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7 March 2014

Inquiry into the Services Sector
New Zealand Productivity Commission
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BOOSTING PRODUCTIVITY IN THE SERVICES SECTOR

The Insurance Council of New Zealand (Insurance Council) appreciates the opportunity to comment on the Productivity Commission's Second Interim Report on Boosting Productivity in the Services Sector.

In particular, we would like to reiterate a number of points raised in our initial submission which were not specifically addressed in the report and also provide comment on aspects of the review regarding competition and switching tools.

1. Insurance Council

The Insurance Council is the industry representation body for fire and general insurance in New Zealand. The Council aims to assist members in key areas affecting their business through effective advocacy and communication.

The Council currently has 29 members who collectively write more than 95 percent of all fire and general insurance in New Zealand. Insurance Council members, both insurers and reinsurers, are a significant part of the New Zealand financial services system. Our members currently protect more than $0.5 trillion of New Zealanders' assets, including over $170 billion of home mortgages.

The Insurance Council plays an active role in representing the insurance industry. Our members are licensed under the Insurance (Prudential Supervision) Act 2010 and signatories to the Fair Insurance Code that requires insurers to act ethically. We also perform an important role in informing and educating consumers about key insurance issues and risks.

2. Stimulating Services Competition

2.1. Switching tools for insurance

The second interim report identifies financial and insurance services as one of the industries where "*the intensity of competition is relatively weaker*" and also specifically discusses the benefits of government funded health insurance comparison websites. These references to weak competition and government intervention cause some concern.

The competition heat map from the report (figure 2.11) seems subjective and generalised. It does not differentiate between separate sub-sets of the finance and insurance industry. For example, the Insurance Council has 27 members who write insurance and reinsurance business in New Zealand and there are a number of other insurers outside of the Insurance Council's membership who provide cover in New Zealand.

A number of the largest global insurance companies also operate in the New Zealand insurance market and through their significant capacity create competition. Council membership also includes insurance company members that derive a portion of their business revenue as inwards reinsurance from overseas and they are therefore exporters of insurance capacity and services in a competitive global market.

Further, insurance brokers add another competitive element to the insurance industry by acting on behalf of consumers to get the best arrangement for their client. This naturally promotes competition.

It is also important to note that there are competitive differences between different lines of the general insurance market in New Zealand, so it is simplistic to say the intensity of competition is relatively weaker in all financial and insurance services.

Similarly, the generalisation relating to financial and insurance services doesn't take into account the differences in switching costs between insurance and finance products. Health and life insurance policies may have higher switching costs due to the likelihood of increased premium if switching providers when the insured has a pre-existing condition. However, even within the fire and general insurance industry there will be differences between switching costs depending on the complexity and bespoke nature of the product.

We would be concerned if the government was to develop switching tools for fire and general insurance products based on the broad assumption that competition is relatively weak in all financial and insurance services. Further, while the Insurance Council acknowledges the benefit of switching tools for some New Zealand consumers in the electricity sector, these tools would not provide the same benefit for consumers of differentiated products such as fire and health insurance policies.

There would be a major risk that if a price comparison tool was established for insurance that consumers would focus solely on price as opposed to the detail of what the cover and risk is. Decisions made solely on price could lead consumers to be less aware of their cover and more vulnerable should disaster strike if the cover is not adequate for their specific needs.

Once a consumer is informed enough to make a decision as to how they can best manage their own risk, then there are relatively low switching costs for fire and general products. As outlined in the below section, greater emphasis needs to be put into consumer understanding of risk, rather than the promotion of switching tools.

This aligns with section 4 of the Insurance (Prudential Supervision) Act 2010 which states that "*members of the public are responsible for their own decisions relating to insurance*" and there is a desirability to provide "*to the public adequate information to enable members of the public to make those decisions*." Encouraging switching tools with generic price comparisons goes against the principles of developing better consumer understanding.

2.2. Suggested changes not addressed in the report

The report fails to make solid recommendations as to a number of the specific issues we raised in our submission on the first interim report, particularly around increasing market attractiveness, providing a clearer regulatory framework, promoting financial literacy and increasing transparency.

Below we reiterate a number of ways in which government could better assist competition in the financial and insurance services. From our perspective it would make far more sense to address these fundamental concerns than promote comparison websites.

Market Attractiveness

The New Zealand insurance market could become more competitive for existing and new participants by removing obstacles to productivity, making the market more attractive.

For example, the level of capital insurers are required to hold under the Reserve Bank's Solvency Standard can act as an impediment to competition. Higher capital requirements discourage investment in New Zealand and make the market less attractive for new entrants. This inevitably affects competition and impedes the affordability and availability of insurance.

Current taxes imposed on insurance products act as a further disincentive to participation in the New Zealand market. Taxes on voluntary products, such as insurance, are inherently inefficient and inequitable. They artificially increase the cost of insurance, leading to higher rates of under and non-insurance and reduced size and profitability of market. This will inevitably lead to a less competitive market as fewer players are encouraged to participate. The government could address this issue by undertaking considered review of inefficient insurance taxes such as the Fire Service Levy (as has been undertaken in Australia).

Burdensome regulations, levies and taxes directly affect the cost of conducting business for a number of industries in New Zealand. The effect of this can already be seen in the movement of some insurance companies towards centralising operations offshore. Addressing these compliance costs would provide the government with a real opportunity to stimulate competition.

Clarity of Regulatory Framework

Competition between services is stimulated by providing a level playing-field. Having a clearly defined regulatory framework, for both existing and potential market participants, is essential to a level playing field.

New Zealand's current regulatory regime for insurance is fragmented and unclear. For example, New Zealand has a number of regulatory supervisors and relevant pieces of legislation with respect to insurance market conduct. This fragmentation clouds the operating environment for existing players and doesn't promote ease of entry for new players. It also ends up with confusion for consumers.

By contrast, Australia has two distinct towers of regulation. A clear tower for prudential regulation via APRA (just like via the Reserve Bank under our Insurance Prudential Supervision Act 2010) and a clear tower for market conduct through the Insurance Contracts Act 1984 (administered by ASIC). The Government's proposed Insurance Contracts Bill will go some way towards promoting a single piece of regulation for market conduct in New Zealand, but there needs to be a similar move towards establishing a single regulator to administer that policy.

A clear and unequivocal regulatory framework would provide a more level playing field and encourage investment in New Zealand's insurance industry, leading to greater competition.

Financial Literacy

The insurance industry is a complex one in terms of the options available to the consumer. Government needs to undertake a more active role in promoting financial literacy, so that all New Zealanders have a better perception of financial matters and a more fundamental understanding of risk.

The consumer has access to a variety of distinct commercial and consumer products, available either directly from the insurer or through an intermediated agent. The product can be bought from either an onshore or offshore insurer and for numerous different risks.

The industry can also be complex with respect to consumer remedy, with differing pieces of market conduct regulation (i.e. the Fair Trading Act, the Financial Markets Conduct Act, rules relating to financial advisers under the Financial Advisers Act, and the Unfair Contract Term provisions in the Consumer Law Reform Act) and a number of different resolution or complaint channels (internal dispute committees, external dispute resolution services, FMA, MBIE, small claims tribunals and courts).

As noted above, co-ordination of at least the market conduct regulation side of things is needed to provide certainty and clarity for insurers and their consumers. However, this amalgamation also needs to be aligned with greater education by government.

New Zealanders need to better understand and appreciate risk. This is crucial to developing a more astute consumer base and reducing information asymmetries. This will ultimately lead to enhanced competition as consumers become more technically aware of what products best suit their individual needs.

Further, there should be more encouragement for New Zealanders to understand risk and protect themselves from it, so that in times of disaster the burden on government and therefore New Zealanders to pick up the costs of dealing with the effects on uninsured New Zealanders can be substantially reduced.

Transparency around Cost

If there is no transparency around the cost of a transaction, then it becomes very difficult for the customer to make an appropriate decision on which is the most cost effective solution for them.

With respect to intermediated insurance, disclosure of remuneration would provide a higher level of transparency and allow customers to be aware of the level of fees and commissions they are paying to their intermediary and, as a result, make better and more informed decisions. However, currently New Zealand does not require any remuneration disclosure by insurance brokers.

This means there is effectively no legislative incentive for brokers to ensure recommendations are based on the client's best interest, rather than the level of commissions received. Similar concerns existed with financial brokers prior to the implementation of FAA disclosure requirements. However no disclosure obligations have been forthcoming for insurance brokers.

If brokers were required to disclose what the underwriting premium is and be clear as to which amounts are fees, commissions and other charges, then there would be a much more informed consumer base. Government needs to develop similar compulsory disclosure requirements to Australia, through insurance specific legislation.

3. Conclusion

From our perspective, greater thought needs to be given to the above concerns. Simply promoting comparison tools will not address these fundamental concerns and so will not provide the greatest opportunity to enhance productivity in the services sector.

We will very much look forward to seeing the results of the final report. Please contact Simon Wilson on (04) 495 8008 or at simon@icnz.org.nz if you have any queries.

Yours sincerely

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