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Dear Robyn

### **STRENGTHENING ECONOMIC RELATIONS BETWEEN AUSTRALIA AND NEW ZEALAND**

The Insurance Council of New Zealand ("the Insurance Council") appreciates the opportunity to comment on the Australian and New Zealand Productivity Commissions' Discussion Draft "Strengthening trans-Tasman Economic Relations."

In particular, we would like to comment on the following question, set out at page 130 of the Discussion Draft:

*"Q4.5 - How might further integration of trans-Tasman financial services take place? What are the likely gains from such integration?"*

#### **1. Insurance Council**

The Insurance Council is the industry representation body for fire and general insurance in New Zealand. We have 26 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. Our members fund the Insurance & Savings Ombudsman Scheme and we apply an Insurance Council solvency test that confirms the financial stability of our members. We perform an important role in informing and educating consumers about key insurance issues and risks.

A number of our members are part of groups which operate in both Australia and New Zealand. Accordingly, the Insurance Council supports initiatives that help harmonise regulation, where appropriate, and that drive economic growth. Nevertheless, it is imperative that differences in size and scope between the two markets are understood and appreciated when looking at harmonisation.

#### **2. Regulatory Harmonisation**

It is important to firstly recognise the significant differences between New Zealand and Australia's insurance markets and regulatory regimes. There are substantial differences in market size and scope between the two countries, meaning Australian regulations and market conditions may not be workable, or even appropriate, in New Zealand.

If the two respective Governments are seriously considering integrating New Zealand and Australia's insurance markets, they need to completely rethink these regulatory differences, particularly with respect to material differences in underlying liabilities (and the consequential changes in reserving practices) around licensing requirements, accident compensation schemes (ACC), catastrophe insurance models (EQC) and terrorism insurance schemes (Australian Reinsurance Pool Corporation).

### **2.1. Liability Differences**

The law within Australia is inconsistent between states and territories and again between those jurisdictions and at the Federal level. This can be seen, for example, in the way taxes and levies are imposed as well as the way personal injuries are assessed and compensated. There are also differences in liability thresholds and ranges of compensation for what may seem to be similar events. These differences lead to changes in how capital is reserved and managed.

Serious consideration would be required to fully appreciate what it is that is classified as "Australian" and alongside which New Zealand is expected to be consistent. Certainty would be needed to ensure longer term investment and lower friction, and to allow more open and smooth operations on a trans-Tasman basis. This would need to be a gradual process and would require close consultation with the insurance industry over time.

Despite the abovementioned differences, there are certainly some areas where further integration would be beneficial to New Zealand.

## **3. How might further integration of trans-Tasman financial services take place? What are the likely gains from such integration?"**

### **3.1. Regulatory - Solvency Standards**

One area in which New Zealand would benefit from further integration is in respect of solvency standards. The Reserve Bank of New Zealand's proposed solvency requirements are completely out of step with Australia.

The Insurance Council remains 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 certainly 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 is 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.

### **3.1.1. Likely gains from integration**

The New Zealand Government needs to seriously reconsider the current solvency requirements for New Zealand insurers. More pragmatic solvency standards would ensure that New Zealand remains an attractive place for international insurers to do business. It would also help ensure the affordability of insurance for New Zealanders going forward.

### **3.2. Broker Regulation**

New Zealand would also benefit from further integration around broker disclosure regulation. There is currently a serious mismatch between New Zealand and Australia with respect to regulation of insurance brokers. For example, New Zealand does not require any remuneration disclosure by insurance brokers, in complete contrast to the Australian regime.

Australia currently has mandatory remuneration disclosure requirements for brokers giving advice to “retail” clients (i.e. domestic lines for individuals and commercial lines for small businesses). The Corporations Act 2001 requires all sellers of insurance products to retail clients, including registered insurers and brokers, to disclose remuneration through a specific document known as a “Financial Services Guide” before giving advice.

Currently, broker disclosure requirements in New Zealand are much more limited, which is a pragmatic market approach. However, in the area of broker remuneration, there is no disclosure requirement whatsoever. The Insurance Council is concerned that not requiring disclosure of remuneration may have the following negative impacts on New Zealand’s insurance industry:

- continued lack of transparency for consumers regarding the real cost of insurance;
- no real incentive for brokers to ensure their recommendations are based on the client’s best interest, rather than based on the level of commissions received by the broker; and
- falling short of best international practice.

### **3.2.1. Likely gains from integration**

Moving towards the Australian model of disclosure would ensure market integration benefits and enhanced transparency. Disclosure of remuneration would provide a higher level of transparency and allow New Zealand customers to be aware of the level of fees and commissions they are paying and, as a result, make better and more informed decisions.

## **4. Taxation/Levies**

New Zealand would also benefit from reductions in some of the current general levies and taxation placed on insurers (i.e. the fire service levy and the earthquake levy), to ensure that insurance remains affordable and available for a significant proportion of New Zealanders. Otherwise, New Zealand again risks falling behind Australia.

Insurance taxes are both inefficient and inequitable. In some instances, taxes on insurance products can amount to around 30 or 40% of the entire insurance premium, seriously affecting pricing and subsequent consumer choices.

Costs for the fire service levy, for example, should correspond with 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.

#### **4.1.1. Likely gains from integration**

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.

Removing inefficient and inequitable insurance taxes would ensure that New Zealanders are able to remain well insured and would, at the same time, reduce crown liabilities.

## **5. Conclusion**

Thank you again for the opportunity to provide input on the Discussion Paper. The proposals are of significant interest to our members.

Yours sincerely

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