

# Submission

By



To

**Commerce Commission**

On

**IAG (NZ) Holding Ltd Acquisition of Lumley  
General Insurance (NZ) Limited**

**File Reference 14541**

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# INTRODUCTION

IBANZ, the Insurance Brokers Association of New Zealand Inc. is New Zealand's professional body representing the great majority of general insurance brokers in New Zealand. In speaking on behalf of members we are also providing a voice for their clients, the consumer.

Insurance brokers as intermediaries are in a unique position working with their clients as advisers and dealing with insurers to place risks. As a result they have day to day, hands on experience of how the insurance market is working and the effects of structural change. They see the reality of what is happening in the market and have communicated this to us.

We have received an unprecedented level of response to this issue. There is a clear, common message from members - this proposal will adversely affect the operation of the market and have significant negative outcomes for consumers.

We note IBANZ previously submitted to the Commerce Commission on the proposed acquisition by IAG of Lumley and held a telephone conference call with the Commission to discuss the issues raised.

In our first submission we briefly outlined two key concerns which our members have with the proposal; these were the effect on competition and the lack of capacity in the NZ market. In this submission we provide additional comment further on these issues.

## Executive Summary

It is our submission that the acquisition of Lumley by IAG will adversely affect the New Zealand insurance market.

The concentration of market share in one insurer together with that of the second largest insurer creates an unhealthy duopoly situation.

The remaining insurers in the market are unable or unwilling to participate across all risks and/or geographic locations. They tend to be small niche players operating in specific markets. Thus the number of insurers in New Zealand is not the key factor, rather it is what each will or can do that determines the level of competition.

There is little incentive for new players to enter the market where the risk of large scale natural disaster losses are high and financial returns are very limited due to a small premium pool.

Regulatory requirements have set a high hurdle for new entrants or current participants to develop an insurance underwriting business of any size.

Insurance broker's ability to exercise countervailing power will be significantly curtailed by the reduced market size as well as limited capacity and risk appetite.

In this submission our comments include product categories such as commercial property. We believe that pure market share of a particular segment does not reflect the level of competition.

## Competition Analysis

Although accurate statistics on market share are not readily available it is generally accepted that a combined entity will have approximately 51% of the overall market. In personal lines and motor insurance it will be even more dominant with a share of about 66%.

At this level they will have the financial and market strength to drive through change. This is a concern not only for brokers and their consumer clients but also suppliers involved with the insurance market e.g. loss adjusters and panel beaters.

In their submission IAG indicated there are a number of alternative players who could enter the market or grow their current share. We believe this is an over simplification of the situation in that while in theory this is possible in reality it is extremely unlikely.

Following the proposed merger the overall New Zealand insurance market will have two players, IAG and Vero, controlling around 77%; this will create significant competition issues. The remaining players have very small market shares by comparison.

It is also interesting to note a recent report from the Insurance Council that highlighted the fact that switching insurers is not common practice in NZ. This we believe is directly related to the limited options available.

### **Potential New Competitors**

It has been suggested banks are a potential competitor should they take on an underwriting role. Currently they are not involved in this way; instead the approach in New Zealand is to offer branded insurance products underwritten by insurers with the bank clipping the ticket.

There appears to be no appetite among the banks to carry the risk as an underwriter despite doing so in some larger markets overseas. The fact that this has not happened here is hardly surprising given our high exposure to significant natural disaster risk but only a small premium pool from which to build reserves or fund reinsurance.

Equally it seems retailers would have little incentive to move beyond same approach of branding products underwritten by the insurance market. A significant part of these alternative distribution channels are currently underwritten in part or wholly by IAG/Lumley e.g. three of the four major banks and The Warehouse (travel).

# **Barriers to Entry / Expansion**

## **Premium Pool**

In addition to the exposure to significant losses there is also an issue with the small premium pool available in New Zealand. Indeed following the events in Christchurch it has been estimated it will take insurers/reinsurers at least 100 years to recoup their losses from the local market let alone pay for any future major disasters.

New Zealand is therefore not seen as an attractive market to break into or one in which to increase an existing presence. International insurers will wish to have a small presence in New Zealand to build their global branding, but have no incentive to grow substantially when the potential losses far exceed the potential profit.

## **Regulatory Requirements**

Besides our risk prone, economically small market, the recent regulatory control of insurers by the Reserve Bank under the Insurance (Prudential Supervision) Act 2010 creates a further disincentive to enter or grow an insurance business locally.

In particular the solvency standards require a change from the commonly accepted requirement to have capital available to meet a 1:250 year event to the much higher level of a 1:1,000 year event. As a result insurers are facing significant cost increases in the next two years to meet the prudential capital levels or buy additional catastrophe re-insurance.

The New Zealand market will therefore be distinctly less attractive for any new entrant or for an existing insurer to grow their presence. Given the global nature of insurance this is not factor that should be dismissed lightly.

While it has been noted that there are many insurers that have met the regulatory requirements a check will show that virtually all of these are small niche players. Most do not operate in the intermediated market and are certainly not set up or designed to expand beyond their particular niche.

# Countervailing Power

## Intermediaries

It is our contention that the intermediated sector of the market will be substantially affected by this proposal with insurance brokers having limited options to act as a countervailing power.

In its submission IAG acknowledges the importance of the brokers in the distribution of insurance and the impact a broker's recommendation can have. We do not disagree but point out that to be an effective force in driving competition it is essential the broker has access to real options.

The role of brokers in the market place is a combination of providing advice and placing insurance cover. In placing business a broker can drive competition through the tender process however three key factors determine their effectiveness:

- Availability of relevant risk carriers (insurers) in the intermediated market
- Risk capacity of these insurers
- Risk appetite of these insurers

## Market Size

There are currently just three companies in the intermediated market that operate across most insurance lines, IAG, Vero and Lumley; all others have restricted offerings either in the types of insurance they offer, the type of client they service or the geographic regions where they will provide capacity.

Thus it is not the overall number of insurers but the particular offering of each which determines competition in the market or segments of that market.

## Capacity

Following the Christchurch earthquakes the capacity of many insurers has reduced, particularly for natural disaster risks. The real value of insurance is to provide protection against high value losses hence the importance of the availability of natural disaster cover across all of New Zealand.

This reduced capacity requires client policies to have insurers co-insure the risk. In other words rather than one insurer taking on the whole risk, a panel of insurers each contribute capacity to fully underwrite a risk.

Having to use more than one insurer from the few that are available, especially outside Auckland, makes obtaining alternative placements very difficult. The loss of capacity of a company the size of Lumley will have a major impact on the broker's ability to create competitive options.

Of course capacity is not just a natural disaster issue; there are implications for other categories e.g. wood working risks. Generally seen as undesirable these hard to place risks often require the support of more than one insurer. An example given to us is of such a risk where IAG hold 30% and Lumley 35%. The reality is that if these two companies were to merge the future available capacity will not be 65%.

Based on previous experience our members believe that the appetite of the merged entity for hard to place risks will inevitably be less with re-insurance and other criteria determining the maximum exposure that can be accepted. It seems this is a common outcome following a merger.

### **Risk appetite**

Each insurer has their own criteria for the risks they are prepared to accept. This risk appetite has clearly been reduced in recent times; the earthquakes in Canterbury focused the attention of global insurance markets on the risks in New Zealand. They now view New Zealand as having a high level of exposure to natural disaster.

This is important given insurance is a global business. Local insurers are almost all reliant on overseas parents and international reinsurers for support. The heightened awareness of the New Zealand risk profile increases the concern about the viability of operating here.

After Christchurch there was considerable discussion on possibility that the local market would lose support of the insurance market. This has not happened this time but there are clear signals that we are no longer seen as a benign market.

As a consequence the risk appetite of insurers and the supporting reinsurance market has been significantly reduced thus making it more difficult to gain cover. Limited interest means limited opportunity to obtain an alternative quotation on a risk.

### **Geographic Markets**

A further factor impacting on the availability of options for cover is the regional differentiation in the approach to risk. While New Zealand may be small geographically it is never the less divided into very different regions from a risk perspective. There are at least two main market zones, Auckland/Waikato and the rest of New Zealand.

The northern zone is seen as being a better risk in terms of natural disaster as it is outside the main earthquake zones. All insurers will provide cover for this region however over the rest of the country capacity is restricted. For example Zurich does not offer its earthquake capacity south of the Waikato.

We believe therefore that when looking at competition it is dangerous to view the market as a whole. There is a clear geographic differentiation in the market. South of Waikato and particularly within the earthquake prone areas of Wellington, Hawkes Bay and Christchurch the competitive forces are greatly reduced.

Many of our members south of Waikato have advised us that with the loss of Lumley they will struggle to get risks placed and certainly obtaining competitive, alternative quotes will be difficult if not impossible. This problem is particularly acute in the commercial property market.