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Investment Law
Ministry of Economic Development
PO Box 1473
WELLINGTON 6140

Dear Sir/Madam

SUBMISSION ON THE MED DISCUSSION PAPER – REVISED OPTION FOR PROPOSED LEVY TO FUND THE FINANCIAL MARKETS AUTHORITY

The Insurance Council of New Zealand (”the Insurance Council”) appreciates the opportunity to comment on MED’s revised option for a proposed levy to fund the Financial Markets Authority (“FMA”).

1. The Insurance Council

The Insurance Council is the industry representation body for fire and general insurance in New Zealand. The Insurance Council has 25 members which write the substantial majority of New Zealand’s insurance business.

The Insurance Council is active in self-regulating the insurance industry. We promote the Fair Insurance Code that requires insurers to act ethically. We fund the Insurance & Savings Ombudsman Scheme that offers independent review of decisions and we apply an Insurance Council solvency test that confirms the financial stability of our members. We also require members to be independently rated and to publish these ratings. We perform an important role in informing and educating consumers about key insurance issues and risks.

Members currently protect approximately $0.5 trillion of New Zealanders’ assets and last year paid $2.1 billion in claims, not including the estimated $15 billion currently being contributed towards the recovery of Canterbury following recent earthquakes. Approximately $2 billion has already been paid into Christchurch over the past year.

2. Insurance Council Recommendations

- We believe FMA funding should come from general taxation, rather than the proposed levies on Financial Service Providers (“FSP”) and companies.

- The insurance and banking sectors are paying almost 25% of the proposed levy, and on this basis appear to be making a disproportionate contribution to the total costs in relation to the amount of FMA intervention likely in these sectors.

- If the proposed levy structure is to be maintained, we recommend a number of changes in the interests of equity and efficiency.

3. General taxation

We believe FMA funding should come from general taxation, rather than from a levy on FSPs and companies. Prior to the FMA's introduction, the Securities Commission, which is the watch dog of market behaviour, was funded from general taxation because the benefits they provided went directly to the level of the general public. We do not see that this situation has changed.

Ultimately, the cost of regulation will be charged to the general public because all members of the general public are consumers of financial products. Charging all FSP's (on a first tier level) and all companies (on a second tier level) will result in these bodies having to calculate the pricing impacts and passing these down to the general public. This is inefficient and adds cost to the financial process. The cost of calculating, collecting and administrating the proposed tier one and tier two levies will add extra cost to the process when each of the tiers will ultimately be forced to pass these costs on to the general public.

Furthermore, a levy on all FSPs and companies could lead to significant problems with underinsurance and non-insurance. The FMA levy would be yet another layer of regulatory costs for insurers that would inevitably be passed on to customers in the form of increased premiums. The costs of insurance have already increased following the Canterbury earthquakes, due to increased reinsurance costs and higher EQC levies. Significant regulatory costs have also been layered on the industry over the past few years as a result of increased compliance costs arising under the Insurance (Prudential Supervision) Act 2010, Financial Advisers Act 2008 ("FAA") and Financial Service Providers (Registration and Dispute Resolution) Act 2008. This levy would be another significant regulatory cost for insurers to bear which would ultimately be passed on to consumers. The higher the cost of insurance, the more prolific underinsurance and non-insurance will become. The government needs to fully consider the implications of this possibility before imposing further regulatory costs on insurers.

Accordingly, we recommend that instead the levy be applied directly at the lowest and broadest level possible; i.e. at the public level through general taxation.

4. The Revised Proposal

If the recommendation above is not accepted, we make the following comments in respect of the revised proposal.

We support the move to a single levy, rather than the separate FMA and FAA levies that were proposed in the earlier consultation document

The proposed levy model focuses on the subjective issue of benefits to market participants "from the fair, efficient and transparent investment environment supported by the FMA's activities." We believe this focus is incorrect. Prior to the introduction of the FAA, we contend that the insurance market was already "fair, efficient and transparent." One of the primary drivers of regulation was the problems faced by finance companies and financial advisers of FAA Category 1 investment type products. The failures in this part of the financial sector cost New Zealanders billions of dollars and were an important part of the reason for the establishment of the FMA. The focus in setting levies should correspond to where the FMA's resources will likely be concentrated.

Most insurance FSP's have formed QFE's, which will be managed by the FSP and will only require light-touch regulatory oversight by the FMA. The FMA's intervention in insurance companies and banking is likely to be very light, yet it is proposed these sectors provide almost 25% of the total cost of FMA funding. This is inherently inequitable.

5. Further comments on the insured proportionality

The comment that insurers tend to be smaller than banks and are therefore less able to distribute risk shows a lack of understanding of how insurers distribute risk. Insurers, through their reinsurance programme, distribute their risk to layers of reinsurance capital globally. Comparing assets on balance sheets between insurers and other FSPs, is not comparing like-for-like when it comes to risk. On this basis, insurers with global risk spread are less "risky" than other FSPs.

As noted above, the insurance sector is already heavily regulated by the Reserve Bank under the Insurance (Prudential Supervision Act) 2010 (IPSA). Insurers are required to meet strict solvency standards, risk management guidelines and fit and proper guidelines. They are also subject to micro regulatory management. This sector is already contributing heavily to the "fair, efficient and transparent investment environment" that the FMA supports.

In assessing proportionality between categories, we believe that the revised proposal does not take into account this dual regulation faced by the insurance sector and the benefits contributed by the prudential regulatory environment.

Also, if proportionality is based on vulnerability and risk, the players in Category 3 and Category 5 in the revised proposal, appear to be heavily cross subsidised by Category 1 and 2 FSPs. The heavy losses to consumers in the financial service sector were not from the insurance and banking sectors, but from the finance companies and activities of investment advisers and listed companies. This is where the bulk of the FMA focus will inevitably be and the costs to these sectors should reflect this.

6. Conclusion

As stated above:

- We believe FMA funding should come from general taxation, rather than the proposed levies on FSPs and companies.
- The insurance and banking sectors are paying almost 25% of the proposed levy, and on this basis appear to be making a disproportionate contribution to the total costs in relation to the amount of FMA intervention likely in these sectors.
- If the proposed levy structure is to be maintained, we recommend a number of changes in the interests of equity and efficiency and would appreciate an opportunity to discuss appropriate levy levels.

Thank you again for the opportunity to provide input on this discussion paper. The proposals are of significant interest to our members. We would be happy to discuss any issues raised in our submission. Please contact Terry Jordan on (04) 495 8002 or at terry@icnz.org.nz.

Yours sincerely

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