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To Whom It May Concern,

ICNZ submission on the review of FMA funding

Introduction

1. Thank you for the opportunity to submit on this review. We understand that some of our members will also be submitting to you directly.

2. We submit for the Insurance Council of New Zealand (ICNZ). ICNZ represents the interests of its 28 members, who are general insurers – that is, not life or health insurers – and insure approximately $600 billion of New Zealand's assets and liabilities. This figure represents about 95 percent of the general insurance market in New Zealand.

3. Distinguishing "general insurers" as a distinct category of "insurers and "the insurance industry" is perhaps stating the obvious, but is critical to understanding our position. Too often stakeholders we consult with do not appreciate the differences between general insurance and other types of insurance. We submit that general insurers pose a different regulatory risk to life and health insurers, which should be reflected in a separate levy applicable to general insurers.

4. Despite highlighting the unique position of general insurers and focusing specifically on the levy applicable to general insurers, we note that the principles we rely on and the arguments we make are just as relevant when applied to other parts of the financial services industry.

5. We support a levy for licensed insurers that:
   a. Is based on fixed GWP bands, for predictability, clarity, and simplicity, though we argue for greater fairness in moving through those bands.
   b. Reduces the overall amount of levy paid by licensed insurers, as has been proposed by MBIE.
   c. Distinguishes general insurer from life and health insurers, given the differences between general insurers and life and health insurers.
   d. Reflects equity and risk better by setting those GWP bands and the amounts payable under those bands at a more proportionate level to each other and to other financial sector participants.
   e. Does not levy an insurers' offshore GWP.
   f. Allows licensed insurers operating in groups, under a parent company that is also a New Zealand licensed insurer, to aggregate their GWP for the purposes of levy calculation.

6. We note that we have not provided specific alternative solutions to the current levy. Our view is that it is not the role of an industry organisation to agree on a specific solution, as there will inevitably be winners and losers of cost-shifting for any specific levy regime among our membership. Instead, we have submitted in favour of a principled approach to help MBIE determine specific allocations of FMA funding between insurers.

7. We also argue for greater transparency in FMA expenditure. We set out our reasons in the following sections.

Problems with the current levy

8. Our members are licensed under the *Insurance (Prudential Supervision) Act 2010* and regulated by the Reserve Bank of New Zealand ('RBNZ'). While RBNZ and FMA have different regulatory functions, we note that our members have far more regulatory interaction with RBNZ than FMA. General insurers currently have very little, if anything, to do with FMA. Indeed, some of our members have had interactions with FMA where our member has brought inappropriate broker conduct to FMA's attention, but FMA has declined to take any further action in respect of the broker, not because of the inappropriateness of the broker's conduct, but because of the FMA's limited resources. We later submit that FMA should focus on fully and comprehensively addressing manifest risks before conducting reconnaissance in other sectors of the industry, where there is no manifest risk.

9. There are elements of unfairness and anomalies to the current levy. We list some of the key issues here:
   a. Most licensed insurers have little to do with FMA. FMA has provided us with details of the number of complaints it has received since 2011 relating to "insurers". Only nine complaints (eight percent of the total number of complaints) relate to general insurers. The largest chunk relates to intermediaries (61 complaints; 38 percent).

Nine complaints in five years illustrates to us that the risk posed by general insurers, in terms of the level of interaction and potential for interaction with FMA, is extremely low.

b. We have one member who writes approximately 98 percent of its annual gross written premium (GWP) offshore, through insurance entities that are regulated in those offshore jurisdictions. This member pays FMA levies in respect of all of that GWP, despite the fact that FMA has no jurisdiction to regulate the conduct of the member's offshore business. Further, that offshore business is, in any case, subject to regulatory supervision by regulators equivalent to the FMA in their respective jurisdictions. We submit that offshore GWP should not be factored into levy GWP calculations.
c. The gap between the bands of licensed insurer are significant. We have two members on the cusp of exceeding $250 million in GWP. They will be penalised with a $115,000 jump in levy (from $35,000 to $150,000) for reaching this significant business milestone. We submit that MBIE should consider options to either tighten up levy jump between the GWP bands (such as by introducing new bands), or to give FMA the ability to smooth the transition to the new band over the course of a few years.
d. Some of our members choose to license as QFEs. Those that do have a much higher level of interaction with FMA than the majority of members, who have little if nothing to do with FMA. And yet the up front and ongoing fees for being regulated as a QFE pale in comparison to the licensed insurer levy. We submit that with a revised Financial Advisers Act and mandatory firm licensing coming into force under that Act, that a greater share of FMA costs should be borne by licensed entities, given the greater level of interaction between licensed entities and FMA.
e. For intermediated business, FMA clips the ticket twice for the same insurance policy sold to the same consumer. Both the licensed insurer (who has no interaction with the client and poses minimal market conduct risk) and the broker (who has all the interaction with the client and poses a much higher market conduct risk[1]) pay levy to the FMA under the current regime.

A good levy is based on good public finance principles

10. The Treasury sets out good tax design principles which are a useful way of assessing any public sector finance mechanism. These principles were recently used by the Department of Internal Affairs to assess funding options for Fire and Emergency New Zealand. We strongly support a levy that reflects the principles. Those principles are:
    a. Equity[2]
    b. Sufficiency[3]

[1] We note that, in assessing the comparable risk of different market participants, brokers are almost exclusively responsible for the headline market conduct challenges for regulators of "insurance" in New Zealand and in comparable jurisdictions.

[2] Equity means levy payers should pay an amount relative to the amount they use FMA's services.

[3] Sufficiency means FMA has enough funding to carry out its functions.

c. Predictability and clarity[4]
d. Adaptability[5]
e. Non-distortionary[6]
f. Cost effective.[7]

11. One aspect of equity is that if the levy is funding a public good, those levy payers who have a greater ability to pay, pay more. We submit the current levy is far too skewed in favour of this consideration. We acknowledge that setting the levy initially needed to involve a degree of art over science. However, the same approach is not justifiable now. The levy should have a greater focus on principle instead of aligning the FMA's costs to the deepest pockets.

12. One of our members supports a solution that involves insurers paying a levy that is proportionate to their market share. That member will be submitting to MBIE directly on that solution.

13. The next sections of our submission focus on these principles in more depth.

The levy should be more equitable

14. Levy payers should pay an amount relative to the amount they use and benefit from FMA's services. An extreme version of this principle would be a pure "user-pays" model, where FMA invoices the entities it has had regulatory interactions with over the course of a year. We do not support a pure user-pays model, but we strongly submit that the levy regime must reflect where FMA allocates its resources and who it regulates to a greater extent. The current levy allocations lack equity.

15. Our submission for more equity to the levy operates at two levels.

The public should pay an equitable share of FMA's costs

16. The first is equity as between the greater public and the financial services industry in respect of their respective share of FMA's costs. The public currently contributes 40 percent of the FMA's costs, and the industry currently contributes 60 percent. However, MBIE proposes FMA's increased expenditure should be borne in full by industry. This is particularly concerning given the enhanced funding case is circa $10m, which is 30 percent of FMA's current operating costs and 58 percent of the amount industry currently pays. We return to the point later, but we submit that more transparency is required around FMA's enhanced funding proposal. We submit a far more detailed business case is necessary to justify the expenditure.

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4 Predictability and clarity mean levy should not be subject to sudden change; should be calculated readily and easily, and payers should be aware of the change and how and when it applies.
5 Adaptability means the funding base should change in line with changes to FMA's services.
6 Non-distortionary means the effect of the funding method on a levy payer's decision making is kept to a minimum.
7 Cost-effective means the costs of administering and collecting the funding are kept to a minimum, and the enforcement of payments is straight-forward.

17. We strongly disagree that the current 60-40 industry-to-government split of FMA costs should be altered so significantly. No rationale has been provided for shifting more costs onto industry. We would expect much greater analysis and sound reasons before these kinds of significant financial decisions are made by government. MBIE states that a well-regulated financial market benefits the entire economy. We agree. So it is equitable for the broader public to continue to fund its fair share of FMA's operating costs because the broader public continues to receive the benefits of FMA's regulatory activities.

Levy payers should pay an equitable share of FMA's costs

18. The second is equity as between levy payers in the financial services industry who currently contribute to the 60 percent share of FMA's costs.

19. As we note above, the current levy is skewed towards whomever has the deepest pockets. We say that adjustments should be made to the levy allocations between financial services industry participants to make the levy more equitable. In particular, we argue that in setting levy MBIE must consider regulatory risk (assessed both in terms of actual and potential risks) broadly, and which parts of the industry FMA regulatory activity focuses on in particular. This would also be consistent with Cabinet's expectations of regulatory stewardship.

20. We also submit with the upcoming Financial Advisers Act licensing regime, that the FMA should be able to recover a larger proportion of its costs through its licensing activity in accordance with its activities and resource demands.

21. We note the argument that all financial service providers benefit from high standards of industry conduct marshalled by a credible regulator. We agree. But this argument can only go so far when it is translated into how much levy a financial service provider should pay for that well-regulated market. At its extreme, the argument would mean every levy payer pays the exact same set rate which would, for different reasons, be totally inequitable. Moreover, financial service providers do not benefit equally from an effective FMA. This means there must be some other, separate set of reasons used to strike an equitable balance between levy payers. As noted above, we are concerned that the basis for the current levy is too skewed towards the deepest pocket.

General insurers pose an extremely low regulatory risk to FMA

22. We note the FMA wants to enhance its monitoring of licensed insurers (and banks) to be able to better assess the risk posed by these entities. FMA cited an increase in the number of complaints against insurers and banks, and the implementation of the Fair Dealing provisions of the Financial Markets Conduct Act 2013 ('FMCA') in particular.

23. If MBIE accepts our submission above that the levy should be set more equitably to reflect risk better, we submit that the risk posed by general insurers is minimal.

24. First, it appears complaints about licensed general insurers to FMA are scarce. FMA has received nine complaints in five years. This is hardly enough to suggest to us it is worth greater surveillance of general insurers.

25. Second, we note that consumers and small-medium enterprises can access the independent external dispute resolution schemes for redress for their complaint.[8] The schemes are approved by a Minster under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and are 100 percent funded by the industry. The schemes provide fast and effective dispute resolution. They must consider relevant laws in resolving disputes, and so must consider the Fair Dealing provisions of the FMCA in negotiating an agreed outcome to the dispute, or in adjudicating the dispute. The schemes must refer a series of material complaints to the appropriate regulator. So, practically, in the majority of cases people with complaints about the conduct of general insurers will go to the schemes to have their complaint heard and any consequent financial losses remedied remedied. Any unresolved complaints or systemic issues will be referred to the FMA for consideration. The FMA's best market monitoring mechanism already exists, and is industry funded.

26. We are not suggesting that FMA should be refused funds to invest in systems to improve its monitoring of the industry. We are suggesting that, despite the FMCA Fair Dealing provisions coming into force, any issues arising will be handled promptly and professionally by the existing industry-funded dispute resolution schemes, which leaves an extremely low residual risk requiring FMA intervention.

27. There are two further reasons general insurers pose a low regulatory risk, which should be reflected in lower levies:

   a. High standards of self-regulation reduce regulatory risk for government regulators. ICNZ members (about 95 percent of general insurance GWP underwritten in New Zealand) are bound to adhere to the Fair Insurance Code. The Code sets high standards. Those standards are more prescriptive and specific to general insurance. They are also more demanding and prescriptive than the FMCA Fair Dealing provisions in terms of how insurers must deal with customers. The Code is policed by the industry dispute resolution schemes and, where any significant breaches of the Code are identified, must be referred to a Code Compliance Committee consisting of three independent and experienced members. We submit government and FMA should be encouraging high standards of self-regulation; one of the best ways to do this is reduce regulatory costs to sections of industry that do a good job of self-regulating.
   b. General insurers should not be conflated with intermediaries (such as brokers) or life and health insurers. General insurers have a good conduct record as noted elsewhere in this submission and high standards of self-regulation as noted above. Comparatively, intermediaries are responsible for the larger portion of FMA

[8] Indeed, one thing we do not know about the number of general insurance complaints FMA has received is the number that overlapped with complaints addressed, referred to, or more appropriately referred to a dispute resolution scheme.

complaints in the insurance space, and for concerns leading to enhanced regulation in the upcoming amendments to the Financial Advisers Act. Likewise, churn issues in respect of life and health insurance, and the incentives offered and products designed by some insurers in that space in both Australia and New Zealand have warranted more intense regulatory scrutiny. There is a significant difference between general insurers and life and health insurers in terms of business operations, the product offered to the public, and market conduct.

28. We submit general insurers pose a much lower regulatory risk for these reasons, which must be reflected in the outcomes listed at paragraph 5 above.

FMA's expenditure needs to be more transparent

29. We submit that there needs to be much greater transparency around how FMA spends and intends to spend its money. The consultation paper outlines at a high level what will happen under each of the funding options, but we and our members are of the view that those outlines lack a sufficient level of detail required to justify significant increases in expenditure. Whilst we are not opposed to the level of the increase per se, we strongly submit that a robust business case for increased expenditure has not been made. We submit that any enhancements in FMA's budget are not justified by nondescript monitoring exercises in areas of the industry that do not currently pose risk and in which there is no evidence of risk.

30. FMA's largest areas of expenditure are "other regulatory and external facing activities", "corporate and support", and "proactive supervision and monitoring of entities". We cannot tell from these high-level categories exactly where the money is being spent, on what, and in respect of what parts of the financial services industry. More clarity is crucial to being properly informed about, and being able to assess and submit on the different FMA funding options.

31. Thank you again for considering our submission. If you have any questions, please feel free to contact our legal counsel Nick Mereu at nick@icnz.org.nz, or (04) 495 8008. We look forward to the outcome of this review process.

Yours sincerely,

Tim Grafton
Chief Executive

Nick Mereu
Legal Counsel