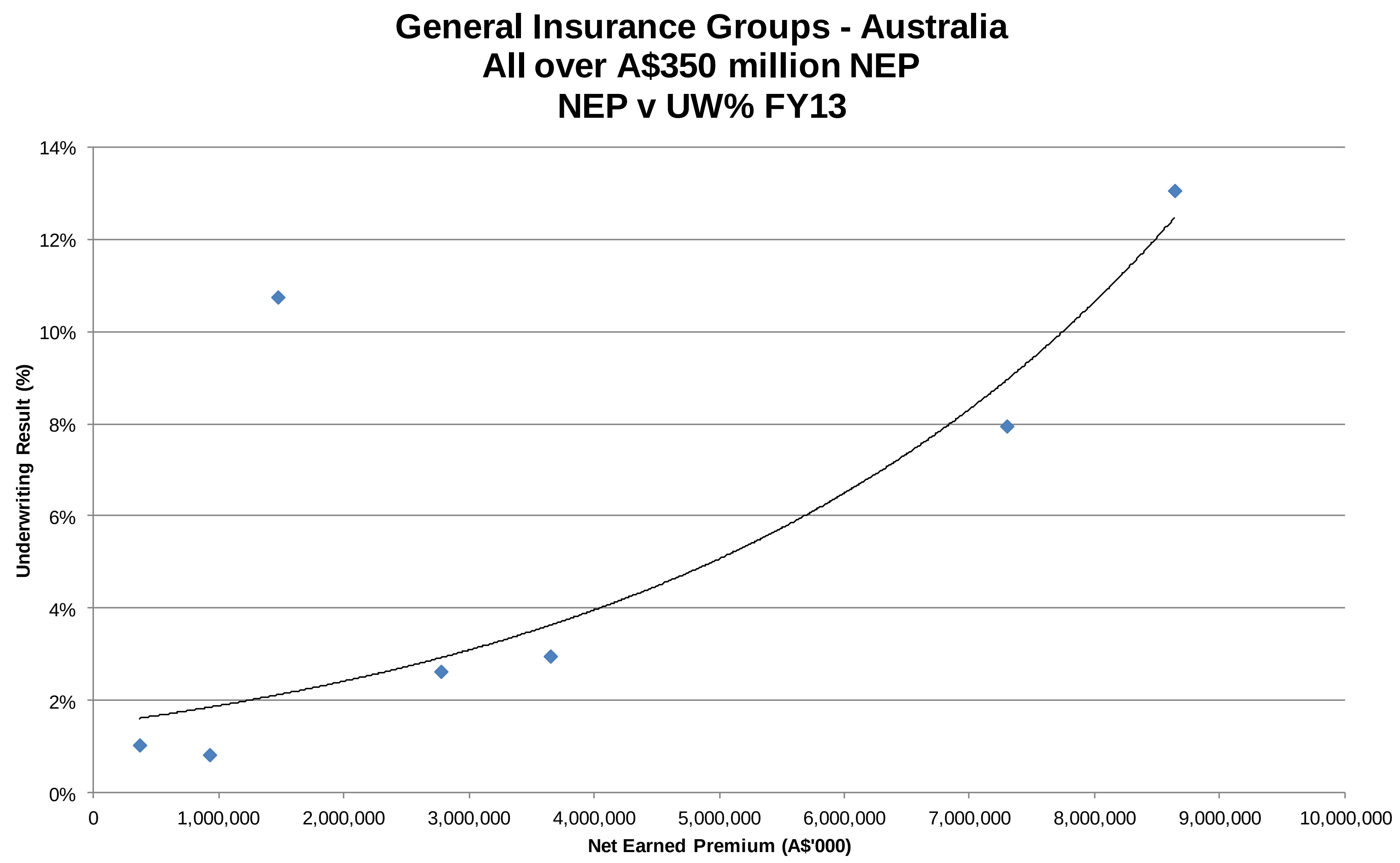
The New Zealand collision repair industry is highly fragmented, while most reputable repairers rely heavily on insurance work to make their businesses viable. Placing even greater buyer power in the hands of IAG, which is already (by some margin) New Zealand's largest acquirer of collision repair services, could well result in suppliers being paid rates below the competitive level, causing them to go out of business. Given the additional market share in both personal and commercial motor that will result from the transaction, Suncorp has significant doubts about IAG's claims that repairers will be able to maintain sufficient work from other sources to keep them viable. Rather, Suncorp considers that there is a real risk that the Proposed Transaction will tip the repair industry to a point that will result in a fundamental structural change.

IAG's clearance application (at 28.2) states that its average repair costs have increased since its acquisition of AMI. However, Suncorp understands that IAG is only now beginning to undertake the rationalisation of its repair network post-acquisition. Suncorp understands that IAG is currently undertaking a process of condensing its repairer network, leading to suppliers being removed from its panel. Many repairers not selected by IAG could go out of business, while repairers selected by IAG may be forced to operate exclusively on IAG work or may be forced to subsidise the lower margin they receive from IAG by charging other insurers more.

Repair costs are the most significant driver of insurance pricing and account for approximately two-thirds of motor premiums. The impact on the repairer market will also have an impact downstream on the motor insurance markets.

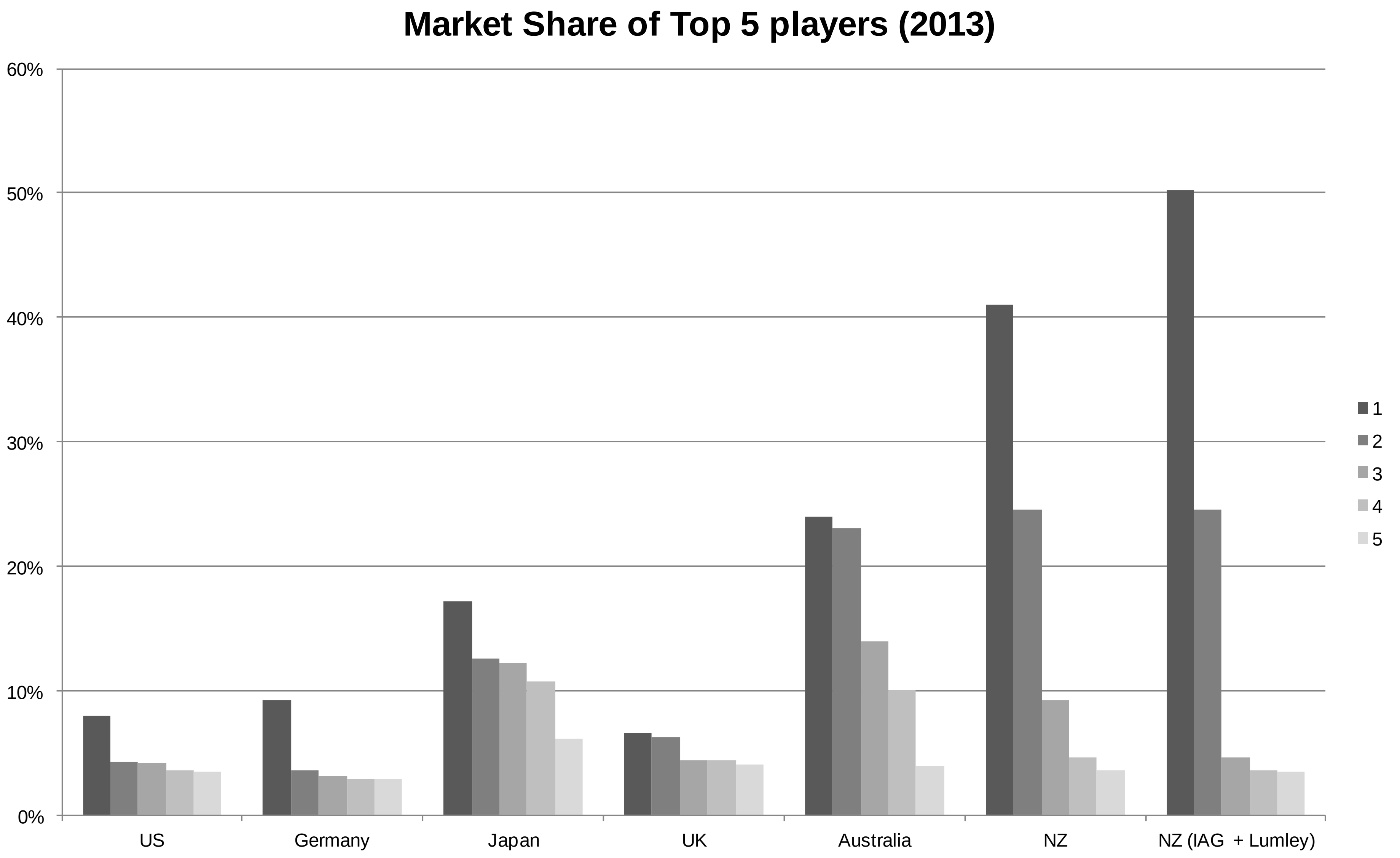
Similar competitive effects are likely in the auto-glass and vehicle insurance salvage markets.

Annex One: Importance of Scale



Source: *APRA.*

Annex Two: International comparison of concentration



Source: *Deutsche Bank; Credit Suisse; ICNZ.*