

# IAG Submission on the Regulatory Institutions and Practices Draft Report

8 May 2014

## Introduction

IAG welcomes this opportunity to provide views on the Productivity Commission's (the Commission) Draft Report (Report) for its Inquiry into Regulatory Institutions and Practices.

IAG's focus in making this submission is to support the Commission's view that significant change is needed to improve the quality of regulation in New Zealand. The matters discussed in this submission represent our views and observations as a business subject to both economy-wide and sector-specific regulations.

Our submission is divided into two sections. The first section provides some high level, general comments on the Report. Overall, IAG considers that the Report contains insightful analysis of the New Zealand regulatory system. We encourage the Commission to ensure that its analysis is translated into tangible recommendations. IAG considers that effective recommendations are necessary if the important insights contained in Report are to be captured and utilised.

In the second section we comment on a number of specific issues where we believe further consideration and analysis is warranted. We also make specific recommendations for improving the quality of regulation in New Zealand on a system-wide basis.

We are happy to speak with the Commission or provide more detail on any of these points if that would assist the Commission as it looks to finalise its recommendations. IAG's contacts for matters relating to this submission are:

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## Summary

Overall, IAG considers that the Report contains insightful analysis of the New Zealand regulatory system. The Report is comprehensive in scope, and will be useful for informing the debate on improving regulatory quality in New Zealand.

One general observation IAG has is that the Report needs to ensure that it has the potential to promote meaningful change. In a number of sections in the Report, the Commission's analysis is not used to support tangible recommendations for improvement of the regulatory system. In other places, the link between the Commission's analysis and its recommendations is not altogether clear. At a high level, we believe that a greater emphasis on effective recommendations is needed in the final report if the insights to be drawn from the Commission's analysis are to be captured and utilised.

Against the background of that general concern, IAG also has a number of specific comments. To that end this submission addresses the following points:

- improving regulator culture;
- effective consultation and engagement;
- judicial review and accountability; and
- system-wide issues of regulatory capability.

We also address some more minor matters.

## Recommendations

In summary, our specific recommendations for improving the New Zealand regulatory system are:

- to develop a Performance Improvement Framework (possibly undertaken by the State Services Commission) specifically tailored for the needs of regulators;
- to promote more regular, and earlier, informal engagement between regulators and interested parties;
- to establish a Parliamentary Commissioner for Regulation (modelled on the existing office of the Parliamentary Commissioner for the Environment); and
- to update the Cabinet Manual to expressly account for the regulatory responsibilities of the executive branch of government.

We also recommend that the Commission investigate:

- ways of improving role clarity for regulators; and
- ways of providing feedback received as a result of the Commission's consultation directly to regulators and officials with regulatory responsibilities.

## General comments

IAG welcomes this opportunity to provide views on the Report. Overall, we consider that the Report makes an excellent contribution to the debate and discussion regarding how regulatory quality can be meaningfully improved in New Zealand.

Specifically, IAG considers that the Commission's Report contains insightful analysis of the New Zealand regulatory system. The Report is comprehensive in scope, and in our view most of the issues that impact on regulatory quality have been addressed thoroughly.

One general observation IAG has is that the Report needs to ensure that it has the potential to promote meaningful change. The Commission's reasoning and analysis is in many places robust and compelling, and by and large we support it. However, in our view it is not always apparent that the recommendations advanced by the Commission are sufficient to link the Commission's analysis to realistic options for positive change.

For example, in a number of sections in the Report, the Commission's analysis is not used to support any tangible recommendations for improvement of the regulatory system. The chapters on "Regulatory Culture and Leadership" and "Consultation and Engagement" contained much useful analysis, but did not result in the Commission making any specific recommendations. In other cases, the link between the Commission's findings and recommendations was not apparent to us. The chapter on "Role Clarity", for instance, could benefit from greater clarity in how the Commission's specific recommendations address the issues its analysis has revealed, in our view.

At a high level, we believe that a greater emphasis on effective recommendations is needed in the final report if the insights to be drawn from the Commission's analysis are to be captured and utilised. This is not intended to detract from the Commission's analysis, but to build on that analysis so that meaningful improvement in regulatory quality can be achieved.

## Specific comments

In this section, we address a number of specific aspects of the Report. Our focus is on:

- improving regulator culture;
- effective consultation and engagement;
- judicial review and accountability; and
- system-wide issues of regulatory capability.

### **Regulator culture**

In IAG's view, good regulatory practice is contingent on good culture within the regulator. We are encouraged that this issue has received significant attention in the Report.

*Regulator culture needs to be different, because regulators are different*

We observe a mix of evidence about the culture and leadership within the regulators we deal with. A key concern we have is that regulators do not always see themselves as discharging a distinct function. Where regulators have a self-perception that is similar to that of traditional bureaucrats, this may give rise to a culture of hierarchy, high levels of risk aversion, formal, rule-driven processes and exclusive focus on particular areas of policy.

This type of culture is particularly harmful in a regulatory context. Regulators need a different culture from other parts of the bureaucracy because the nature of their function can be, and often is, very different. In particular:

- Regulators cannot have a culture of strict hierarchy because they are required to engage directly with stakeholders as well as political superiors. This is reflected in the political independence of many regulators, but more needs to be done to secure cultural change from the inside.
- Regulators cannot afford to be highly risk averse, because virtually all regulation is untested before it is applied to specific market circumstances. Regulators need the skills to manage risk and policy uncertainty in an ongoing way.
- Regulators cannot be rule-driven, because only the minimum requirements can be established by rules. Good or best practice regulation needs to go beyond statutory requirements to establish what is effective in particular circumstances.
- Regulators cannot treat regulation as an isolated matter of policy. Rather, they must be aware of the (dynamic) commercial context in which regulation is required to apply. Also, regulators need to be sensitive to feedback and self-generated learning so that “fast failures” can be used to build successful regulatory practice.

*Regulators can usefully draw on private sector tools*

These type of considerations put regulatory culture into important perspective. In many respects, these features of the nature of the regulatory function align more closely with the private sector than other parts of the public sector.

There is a need to draw on learnings in the private sector. There are a number of tools and approaches available, but IAG would emphasise certain features that in our experience are essential for success:

- Change needs to come from the top down. The chief executive or equivalent of a regulator needs to be given explicit responsibility for managing the culture of a regulatory organisation, and held accountable.
- Assessable requirements need to be built into individual performance assessments. Specific KPIs around the traits and soft skills that promote a better regulatory culture need to be measured and assessed. This avoids the promotion of a strong rhetorical approach to culture that is never translated into practical outcomes.
- There needs to be some consequence for (lack of) performance. Principally, the chief executive’s level of remuneration ought to be in part

based on the achievement of KPIs relating to regulator culture. These KPIs are likely to be different for an organisation depending on its stage of development.

#### *Recommendation*

IAG recommends the development of a Performance Improvement Framework that is tailored specifically for public entities (or divisions within public entities) that perform regulatory functions. The State Services Commission already applies a framework for the public sector generally, but there is a strong need to take into account the distinctive functions, powers and responsibilities of regulatory decision-makers.

#### *Benefits*

In our view, the benefits would include:

- measurable standards to increase accountability for the development of an appropriate internal culture;
- mitigating the effects of path dependency by encouraging flexibility and responsiveness in regulatory implementation;
- a drive towards internalising monitoring, evaluation and self-improvement processes; and
- real incentives to focus on long-term direction and achievement, rather than sacrificing overall quality to address immediate concerns.

We reiterate that these benefits are only likely to be secured if any such framework draws on private sector tools and processes for developing regulator culture.

### **Consultation and engagement**

Chapter 8 of the Report is concerned with consultation and engagement. We broadly support the Commission's distinction between those two concepts. In particular, we believe it is useful to focus on engagement as a wide range of interactions between regulators and stakeholders. Frequent, ongoing engagement lies at the heart of the regulatory function. Formal or informal consultation mechanisms are part of, but cannot substitute completely for, an effective culture and practice of wide and relevant engagement.

#### *Strong need for effective engagement*

In our submission on the Commission's issues paper, we noted that the benefits of effective engagement include improved regulator accountability, better information flow (regulator to stakeholders and vice versa), and enhanced credibility. We reiterate those sentiments. In this submission we focus on practical ways to achieve more engagement by regulatory decision makers.

Effective engagement is essential to securing the quality of everything a regulator does. The need for effective engagement in a regulatory context is heightened compared to other bureaucratic policy-making processes for two reasons:

- regulation impacts on specific stakeholders directly; and
- the nature of regulation often means that elements of policy design and implementation are developed simultaneously.

Effective engagement with affected parties is therefore necessary to predict the effects of regulation, review the quality of decision-making processes and success of outcomes, and to manage regulation on an ongoing basis.

#### *Engagement perceived to be a burden*

Given these dimensions of the regulatory context, we would expect a high level of effective engagement from regulatory decision-makers on an ongoing basis. However, regulators can at times appear to display a preference for avoiding engagement with regulated entities and other stakeholders. Consultation and engagement can be perceived as an additional and possibly unnecessary burden placed on the regulator that inhibits its ability to regulate effectively. This view stands in contrast to the reality that effective engagement is essential to the regulatory function.

Where this perception exists within regulators it can create two types of issues:

- formal (eg, statutory) requirements are treated as maximum requirements, rather than the starting point for effective engagement; and
- there is little willingness to engage outside of formal process (eg, where a formal decision is contemplated).

Such issues risk engagement being treated as a “tick the box” exercise that is carried out only when required.

#### *Lack of transparency a key concern*

One practical outcome of a minimalist approach to engagement can be a lack of transparency in the decision-making process. Some regulators seem to consider that consultation processes are solely for the benefit of the regulator, and affected parties have no valid interest in the effectiveness of those processes.

The reality is that consultation, like regulatory engagement generally, is a two-way process. This necessarily requires a high degree of transparency in regulatory decision-making.

In our previous submission, we outlined the specific benefits of transparency in regulatory decision-making. We are concerned, however, that these benefits are not being realised in practice.

One particular area of concern is that regulators do not always reveal the reasoning behind their decisions. In our view this is poor process that can lead to poor outcomes, but it also impacts on the legitimacy of regulatory decision-making. While there is generally no legal obligation on a regulator to give reasons (unless provided for expressly by statute), unsupported decisions raise concerns of arbitrariness or caprice as they undermine the principles of natural justice.

In our experience, demonstrating the reasoned nature of regulatory decisions:

- concentrates the mind of the regulator on the relevant issues;

- demonstrates to interested parties that their views and evidence have been considered and understood;
- enables it to be readily ascertained whether there are any grounds for appeal or complaint;
- enables a reviewing body to determine whether the decision is correct or supportable; and
- informs a body of precedent so that future decisions can be predicted.

Only a culture of openness that sees engagement with stakeholders and interested parties as an essential part of the regulatory process will be successful in promoting these beneficial outcomes in the absence of a legal duty to be more consultative, engaged and reasoned in decision-making.

#### *Recommendation*

IAG considers that greater focus needs to be placed on the more ‘informal’ means of engagement. For that reason, we recommend that the Commission investigate:

- ways to encourage greater systemisation (and quality) of informal consultation, including monitoring of efforts to engage stakeholders; and
- ways to promote the exposure of regulatory proposals at an early stage, such as through issues papers or thought pieces, that engage stakeholders before controversial proposals are tabled.

In our previous submission to the Commission, we noted that at a high level there are five different means of engagement. Following our consideration of the Report, we consider that a particular focus on the first two mechanisms on that list – informal consultation and exposure of regulatory proposals – deserve particular emphasis. Encouraging a greater appreciation of the benefits of ongoing, informal engagement is what is most needed to improve prevailing practices.

#### *Benefits*

IAG considers that two benefits are likely to flow from this focus on better and more frequent use of informal engagement mechanisms. First, it will encourage regulators to think about engagement at an informal level, which in turn promotes engagement on an ongoing basis outside of formal decision-making. Consultation and engagement becomes part of the regulator’s core function, and not simply an adjunct to a process that results in a formal decision.

Second, better informal engagement is likely to result in improved use of formal consultation mechanisms. Both regulators and stakeholders are likely to be better informed of the market and regulatory context if informal consultation occurs frequently. Further, each party may have a better appreciation of each other’s roles and concerns. We would encourage, for example, one week secondments for regulator staff with key stakeholders (similar to the Parliament Business Trust’s programme for MPs) to build a broader knowledge base of the context in which regulation is required to operate.

## Judicial review and accountability

Chapter 10 of the Report suggests that the Commission has developed quite a strongly held view that judicial review of regulatory decision-making works well. IAG considers that this conclusion is open to question. In particular, we believe that there are a number of practical impediments which mean that judicial review is not an effective accountability mechanism for regulatory decision-making. Other means for securing regulatory accountability are needed.

### *The key consideration is effective regulatory accountability*

In the context of the current Inquiry, we consider that judicial review should be seen as part of the broader accountability framework for regulatory decision-making. It should not be considered in isolation.

Viewed in this way, we consider that judicial review does not do a good job in practice of satisfying the criteria for effective regulatory accountability. It has a number of shortcomings from a regulatory management perspective. These concerns are based primarily on our observations of judicial review, and are supported by the theoretical evidence on the role of judicial review and the effectiveness of regulatory accountability mechanisms.

We emphasise that we are not questioning the merits of judicial review in a general, non-regulatory sense. Judicial review is an important restraint on administrative power generally and is constitutionally significant under New Zealand's system of government. In terms of securing a higher degree of legitimacy for government decision-making generally, we agree with the Commission that judicial review is well attuned to its primary task.

### *Specific issues with judicial review*

In practice, IAG considers that judicial review exhibits the following shortcomings as an effective accountability mechanism for regulatory decision-making:

- Judicial review is prohibitively expensive in many cases.
- Pursuing judicial review is a high risk strategy, as the outcome is very difficult to predict even for experienced practitioners.
- Review only arises as the result of an interested party deciding to take action, and so is inherently damaging to the relationship between the regulator and the parties it regulates. As a result, review does not always occur when there is evidence to support a challenge to regulatory decision-making.
- The purpose of judicial review is to legitimise the use of executive authority, not promote the quality of regulatory decision-making. This is reflected in the substance of the courts' inquiry, which is focused on process values rather than the achievement of social goals that lie at the heart of regulation. It is also reflected in the fact that the courts are reluctant to closely examine the merits of a decision, unless superficially required to by an appeals regime.
- Judicial review carries a myopic focus on a single regulatory decision, rather than seeking to understand whether any failure of process is symptomatic of the regime under which the instant decision is made.

- The empirical research suggests that judicial review has very little effect on bureaucratic behaviour in practice. This may be because it is concerned with specific decisions, and there is little scope to establish a precedent that applies across a number of regimes. This is of concern in a regulatory context, where feedback and self-improvement are key to the successful implementation of a regulatory initiative or regime.
- From an economic perspective, the rationale underlying regulation is dissatisfaction with the efficiency of court room disputes as a means of controlling business conduct. To rely on judicial review as the primary means of securing regulator accountability necessarily imports into the regulatory system many of the significant costs and inefficiencies that regulation is intended to avoid.

Of course, despite these concerns, judicial review should be retained as a backstop when a party feels other avenues have been exhausted, and it continues to play an important role in respect of constitutional propriety. But if it is relied on as the key means of securing regulatory accountability, then the regulatory quality is likely to suffer.

#### *Criteria for alternative accountability mechanisms*

The shortcomings of judicial review in the regulatory context mean that alternatives for securing effective regulatory accountability are necessary. In our view, one of the key requirements for an alternative accountability mechanism is that it is responsive to the needs of a regulatory system in the ways that judicial review is not.

This suggests the following criteria for any effective accountability mechanism:

- it assesses the success of regulation in terms of the achievement of the particular social goals regulation is intended to achieve;
- it opens up assessment to the entire regime or regulatory system, rather than focusing on individual decisions (although of course failures in individual decision making may be treated as symptomatic of broader structural issues);
- it must be effective in actually influencing bureaucratic behaviour; and
- it treats regulation as a distinctive function of government, rather than a standard bureaucratic process.

In some cases, specific appeal rights may satisfy these criteria, although we take from the Commission’s analysis that it has little appetite for this alternative. If that is the case, then another approach is to investigate administrative accountability mechanisms. The challenge with administrative accountability mechanisms is to ensure they have the “teeth” to be effective in practice. The findings of the responsible institution must therefore be taken seriously by regulators, but also influence political and policy decision-making that impacts on regulatory quality.

#### *Recommendation*

IAG recommends establishing an officer of Parliament with responsibility for regulatory quality. This “Parliamentary Commissioner for Regulation” would be

modelled on the Office of the Parliamentary Commissioner for the Environment due to the relevant similarities in the contexts in which each Commissioner would be required to operate, which include:

- dealing with controversial matters that cut across government policy objectives;
- ensuring that issues of environmental/regulatory quality are appropriately considered in a politically neutral manner;
- developing expertise, and creating a body of precedent that can apply across a number of policy areas and regimes; and
- remaining staunchly independent, which will carry significant influence from the level of Cabinet on down through the regulatory management system.

The establishment of a Parliamentary Commissioner for Regulation would act as an important complement to other administrative checks. For example, the Regulations Review Committee is limited in both scope (its focus is on government regulations, deemed regulations and bylaws) and resourcing. This reflects its nature as an ad hoc Select Committee with the primary task of responding to specific complaints.

A Parliamentary Commissioner for Regulation would allow a focus on tertiary legislation (where significant regulatory discretion is often exercised), would be staffed by experts that would develop experience and precedent over time, and would be able to use a specific complaint as an avenue for deeper investigation into specific regulatory regimes or practices where required. In short, it would provide a more systematic and accessible mechanism for securing accountability.

As a result of this improved accountability, Ministers with responsibility for regulatory matters will likely face political pressure to respond to a wider range of perceived regulatory failings. For example, the Regulatory Reform portfolio would likely take on greater prominence, possibly being given as the primary responsibility of a senior Cabinet member. The current political arrangements leave a gap between the Regulations Review Committee and specific Ministerial responsibility, particularly with respect to systemic failings. A Parliamentary Commissioner for Regulation would go some way towards filling that gap.

### *Benefits*

The benefits of a Parliamentary Commissioner for Regulation include:

- an ability to undertake political and policy neutral review that remains sensitive to the social policy goals that motivate particular regulatory regimes;
- a systemic approach to the review of regulation, rather than a myopic focus on one-off error correction of individual decisions;
- accessibility for a range of affected parties, as anyone can write in bringing particular issues to the Commissioner's attention;
- a clear mandate to address chronic regulatory failure that may not be sufficiently acute to attract political attention;

- recognition that there is a strong element of political accountability needed to ensure the ongoing quality of regulation;
- a graduated option between appealing to the regulatory decision-maker directly and the 'nuclear option' of judicial review; and
- political (rather than legal) scrutiny that creates incentives for regulators to pursue good regulatory practice, rather than focus on satisfying minimum (legal) obligations.

### **Capability of the regulatory management system**

The Commission's systemic approach to the issue of regulatory quality usefully highlights that regulators are not the only entities with significant responsibilities in the regulatory system. Politicians, policy officials, advisors and judges all have an important role to play in ensuring the overall quality of the New Zealand regulatory management system.

This is reflected in a number of the specific recommendations made by the Commission in the Report. Under these recommendations, responsibility for achieving a meaningful improvement in regulatory quality falls on a number of parties that may not usually or exclusively be associated with regulatory outcomes.

IAG's concern is that the institutional capability of these officials and bodies should not be taken for granted. The same level of scrutiny that applies to those with direct responsibility for regulatory decision-making (ie, regulators) needs to be applied to those with broader responsibilities for quality within the regulatory 'eco-system'. The need to ensure quality from a regulatory perspective may even be greater, as politicians, officials and judges are all likely to have a range of responsibilities and not necessarily have particular expertise in regulatory matters.

#### *Key concerns*

IAG has a number of concerns with the overall management of regulatory quality in New Zealand, which extends beyond the remit of individual regulators. These issues include:

- No incentives to address chronic rather than acute regulatory failure. Attention on specific regulatory issues arise only in the event of serious failure.
- No responsibility to ensure regulators receive adequate funding, or that funding mechanisms are appropriate given the nature of the regulation (industry affected and powers conferred).
- A focus on the review and accountability in respect of specific outcomes, rather than regulatory processes and regimes generally. Further, regulator independence may afford an opportunity for those with political responsibility for regulation to attribute responsibility to the regulator for a particular outcome, rather than accepting responsibility on a system-wide basis.

In our view, these issues largely stem from a lack of accountability within New Zealand's wider regulatory management system. Only initiatives that address the

capability of the regulatory management system as a whole will be able to promote meaningful change.

#### *Recommendation*

IAG recommends that the Cabinet Manual be updated to specifically address the regulatory functions of government and outline at a high level the responsibilities of Ministers. This is likely to have a number of benefits:

- symbolic recognition of the importance of regulation with the framework of government powers and responsibilities;
- the potential for responsibility for regulatory matters to be taken seriously by giving the portfolio to a senior member of Cabinet as his or her primary responsibility;
- acknowledgement of the need for political accountability for regulatory frameworks; and
- promotion of top-down and system-wide responsibility for regulatory processes and outcomes.

#### **Other issues**

There are two final issues in respect of which we have additional comments.

#### *Role clarity*

A lack of role clarity between regulators is an ongoing and significant issue. We have seen this demonstrated again recently with the Commerce Commission and the Financial Markets Authority entering into an MOU to clarify their respective jurisdictions and obligations. That regulators feel they must enter into MOUs to 'clarify' their respective roles and responsibilities is evidence of a failing on the part of policy and legislative design. This is likely to be symptomatic of broader issues of regulatory design and confusion over the purpose of regulatory regimes right from the moment of initial development.

We encourage the Commission to investigate this area further, with a view towards making more specific recommendations to address this issue. While we support the idea of greater use of exposure drafts for new legislation, what is needed is specific, tangible guidance that can be followed to ensure that overlap or ambiguity in responsibility for regulation can be avoided.

#### *Take opportunity to provide information gathered to regulators*

The Commission has, through the course of this inquiry, received a large amount of information and insight on the current workings of regulatory processes. This information is of relevance generically but also in respect of specific regulatory regimes. IAG considers that it would be beneficial to make use of this information by providing it informally to regulators and others currently involved in regulatory decision-making. Given the excellent work of the Commission to date in collecting and collating this information, it would be unfortunate to miss an opportunity to potentially improve regulatory quality on an informal basis.