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Inquiry into Regulatory Institutions and Practices
New Zealand Productivity Commission
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REGULATORY INSTITUTIONS AND PRACTICES

The Insurance Council of New Zealand (Insurance Council) appreciates the opportunity to comment on the New Zealand Productivity Commissions' Draft Report on Regulatory Institutions and Practices. The review provides an important opportunity to fundamentally reassess the regulatory framework and standards of New Zealand.

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. We also perform an important role in informing and educating consumers about key insurance issues and risks.

The Council currently has 29 members who would 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 are signatories to the Fair Insurance Code that requires insurers to act ethically. Our members are also subject to regulation of market conduct by the FMA, regulation of competition and pricing by the Commerce Commission and regulation of health and safety by MBIE.

2. Our comments

2.1. General

The draft report makes a number of sound recommendations with respect to enhancing regulatory institutions and practices in New Zealand. We support the general thrust of the recommendation-based paper and support the focus on fundamental issues around transparency, capability, performance and accountability.

As noted by the Commission, *"there is no clear government strategy for regulation, no programme for its improvement, and no clear "owner" of the system. Nor is there enough information on the performance and impacts of the regulatory system*." Government should take a more holistic view towards regulation and ensure greater consistency of regulatory quality and performance.

Nevertheless, there are certain recommendations in the review that we believe should be strengthened and a number of other elements which should be explored further by the Commission in the final report. We outline these concerns in the following sections and provide recommendations to address our concerns.

2.2. Consultation and Engagement

A number of submitters have raised issue with the "*time allowed for consultation*", "*pre-existing opinions and beliefs*", the "*capability of regulators to engage effectively*" and "*consultation overload*." We share these fundamental concerns.

We strongly support the report's suggestion that there should be greater consultation on exposure drafts of bills before their introduction to Parliament and greater consultation by regulators on how they interpret and intend to carry out their legislative mandate, including how they will make trade-offs. We agree that *"earlier consultation with affected parties can help identify and resolve problems, especially where the proposed regimes are complex or technical…"*

However, despite the acknowledgment that earlier and more effective consultation and engagement would provide regulatory benefit, there is no formal recommendation made in Chapter 8. We believe there should be an enhanced statutory requirement for regulators to consult on proposals, particularly with industries such as the insurance industry where issues are highly technical in nature.

For example, legislation could be introduced to require:

- a minimum time for consultation, and
- that any consultation papers are subject to formal review by Treasury (or an equivalent oversight body) before being released for consultation.

Regulators could also be asked to issue a response paper that sets out specifically what its responses are to comments made, with a second round of consultation required if proposed changes are significantly different from those in the first paper.

This would align with the suggestion in the Commission's Case Study on Regulation of the Financial Sector, to give consideration to:

> *...the development of minimum standards for consultation on regulatory proposals, including in respect of minimum periods for consultation, obligations to have regard to the views of stakeholders, transparency of the assessment of submissions and regulator responses, and greater involvement of external expert review of regulatory proposals.*

Without becoming an obtrusive process, we would encourage the Commission and Government to continue to look at ways to ensure effective consultation is made mandatory.

2.3. Transparency and Accountability

We agree with the recommendation at 6.3 that*, "All regulators should publish and maintain up-to-date information about their regulatory decision making processes, including timelines and the information or principles that inform their regulatory decisions."*

It's crucial that regulators are held to account for their conduct, particularly when it comes to demonstrating how standards or regulations will be implemented and how certain decisions have been made.

Nevertheless, we still believe the regulatory regime in New Zealand could be strengthened by requiring greater accountability of the entities which implement and/or develop regulation, particularly through the establishment of a merits review framework.

2.4. Decision Review

We are not convinced by the Productivity Commission's suggestions that a merits review process would not provide additional benefit to the regulatory framework in New Zealand.

The Commission states that:

> *The overlap between judicial review and appeal means that judicial review already adequately provides many of the advantages that submitters to the inquiry ascribed to merits review or appeals.*

The above comment seems to overstate the overlap between judicial review and appeal. We acknowledge that New Zealand judges may increasingly enter into merits review. However, we disagree that the "trend" away from the strict *Wednesbury* standard has a sufficiently "wide scope" in New Zealand law to place incentive on regulators to get it right.

The scope of the Courts' engagement in merits review depends on the particular judge reviewing the claim. This leads to uncertainty for industries and their consumers.

In Australia, merits review sits alongside judicial review and, as the Commission notes, merits review changes the behaviour of regulators in Australia. In our view, merits review would increase the scope of appeal of regulatory decision making in New Zealand, to better hold regulators to account. In instances where there has been ineffective consultation and engagement, or simply poor decision making, this mechanism would provide an effective alternative remedy to judicial review.

In fact, the draft Report seems somewhat contradictory in that it also acknowledges the benefit of further appeal rights, by stating that:

> *"Access to appeal (or merits review) should be available where it is likely to improve the quality of regulation, in terms of the objectives of the regulatory regime, taking into account the costs of providing it."*

We believe merits review would provide an overall improvement to the quality of regulation in the financial services industry, by sharpening the incentives on regulators to get it right, and so driving regulators to make reasonable decisions.

2.5. Performance

We support greater emphasis on regulatory performance as a means of accountability. As suggested in the report, regulators with clear and well-understood roles and objectives can more easily be held to account. A standardised set of performance measurements would assist in providing the granular data needed to better manage regulatory performance.

The *'comparable information that could be collected from regulators'* at table 3.1 would provide much greater accountability, particularly the efficiency, effectiveness, responsiveness, burden of activity and transparency/accountability requirements. Standardised reporting requirements along these lines would allow the public to easily compare agency practices and identify examples of good practice.

For the financial services industry in particular, it is important that Treasury take a more active role in oversight and performance monitoring. Our sense is that the Treasury is currently under-resourced to effectively monitor and scrutinise regulators such as the Reserve Bank. We believe a much more focused and better-resourced effort is needed by the Treasury in this area, much more akin to that in Australia and the UK.

We also support the finding in the Commission's Case Study on Regulation of the Financial Sector that "*Consideration could also be given to the specification of KPIs for regulators, mainly of an outcomes-based nature, where the KPIs are set by the responsible minister after consultation with the regulator and other stakeholders*." Key performance indicators would help provide a consistent set of clear objectives for regulators.

2.6. Workforce Capability

It is important to have appropriate workforce capability in any regulatory regime; however, this is particularly true in a technical industry such as insurance.

We agree with the recommendations at 12.1, that regulators should have better workforce capability development programmes, i.e. that regulators should:

- *focus on recruiting and retaining staff with the appropriate industry knowledge and mix of enforcement, investigative and communication competencies;*
- *provide appropriate training and written guidance for staff, and monitor regulator practices for consistency with this guidance;*
- *facilitate opportunities for staff to improve their understanding of the regulated environment, business practices and the nature and magnitude of the compliance costs their engagement imposes on business; and*
- *implement cooperative arrangements with other regulators that facilitate the sharing of knowledge and resources.*

Regulators should be required to consistently identify skill levels and gaps that may exist in resourcing.

With respect to *recruiting* and *facilitating opportunities*, greater consideration should be given to how public bodies can better interact with private organisations to leverage technical expertise and knowledge, whether through concerted recruitment initiatives, scheduled work placements or informal industry meetings.

Private industry is often more than willing to share its knowledge and expertise, but there seems to be a lack of concerted effort by regulators to actually utilise this resource. Regulator's workforce capability development programmes should be required to specifically take this into account.

Further, having consistent, comprehensive performance indicators, as discussed in the previous section, will also naturally improve workforce capability.

2.7. Compliance Costs

Page 1 of the Report states that, "*poorly conceived and implemented regulatory arrangements can also impose significant costs*." Compliance costs are a significant concern for all businesses that face increased regulation. However, they are mentioned infrequently in the Commission's report.

In our view, regulators must have regard to business compliance costs. Attempts to measure these costs within New Zealand over time have been haphazard. There has been little research to show exactly how these costs change over time.

We believe the Commission should take more consideration of compliance costs in the final report, to ensure that enhanced regulatory practices lead to a reduction in business compliance costs.

2.8. Fees/Levies

We share concerns with other submitters as to the quality of consultation currently taking place before regulatory fees or levies are introduced.

When the FMA levy was introduced for example, there was very limited consultation and despite repeated submissions outlining the inequitable nature of the proposed levy, no significant change was ever made with respect to insurance contributions.

The FMA levy has been targeted towards financial market participants because they are the 'end-users' of FMA services. However, the focus in setting levies seems to have little correlation to how the FMA's resources will likely be concentrated.

Insurers do not pose the same risks as banks, financial companies or insurance brokers. However, some insurers are required to contribute up to $150,000 towards the funding of the FMA despite having very little interaction with the Authority. Insurer contributions are arbitrarily calculated and seem to be based on who is perceived to have the deepest pockets.

The basis for such a significant contribution seems to be that insurers benefit from a sound financial sector. While this is undoubtedly true, this is just as true for of any other market participant. Funding mechanisms should not work to further exacerbate compliance costs for potential and existing market participants.

Despite raising these points on numerous occasions with government, it seems clear there was little understanding or appreciation of our submissions. We agree there should be much *"more rigorous consultation and impact assessment before fees are introduced."* There also should be more effective review of imposed levy regimes to ensure they remain appropriate over time.

2.9. Regulatory Uncertainty

The report looks at regulatory uncertainty and the idea that unexpected changes in regulatory settings, implementation or enforcement can discourage investment. We believe this topic should be given greater weight in the final report.

Regulatory uncertainty will inevitably reduce international investment and subsequently competition. It will discourage international providers from investing capital into the New Zealand economy, particularly if that capital can be more efficiently allocated elsewhere with lower risk. As such, it should be avoided as much as possible.

Uncertainty can also be created by regulatory creep, i.e. "*the extension of the scope or impact of regulation in a non-transparent manner either deliberately or unintentionally.*" Regulatory creep can affect firms and the wider community by increasing the cost of regulation.

The insurance industry has specific concern with the potential for regulatory creep by the Reserve Bank. Not only could this directly impede efficiency and productivity for current market participants, but through uncertainty and compliance costs could discourage investment from potential market participants.

It is important for the government to promote more transparent and consistent regulation, as well as performance measurements, to avoid regulatory uncertainty and creep.

2.10. Regulatory Overlap

We agree with the report's comment that overlaps "*create unnecessary costs for regulated firms and cause confusion about which regulatory obligation or agency has priority*."

With respect to the insurance industry there is concern around duplicate oversight between the FMA and the Commerce Commission for unfair contract terms. The FMA has primary responsibility for insurance market conduct issues. However, the Commerce Commission has been given the task of overseeing unfair contract term provisions, which fall clearly within the space of market conduct.

Australia has two distinct towers of regulation – the so-called "twin peaks" model. There is 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).

If some elements of regulatory oversight remain with the Commerce Commission (i.e. for unfair contract terms) then this will lead to entrenched regulatory fragmentation, inefficiency and uncertainty. There would be clear benefit in amalgamating knowledge within one market conduct regulatory body, as in Australia, so that insurance conduct matters could be dealt with consistently and effectively.

Having a single market conduct regulator would also encourage a better working relationship between government and stakeholders, as market participants would not be required to commit resources across a number of different bodies. It would also reduce the risk of inconsistent policy and regulatory practice between different agencies, which is a risk under the current framework.

These recommendations are consistent with the finding in the Commission's Case Study on Regulation of the Financial Sector that, "*It would be desirable for greater clarity on the*

demarcation between the responsibilities of the financial sector regulators, with a view to avoiding unnecessary overlaps in responsibility."

In this vein, we also believe it is important to have greater consultation and coordination between financial sector regulators, to ensure a holistic approach to financial sector regulation, such that "*big picture*" issues are adequately taken into account in seeking to promote a sound, resilient, efficient and dynamic financial system.

We strongly support the comment in the Commission's Case Study on Regulation of the Financial Sector, that:

> *Given the complex range of regulatory requirements applicable to the financial sector, and the number of regulators involved, coordination between the regulators is essential. Effective coordination is essential in order to avoid unnecessary duplication of function, avoid unnecessary inconsistency in approach to related issues, and to synchronise consultation with stakeholders on cross-regulator issues where practicable.*

2.11. Gaps in Regulation

There should be greater emphasis in the final paper on identifying and addressing existing gaps in regulation.

As noted in the report, "*Gaps may appear either within or between regulatory regimes, leaving some activities uncontrolled or ineffectively overseen.*" In the insurance industry context we believe this has played out through the failure to implement appropriate regulation of insurance brokers.

While insurance companies have now become one of the most regulated groups in New Zealand, there has been little attention paid towards insurance brokers. Brokers have a significant presence in New Zealand, are independent of insurance companies and should be regulated as such.

If the Government's intention is to have a sound, reputable and unbiased intermediated market then it should ensure proper market conduct regulation is put in place for brokers, as it is inappropriate to expect insurers to regulate the intermediated insurance market.

The Government should consider what mechanisms would be appropriate to ensure effective regulation of the intermediated insurance industry. For example, insurance intermediaries should be required to:

- disclose remuneration received (to provide greater transparency and allow customers to make more informed decisions)
- retain premiums for a less onerous period of time (brokers are currently permitted a significant period by which to retain premium owed to the insurer)
- disclose the insurer's financial strength rating where they act as the insured's agent (currently this duty belongs to insurers who have no direct contact with insureds)
- retain appropriate liability insurances
- have effective systems in place around general conduct, record retention, audit and best practice

Gaps in regulation, of this nature, should be better addressed and we believe greater emphasis on this point is required in the paper.

2.12. Earlier Stages of the Regulatory Process

While we believe the recommendations outlined are generally in the right direction, the current inquiry only looks to enhance the box of regulator capability and behaviour. The ability to achieve significant change also requires an examination of the other boxes that make up the process by which regulation occurs, specifically the political aspect of regulation making.

What causes concern is how the political aspect of regulation significantly hangs over current regulatory processes. This aspect is now widely acknowledged as one that can and does create significant difficulties for regulators, and there currently appears to be little that can be done to improve this situation.

Without changes that go beyond the terms and references that this inquiry is focussed on, recommendations such as introducing Really Responsive Regulation (as mentioned in chapter 11) may fall short of their potential to improve regulatory practices in New Zealand.

An inquiry on regulatory practices that does not also take into account the Government's initial decision to regulate will mean the end result not having the desired level of effect intended. To that end, we support Business NZ's submission that some form of Regulatory Responsibility Act is required in New Zealand, to ensure that political aspects of regulation making do not become an undue burden on regulators and the policy making process.

We recommend that the Commission acknowledges the importance of addressing the earlier stages of the regulatory process to ensure the quality of regulation is improved.

3. Summary

As noted above, while we support the general thrust of the recommendation-based paper, we believe there are certain recommendations in the review that could be strengthened and other elements that require greater consideration. This would lead to a more comprehensive and pointed review.

Thank you again for the opportunity to provide input on the draft report. The proposals are of significant interest to our members and we look forward to the next stage of this review. Please contact Nick Mereu, our Legal Counsel, on (04) 495 8008 or at nick@icnz.org.nz if you have any queries.

Yours sincerely

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