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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 New Zealand Productivity Commissions' Issues Paper 'Boosting productivity in the services sector.'

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 26 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. Role of Insurance Sector in the Economy

Insurance plays a fundamental role underpinning the economy and growth. As a risk management tool it encourages increased investment by reducing the capital businesses need to operate. It enables higher risk/return activities to support growth and through the investment of premium it supports capital growth in the wider economy. It also provides access to offshore funds through reinsurance, as evidenced following the Canterbury earthquakes, and saves taxpayers and the Government from provisioning entirely for catastrophe events.

For such a significant industry, the workings of the insurance sector are not well understood by government.

3. Impediments to Improved Productivity and Growth - Unnecessary Regulation

Q6 - What is the potential for improved productivity and growth in service industries that you are familiar with? What are the impediments to improved productivity and growth in those industries?

Q18 - Which service industries are significantly affected by industry-specific regulation? Are there opportunities for improvement?

The Insurance Council is concerned that unnecessary or confused regulation can act as a significant impediment to productivity and growth in service industries.

The insurance industry has been subject to a range of recent regulation which will have implication for the growth and productivity of insurers going forward. Often this regulation has been the result of poor consultation and limited understanding of the industry by government. We would encourage the Government to expend further resource into looking at ways to ensure effective consultation and regulatory development is undertaken.

3.1. Example of Ineffective Consultation

One recent example of limited consultation, which could significantly affect the industry, is in respect of unfair contract term (UCT) provisions introduced with the Consumer Law Reform Bill.

The proposed UCT provisions currently under consideration were introduced for the first time in the Bill as reported back from the Select Committee on 2 October 2012, meaning there was little, if any, consideration of the Unfair Contract Term provisions in respect of financial services. The provisions in the Bill, and their application to insurance contracts, were not fully considered or appreciated by the Select Committee, or government officials. Nor was there consideration at this early stage of the exemption for insurance contracts that currently exists in Australia.

The UCT provisions have the potential to produce significant unintended consequences for insurers, impacting on insurance affordability and potentially insurer solvency. These potential unintended consequences were repeatedly conveyed to government officials, but little has been done to address these concerns.

There is a general concern around the understanding of technical insurance matters within government as there are significant implications for the wider economy if regulation is developed which negatively affects the industry.

3.2. Merits Review Process

One particular initiative that should be considered by the Commission is the establishment of a merits review framework.

In Australia there is a merits review framework established under the Administrative Appeals Tribunal Act 1975. This Act established the Administrative Appeals Tribunal (AAT), a body that reviews a wide range of administrative decisions made by Australian Government ministers, departments and agencies, including some other tribunals.

This judicial arrangement enables an affected party to apply to the AAT to review, and potentially overturn, an administrative/regulatory proposal by a government agency. The AAT considers the material before it and decides what the correct or preferable decision is. It may affirm, vary or set aside the decision under review.

This initiative would help strengthen accountability around regulation-making powers and ultimately help drive productivity and growth in the services sector. The Government should also consider other potential initiatives, such as establishing an independent Office of Regulatory Review which could review proposed regulation and report on proposals at an early stage, to avoid unnecessary and over-burdensome regulation.

4. Barriers to Cross-Border Investment in Service Industries

Q13 - What barriers exist to cross-border investment in service industries? How do those barriers affect New Zealand service industries and the economy more generally? Are there opportunities to remove or reduce these barriers?

There could be significant productivity benefits in looking to align particular regulatory developments in the Australian and New Zealand insurance industries, to help drive cross-border investment.

Harmonisation for harmonisation's sake is not desirable; however, there are some particular areas in which regulatory harmonisation with Australia would benefit productivity and growth. Here are some specific examples where harmonisation would be beneficial.

4.1. Insurance Industry Regulation

There is some confusion with the current regulatory regime for insurers in New Zealand.

Australia effectively has two 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. By contrast, there is no clear single piece of regulation for market conduct for the insurance industry in New Zealand. We have a number of regulatory supervisors and a number of relevant pieces of legislation in respect of market conduct.

This fragmentation leads to inconsistent and sometimes inappropriate introduction of regulation. We also end up with confusion for consumers. This can act as a disincentive to investment in the industry as there is uncertainty around compliance and exposure.

4.2. Solvency Standards

The Reserve Bank of New Zealand's proposed solvency requirements could act as a barrier to cross-border investment.

New Zealand's proposed solvency requirements are completely out of synchronisation with Australia. We remain concerned with the level of capital required under the proposed New Zealand standard in comparison to the Australian APRA requirements. The difference in catastrophe risk profile between New Zealand and Australia is not so great so as to justify such a significantly different solvency requirement (Australia is currently required to purchase sufficient reinsurance to cover each 1 in 250 year event, whereas New Zealand will soon be required to purchase sufficient reinsurance to cover each 1 in 1000 year event).

We agree with the Insurance Council of Australia in that such stringent requirements will only serve to impede international competitiveness. Higher capital requirements will likely discourage investment in New Zealand and be a significant barrier to entry to the New Zealand market. The proposed 1:1000 requirement will make New Zealand a much less attractive place for international insurers to do business and will negatively impede the affordability and availability of insurance for all New Zealanders, inevitably placing greater burden on the state in the event of disaster.

4.3. Taxation/Levies

There are also potential cross-border investment issues associated with current taxes and levies applied to insurance contracts. It is imperative to have reductions in some of the current general levies and taxation to ensure that insurance remains affordable and to encourage investment in our industry.

The funding of the Fire Service should be switched from a levy applied to insurance to property rates or general taxation, rather than insurance (a shift of burden which has been recognised within Australia). Otherwise those with insurance are effectively cross-subsidising those without. This is an example of where New Zealand is lagging behind Australia in regulatory development.

Compliance costs are directly causing increases in insurance costs and so long as these costs continue there will be significant problems with under and non-insurance in New Zealand. There will also be implications for cross-border investment, as levies and taxes directly affect the cost of conducting insurance business.

4.4. Broker disclosure

There are potential issues associated with our lack of disclosure obligations for insurance brokers. New Zealand does not require any remuneration disclosure by insurance brokers, in complete contrast to the Australian regime, which is surprising given the potential conflict of interest around providing advice on the basis of commission received, rather than the client's best interest.

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 and, as a result, make better and more informed decisions. We have repeatedly conveyed these points to the government.

Government has indicated that work is needed in this space, but nothing in effect has been done to pursue implementation in the short-term. Not having mandatory disclosure leads to issues around affordability, transparency and trust. These issues will inevitably affect cross-border investment.

4.5. Summary

We certainly would not want to adopt all aspects of the Australian regulatory regime, as many regulations will be inconsistent with our own distinct market. Any harmonisation needs to reflect the size of our market and the fair balance of rights between parties. Finding this balance will again require close consultation with the industry.

It is important to note that our members rely on best practices from a number of similar jurisdictions, not just Australia, so it is important to have discussion with the industry on what other developments may benefit the industry. We trust the Productivity Commission is also looking at other regimes in terms of achieving its productivity objectives.

5. Further Analysis and Consultation

Q22 - What topics should be considered for in-depth analysis in Part B of the inquiry? In what ways do they meet the criteria in the Terms of Reference?

Q23 - With whom should the Commission consult?

We would encourage the Productivity Commission to specifically address the abovementioned concerns during its inquiry, i.e. establishing more effective industry consultation and a merit review process, and aligning particular regulatory developments with Australia to drive productivity and growth.

The insurance industry is noted as a high performing subsector in the Terms of Reference and it would make sense to focus on implications for such an industry. Addressing the above concerns would have significant benefit for our industry and would likely impact on New Zealand's overall productivity performance. There are also a number of concrete recommendations identified in this submission which could directly assist the overcoming of current impediments.

We would encourage the Productivity Commission to consult directly with all stakeholders in the services sector and in particular with the insurance industry which plays a vital role in the New Zealand economy.

6. Conclusion

Thank you again for the opportunity to provide input on the Issues Paper. The proposals are of significant interest to our members and we look forward to the next stage of review. 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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