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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 Productivity Commission's First Interim Report on 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 27 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. Stimulating Services Competition

Q 8.1 – Which… topics rank most highly in relation to the selection criteria in the inquiry terms of reference?

We believe the topic *Stimulating Services Competition* would rank most highly in relation to the selection criteria identified. This topic has the greatest potential to impact on New Zealand's overall productivity performance and lead to concrete recommendations for change to government policy.

We provide two such recommendations for change below. These changes relate specifically to the insurance industry but there are a number of core industries which would benefit from similar change.

Market Attractiveness

The New Zealand insurance market could become more competitive for existing and new participants by removing obstacles to productivity, making the market more attractive.

As highlighted in our previous submission, the level of capital insurers are required to hold under the Reserve Bank's Solvency Standard can impede international competitiveness (Australia is currently required to purchase reinsurance under its solvency standards to cover each 1 in 250 year catastrophe event, whereas New Zealand will soon be required to purchase sufficient reinsurance to cover each 1 in 1000 year event). These significantly higher capital requirements discourage investment in New Zealand and make the market less attractive for new entrants. This inevitably affects competition and impedes the affordability and availability of insurance.

Current taxes imposed on insurance products act as a further disincentive to participation in the New Zealand market. Taxes on voluntary products, such as insurance, are inherently inefficient and inequitable. They artificially increase the cost of insurance, leading to higher rates of under and non-insurance and reduced size and profitability of market. This will inevitably lead to a less competitive market as fewer players are encouraged to participate. The government could address this issue by undertaking considered review of inefficient insurance taxes such as the Fire Service Levy (as has been undertaken in Australia).

Burdensome regulations, levies and taxes directly affect the cost of conducting business for a number of industries in New Zealand. The effect of this can already be seen in the movement of some insurance companies towards centralising operations offshore. Addressing these compliance costs would provide the government with a real opportunity to stimulate competition.

Clarity of Regulatory Framework

Competition between services is stimulated by providing a level playing-field. Having a clearly defined regulatory framework, for both existing and potential market participants, is essential to a level playing field.

New Zealand's current regulatory regime for insurance is fragmented and unclear. For example, New Zealand has a number of regulatory supervisors and relevant pieces of legislation with respect to insurance market conduct. This fragmentation clouds the operating environment for existing players and doesn't promote ease of entry for new players. It also ends up with confusion for consumers.

By contrast, Australia has two distinct 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 (administered by ASIC). The Government's proposed Insurance Contracts Bill will go some way towards promoting a single piece of regulation for market conduct in New Zealand, but there needs to be a similar move towards establishing a single regulator to administer that policy.

A clear and unequivocal regulatory framework would provide a more level playing field and encourage investment in New Zealand's insurance industry, leading to greater competition.

3. Government's role in Information asymmetries and switching costs

Q 8.9 - Is there a role for government in further provision of consumer information and switching tools? If so, in which markets?

As noted above, the government can play a key role in stimulating services competition. Below we outline two specific ways in which government could assist competition, by promoting greater availability of information for consumers, ensuring consumers are able to make more informed decisions.

Understanding of Insurance Framework

The insurance industry is a complex one in terms of the options available to the consumer.

The consumer has access to a variety of distinct commercial and consumer products, available either directly from the insurer or through an intermediated agent. The product can be bought from either an onshore or offshore insurer and for numerous different risks.

The industry can also be complex with respect to consumer remedy, with differing pieces of market conduct regulation (i.e. the Fair Trading Act, the Financial Markets Conduct Bill, rules relating to financial advisers under the Financial Advisers Act, and the Unfair Contract Term provisions in the Consumer Law Reform Bill) and a number of different resolution or complaint channels (internal dispute committees, external dispute resolution services, FMA, MBIE, small claims tribunals and courts).

Co-ordination of at least the market conduct regulation side of things is needed to provide certainty and clarity for insurers and their consumers. However, this amalgamation also needs to be aligned with greater education by government.

Government needs to undertake a more active role in promoting financial literacy, so that all New Zealanders have a better perception of financial matters and a more fundamental understanding of risk. This is crucial to developing a more astute consumer base and reducing information asymmetries. This will ultimately lead to enhanced competition as consumers become more technically aware of what product best suits their individual needs.

Switching Tools

Insurers would be concerned if government were to develop switching tools for insurance products. While the Insurance Council acknowledges the benefit of such tools for some consumers in the electricity sector, these tools would not provide the same benefit for consumers of differentiated products such as insurance policies.

There would be a major risk that if a price comparison tool was established for insurance that consumers would focus solely on price as opposed to the detail of what the cover and risk is. Decisions made solely on price could lead consumers to be less aware of their cover and more vulnerable should disaster strike if the cover is not adequate for their specific needs.

As discussed above, government needs to instead ensure that consumers have a better understanding of risk, so that they can be more aware of what insurance product best suits their individual needs.

Transparency around Cost

If there is no transparency around the cost of a transaction, then it becomes very difficult for the customer to make appropriate decisions on which is the most cost effective solution for them.

With respect to insurance, 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. However, currently New Zealand does not require any remuneration disclosure by insurance brokers.

This means there is effectively no legislative incentive for brokers to ensure recommendations are based on the client's best interest, rather than the level of commissions received. Similar concerns existed with financial brokers prior to the implementation of FAA disclosure requirements, however no disclosure obligations have been forthcoming for insurance brokers.

If brokers were required to disclose what the underwriting premium is and be clear as to which amounts are fees, commissions and other charges, then there would be a much more informed consumer base. Government needs to develop similar compulsory disclosure requirements to Australia, through insurance specific legislation.

4. Conclusion

From our perspective, undertaking a robust analysis of *stimulating services competition* would provide the greatest opportunity to enhance productivity in the services sector. As outlined above, there are clearly a number of policy initiatives that could be undertaken to promote greater competition.

We will very much look forward to seeing the results of the interim report. 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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