ICNZ Insurance Council of New Zealand

Insurance Council of New Zealand
P.O. Box 474 Wellington 6140
Level 2, 139 The Terrace
Tel 64 4 472 5230
email icnz@icnz.org.nz
Fax 64 4 473 3011
www.icnz.org.nz

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Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

Emailed to: FMALevyReview@mbie.govt.nz

ICNZ submission on Review of Financial Markets Authority Funding and Levy

Thank you for the opportunity to submit on the discussion paper titled Review of Financial Markets Authority Funding and Levy ('discussion paper'), which was released by the Ministry of Business, Innovation and Employment (MBIE) and the Financial Markets Authority (FMA) on 28 January 2020.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

Please contact Andrew Saunders (andrew@icnz.org.nz or 04 914 2224) if you have any questions on our submission or require further information.

This submission is in two parts:

- Overarching comments
- Responses to questions in the discussion paper

Overarching comments

Increasing the FMA's funding and FMA levies

ICNZ supports appropriate increases in the FMA's funding to enable it to carry out its statutory functions and take on a more active regulatory role. It is however important, particularly given the proposed extent of the FMA funding increases, that these are matched by business planning measures that strengthen the FMA's accountability for outcomes and enable more robust analysis of how resource allocation is linked to cost recovery through levies.

Also, whilst ICNZ supports increasing the FMA's resourcing to undertake its statutory role effectively, we note it is a remarkable consultation where the status quo is not even considered and all options result in very significant increases in levy funding - for general insurers increases of close to 100% under the lowest option to almost 200% under the higher options.[1]

These levy increases will come into effect soon after consultation and at the same time as increased specific fees and levies for entities associated with the new financial advice regime (consulted on in 2019), potential additional levies associated with the FMA's proposed roles in relation to conduct regulation and insurance contracts law in coming years, the potential for new levies for funding RBNZ in future, as well as all the direct costs associated with implementing the regulatory reforms themselves. The increased regulatory burden associated with all these needs to be considered in totality.

This is all occurring at the same time as concerns are being raised about increases in insurance premiums in some contexts. Recognition needs to be had of the impacts of all this regulatory change and to ensuring increases in direct and indirect regulatory costs are reasonable, moderate and predictable. Increasing costs are ultimately borne by customers, can contribute to issues of under insurance in New Zealand, and may deter providers from participating in some or all parts of the market. Such consequences would be contradictory to the wider objectives policy makers, regulators and the sector are wanting to achieve. It is important the regulatory regime remains attractive to international risk capital as this is in turn critical to ensuring a dynamic insurance market exists in New Zealand.

Linking the FMA's resourcing to levy collection

At present the FMA levy is allocated to different classes and tiers of entities based on an evaluation of the extent to which they 'benefit from participating in a well-regulated market', which is seemingly unquantifiable and therefore leads to essentially arbitrary levy allocation decisions that are more art than science. Going forward there is a need to introduce systems into the FMA's planning and resource allocation so that the linkage and benefits of its activities to various sub-sectors (i.e. levy classes) or to entity sizes (i.e. levy tiers) can be objectively evaluated.

We also note little consideration appears to be given in levy setting to recognising industry efforts to improve conduct and reduce risk and the substantial amount that for example general insurers have expended, and continue to spend, on doing this. Those parts of the sector that have developed codes (e.g. the Fair Insurance Code) that set service standards and require self-reporting of complaints and process for remediating issues pose less risk than otherwise.

Improving the process of reviewing funding and levies

In terms of the process of this review we have three concerns. First, the scope and nature of the review of FMA fees and levies that took place in late 2018/early 2019[2] gave the impression that costs associated with the implementing the financial advice reforms had already been considered. While it was noted in that consultation that it was primarily a reallocation of levies it did not signal that significant levy increases were coming around the corner or that implementation of the financial advice reforms had not been priced in. Therefore, the release of this review at this time, and the scale of the levy changes proposed, came as surprise to the sector.

[1] As outlined in the Annex to the discussion paper.
[2] MBIE discussion paper, Financial advice provider licensing fees and changes to the FMA levy, December 2018.

Secondly, given the timing of this consultation and the need for government to make decisions very swiftly afterwards (given the results will be part of Budget 2020 in May) means there is little time for meaningful discussion of either the FMA's required funding or potential for making meaningful changes to the levy allocation model. This latter point might not matter much if the proposed levy changes were modest, but they are not. In future we would expect to see earlier and more through engagement on funding issues as this would enable a more meaningful involvement from the wider sector.

Finally, the gap between this consultation and the new levy rates coming into effect is less than six months and it will be probably be less than two months between them being confirmed and coming into effect. This gives little time for entities to revise their budgets to account for what will, under any of the proposed options, represent significant increases in the levy for entities. Increasing the levies in a more phased way over coming years would mitigate this impact.

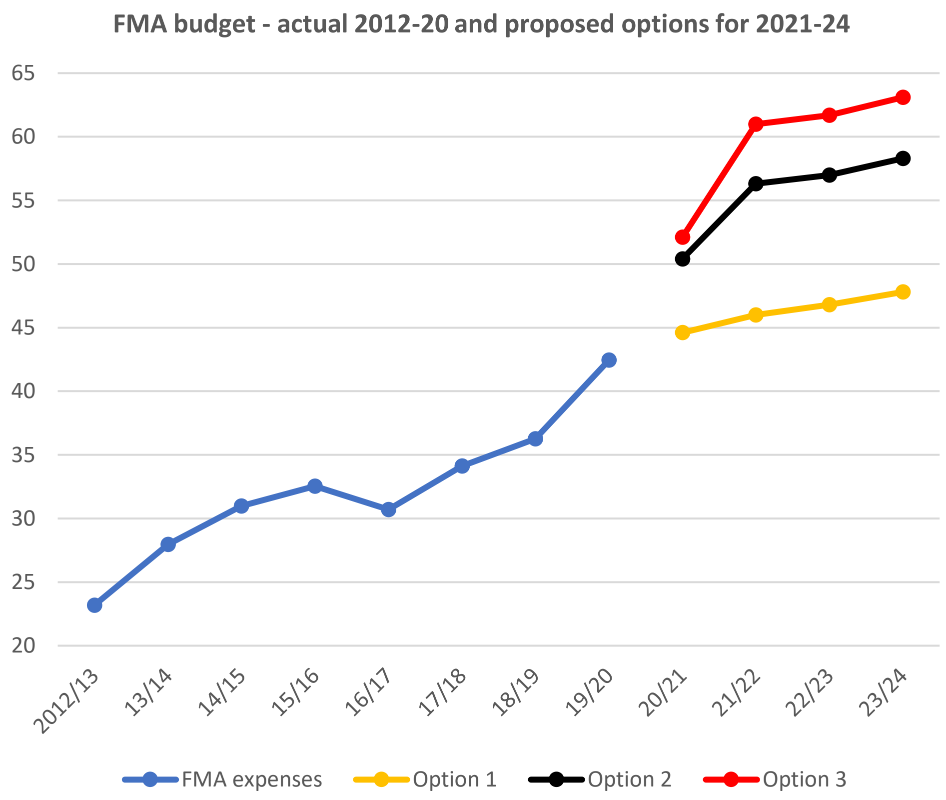
Responses to questions in the discussion paper

Question 1 - Do you have any feedback on the objectives of the review?

The objectives for the review outlined in paragraph 11 of the discussion paper are broadly appropriate.

Question 2 - Which of the FMA funding options do you consider to be most appropriate and why?

As outlined above, ICNZ supports the FMA's funding being increased to enable it to effectively perform its regulatory role. The discussion paper proposes three funding options for the FMA, which are shown in the following chart.



Of the three options proposed and shown above, we note that the discussion paper makes plain that government considers Option 1 to be unpalatable[3], and that Option 3 is the FMA's preferred option. Of the three options, all of which increase the FMA's funding, on balance and for the following reasons we consider that Option 2 (base funding case) would be the most appropriate option to progress:

- The total funding of $56.081 million per annum would represent a significant increase (approximately 30%) in the FMA's funding from its current year spend and enable the FMA to meet its statutory obligations and increase its capability across a range of functions over its current spend.
- It would give the FMA more capability to prepare for and implement the imminent financial advice reforms and to also prepare for the upcoming conduct of financial institutions regime.
- The levels of recruitment required by FMA will be more achievable than for Option 3 (enhanced case), as identified in the PWC report.
- Combined with appropriate phasing, Option 2 would reduce the level of disruption to the FMA that would be associated with the extent of organisational growth under Option 3, allowing the FMA to grow and consolidate before carefully considering what might be required to implement the planned conduct regime for financial institutions and an extended remit in relation to insurance, which is also intended to come into effect in a few years.
- It would moderate the scale of financial impact on the sector and its entities from increased levies compared with Option 3, recognising imminent increases associated with the introduction of financial advice related fees/levies and potential further increases in levies in future.

Question 3 - Are there any areas of FMA expenditure that you think should be expanded or reduced? Why?

No specific comments, noting that the nature and process of this review is not well suited to exploring this and that there was very little sectoral (i.e. non-government) input into the PWC report. We would welcome increased and earlier engagement by the FMA in future on its planning processes and planned resource allocation, which would facilitate better input from the sector on issues of this kind.

Question 4 - Do you think that the proposed additional funding for the FMA should be wholly levy recovered or should the Crown contribute towards the increase? Why?

Maintaining the Crown's proportional contribution is important to reflect the public good aspects of the FMA's work and ensure that through the annual Budget process, and future reviews of the levy, the Crown maintains an appropriate level of direct interest in the levels of funding provided to it. ICNZ therefore considers the Crown should also contribute towards the significant increases in FMA funding by at least maintaining its current 25% funding contribution (Option B). Given the extent of levy increases for financial services entities, even if the Crown maintains this level, it would be unreasonable to further compound the increases for the sector by at the same time reducing the Crown's relative contribution.

[3] Noting the extensive negative comments on Option 1 in paragraph 66-81 of the discussion paper.

The current 25% Crown funding level ($9 million per annum) already represents a significant reduction from the 39% (then $11 million) the Government was providing to the FMA in 2015. If the Crown maintains the current nominal funding level of $9 million per annum (Option A), its contribution will rapidly decrease given the level of funding increases for FMA that are planned (from 25% to 16% under the base case) and would continue to erode further over time.

We see no evidence that the public good aspects of the FMA's work are decreasing to justify a decrease in the proportion of the FMA's funding that is funded by the Crown. No rationale for this is identified in the discussion paper or the PWC report. Compared to when the FMA was first formed, the scope of consumers that come within its remit is much broader and if anything, this makes a case for increasing the Crown's proportion contribution rather than reducing it. The FMA was originally focused mainly on investment products, then to financial advice and now to also include insurers and banks, which were previously on the perimeter for the FMA.

Question 5 - What is the appropriate Crown/levy split of the FMA's appropriation and why?

Further to our answer to Question 4 we consider that maintaining the current split of 25% Crown and 75% levy funded is logical and would be appropriate. In future the appropriate Crown/levy split needs to be subject to more rigorous analysis.

Question 6 - Do you have any comments on the proposed new levy classes/tiers? Should further classes be considered?

We have no comments on the proposed new levy classes outlined in paragraphs 142-152.

Question 7 - Do you have any comments on the different tiers in the levy model?

In responding to this question, we address proposed changes to both levy classes and the tiers within them. Our comments are focussed on class 3 (licenced insurers) and use the figures outlined in the discussion paper, recognising these assume that Crown's share is reduced and so will be different should that not occur.

We note that as outlined in paragraph 139 of the discussion paper, MBIE considers the proportion of levy paid by the classes for registered banks/NBDTs, licensed insurers and classes 14 and 15 should be increased. The explanation for this in the discussion paper (refer paragraph 140) is minimal, relying simply on perceptions of the 'degree of benefit that these organisations receive from participating in a well-regulated environment'. This is not something that can be critically analysed in any meaningful way given the absence of any information in the discussion paper on how that degree of benefit might be evaluated and given the fact that the financial services industry operated in New Zealand for over a hundred years before the advent of the FMA. As outlined elsewhere in this submission, going forward a more rigorous and transparent framework needs to be found for underpinning allocation of the FMA levy. This would help to achieve the third objective of the review 'ensure that the FMA levy-settings remain appropriate and proportionate to the benefits received'.

We understand that the proportional increase for insurers as a class suggested in paragraph 139 will be from 7.4% to 9.9% of the total levy revenue and the total levy collected from insurers is expected to grow from less than $2 million to almost $5 million under the highest option. ICNZ questions the rationale for increasing the proportion of levy paid by insurers as a class, particularly given general insurers have yet to be a focus of, or have significant interactions, with the FMA. We note there is also no explanation in the discussion paper for material differences across those classes subject to a proportional increase, for example why the highest tier of banks are proposed to increase by between 46% and 111% whereas the highest tier of insurers are proposed to increase by a materially higher proportion of between 88% and 171%.

ICNZ recognises that while the allocation of levy funding across classes and tiers is based on a model and the products of the levy model are shown in the discussion paper, how the model works is not outlined specifically and there is no stated methodology for determining the benefits to various sub-sectors (i.e. levy classes) or to entity sizes (i.e. levy tiers) within that. Given this, the discussion of the allocation between classes and tiers becomes largely arbitrary.

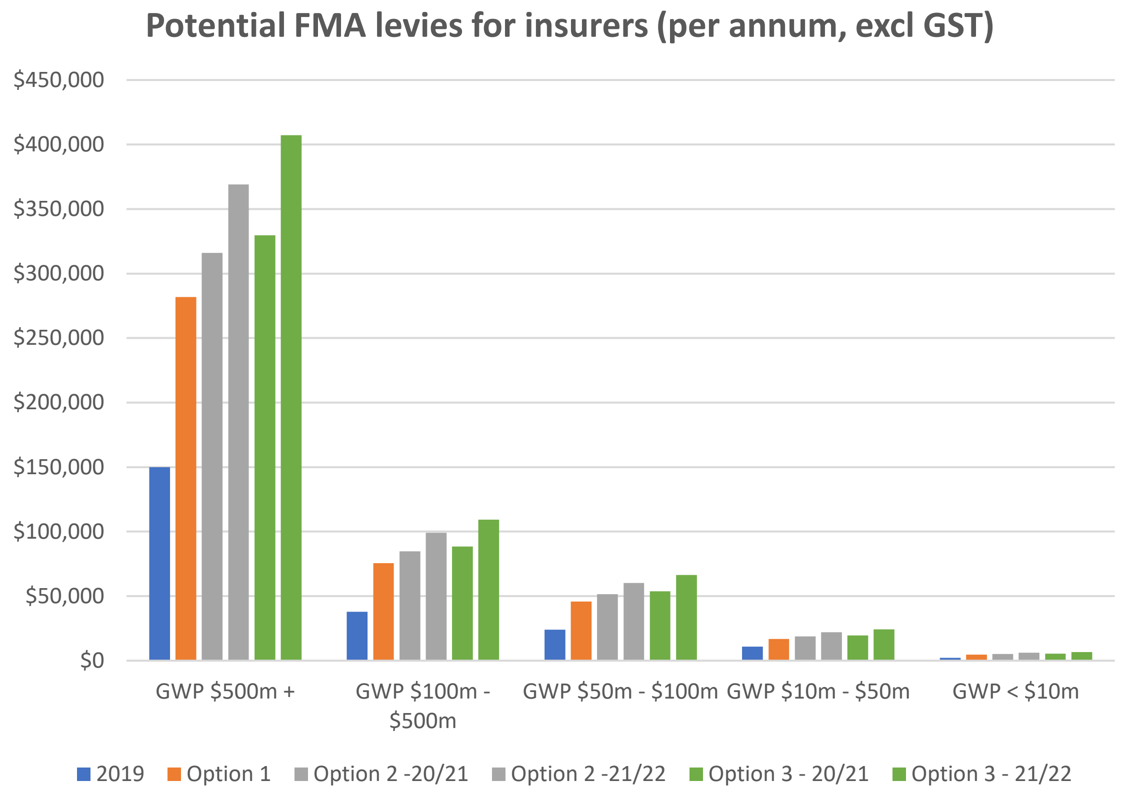
The current FMA levy currently groups all insurers (general/life/health) into a single levy class. This does not recognise the fundamental differences between the three sub-sectors or the relative weight of FMA's activity in relation to them. Neither does it recognise that the FMA's increasing focus on consumers through the financial advice reforms (and subsequent conduct regime) is more relevant to some general insurers that to others (i.e. some general insurers do not offer consumer products). While we recognise there are already 15 levy classes (with three more proposed) and currently 59 total tiers there are material differences in the nature of insurers across and within the various sub-sectors of the insurance sector and these create the potential for a disconnect between regulatory activity and cost recovery. Given the limited time for evaluating and further considering these issues we are not in a position to recommend specific changes at this time, however, we consider these matters need to be properly investigated the next time the levy is reviewed.

The gaps between the tiers are significant and abrupt, do not reflect the nature of different entities (i.e. the extent to which they conduct specifically regulated activities), and have been the same since 2017. An insurer with an annual GWP of $505 million pays almost 400% more than an insurer with GWP of $495 million. The abruptness of these and the scale of change (an increase in levy in future of between $200,000-$300,000 for moving up to the top tier and $30,000-$40,000 for the next tier) has the potential impact to affect business decisions (i.e. not wanting to take on an additional large customer to avoid moving up a tier and incurring significantly more levy, which might make the extra business uneconomic on a marginal basis).

Acting as a deterrent to incremental growth by insurers close to the top of a tier creates potential tension with wider regulatory outcomes and customers interests. Consideration needs to be given to the tiers, the existing position of entities within them and whether changes are required to achieve a suitable level of equitability across entities and reduce potential distortions. ICNZ suggests consideration should be given to adding an additional tier for insurers between $500 million and $1 billion per annum of GWP or to increasing the top of existing second tier to level higher than $500 million.

Question 8 - Do you have any feedback on the impacts of the proposed changes to the levies presented in the Annex?

Overall, we note the fee increases for insurers across the various tiers are very significant (e.g. 88% to 171% for the highest GWP tier and 99% to 187% for the next tier) and these are shown in the following chart.



We also note these increases are for the levy alone and do not include the levy/fee increases for some entities that will be Financial Advice Providers (FAPs), where the charges for a FAP with many nominated representatives will be much higher than that currently applying to them as a QFE. Neither does this include the potential further increases in general FMA levies (and/or targeted fees and levies) that may be sought in future when the FMA's role expands in response to the introduction of conduct related regulation and as a result of insurance contract law reform.

The additional costs imposed on general insurers of up to $3 million per annum will increase the costs of providing of insurance to New Zealand customers. This will ultimately affect accessibility of insurance to those who need it with the increases likely to be reflected through higher premiums.

Conclusion

Thank you again for the opportunity to submit on the discussion paper. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,

Tim Grafton
Chief Executive

Andrew Saunders
Regulatory Affairs Manager