NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Productivity Commission

on the

Regulatory Institutions & Practices Issues Paper

31 October 2013

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Submission by the New Zealand Bankers' Association to the Productivity Commission on the Regulatory Institutions and Practices Issues Paper

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

2. The following fourteen registered banks in New Zealand are members of NZBA:

   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited, and
   - Westpac New Zealand Limited.

   If you have any questions about this submission, or would like to discuss any aspect of it further, please contact:

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Executive Summary

3. NZBA welcomes the decision by the Productivity Commission to undertake an inquiry into regulatory institutions and practices.

4. NZBA submits that quality regulation is essential to an efficient and well-functioning economy. Poorly conceived and implemented regulation can significantly hinder innovation, productivity and ultimately economic growth.

5. It is an unfortunate reality that too many of New Zealand's regulatory regimes are poorly designed and executed, and despite the best efforts of successive Governments continue to fail to deliver better policy outcomes.

6. We hope the Productivity Commission inquiry results in the establishment of clear and enforceable best practice regulatory guidelines for government organisations, and identifies areas for improvement in existing regulatory regimes which will improve future outcomes.

7. We have structured our submission by examining six key areas that we have identified as needing major improvement. This list is not exhaustive but rather an attempt to highlight the most common issues we encounter.

8. For obvious reasons the case studies we have used in our submission are focused on financial sector regulators, but we would note that the issues identified are not unique to this sector and are commonplace amongst many regulators.

Key points

Meaningful regulatory guidelines

9. In our experience more often than not current regulatory guidelines, such as the Government's 2009 statement on "Better Regulation, Less Regulation" and the Treasury's Regulatory Impact Analysis Handbook are not followed or attract only cursory attention. It appears that these guidelines, although well intentioned, are treated as political 'window dressing' rather than practical advice for officials to follow when developing policy.

10. This has meant the quality of regulatory process documents such as Regulatory Impact Statements (RIS) vary considerably, often resulting in poor quality regulation. For a regulatory regime to be successful it must address a defined problem and present achievable outcomes. Yet too much regulation is being produced that does not even follow this simple process.

11. Regulatory intervention is usually costly. It should generally be a measure of last resort, once all other more cost-effective options have been exhausted. There must also be a clear case of significant market failure and benefits of intervention that will clearly exceed the costs.

12. An example of a recent failure to follow regulatory guidelines is the decision to include significantly amended unreasonable fees provisions in the Credit Contracts and Financial Services Law Reform Bill, which is currently being considered by the Commerce Select Committee. Officials have been unable to produce a problem definition which explains the reason for introducing these new provisions and have not undertaken any cost benefit analysis in relation to these provisions.

13. While the Government has rightly recognised the importance of regulatory reform in building a more productive and competitive economy, it has failed to take the critical step of ensuring that not only are regulatory incentives and resources sound, but also that the any decision to regulate is firmly based and the quality of regulation improved.

14. The existing regulatory guidelines are admirable in their intent. However, they are largely meaningless in their current somewhat toothless state. In our view, it is imperative that the enforceability of the guidelines is strengthened in order to avoid the development of further regulation such as the unfair contract provisions that fail to comply with even simple regulation making guidelines.

15. One obvious immediate step in this area advocated by Business NZ and supported by the NZBA is for the Productivity Commission to revisit the Regulatory Standards Bill. This Bill has been significantly watered down from the original Regulatory Responsibility Taskforce Report to a position where it is now proposing a regime likely to be far less effective in improving the quality of regulatory decision-making.

16. This represents a potential lost opportunity to implement a sound regulatory process. As such we would encourage the Productivity Commission to consider how the Bill can be improved to better reflect the intent of the original work of the 2009 Taskforce.

Improved engagement

17. NZBA submits the broad relationship between the public and private sectors is a key feature requiring analysis when looking to improve regulatory institutions and practices. Engagement with regulated businesses by regulators needs to be early and meaningful. This engagement should be both formal and informal, as circumstances require.

18. The need for meaningful engagement is even greater when the regulator has wide discretionary powers and a high level of statutory independence. Such regulators provide few to no ‘appeal’ options for affected parties and there is limited oversight of their decisions. Therefore it is vital that organisations captured by the regulation are engaged with extensively from an early stage so that their feedback can be taken on board by the regulator.

19. Unfortunately it is NZBA’s experience that the opposite approach is often the case. Regulators frequently appear to view engagement as a ‘box ticking’ exercise rather than a genuine effort to gain feedback, timeframes for the engagement process are

often unworkable, and in general consultation practices run counter to the expectations set out in the Government statement on regulation.

20. In our experience when consultation or engagement is undertaken, it may lack the robustness that should be expected from policies that can have major impacts on the affected industry. In spite of on-going requests to regulators for more effective dialogue, consultation is seldom signalled well in advance, and the industry is often caught off-guard with the release of consultation documents.

21. A recent example of this was the Consultation Paper on Housing Capital requirements issued by the Reserve Bank. The paper was released on 26 March and submissions closed on 15 April, giving banks just over three weeks to respond, during a period in which three of the four banks being consulted would have been working on half yearly reporting. Furthermore, it was one of four papers released in a three-week period, most of which required the same staff members to respond, causing practical difficulties for banks.

22. Of even more concern, NZBA has encountered regulation being presented in near complete form, with little interaction with impacted entities beforehand. A recent example of this was the process for introducing Open Bank Resolution by the Reserve Bank, where the consultation by the regulator with the banking industry arguably only started after the policy had been set.

23. Overall, we believe that a step-change in engagement with stakeholders by regulators is perhaps the biggest single improvement that could be made by our regulatory institutions. An open, free, and meaningful exchange of views is absolutely essential to regulation working productively and well for all parties.

Strengthened regulatory accountability and transparency

24. Closely connected to the need for more meaningful engagement is the need for increased accountability and transparency from regulators.

25. In accepting the significant powers that regulators have, it is essential that there is transparency in their actions and formal accountability. This need is even greater when the regulator has statutory independence and limited oversight. Ultimately accountability and transparency act to sharpen the incentives on regulators to perform well and also work in the regulators' interest by enhancing their ability to defend their actions against criticism.

26. Regulators by their very nature have significant and widespread powers over the relevant sector. This acts as natural deterrent to constructive criticism of a regulator. Accordingly, robust, formalised accountability and transparency requirements for regulators are essential.

27. In NZBA's experience there is a clear need for a greater level of substantive accountability in order to hold regulators to account for the effects of their activities,

and whether these activities contribute to the desired outcomes of a regulatory regime.

28. A recent example of a lack of substantive accountability in regulatory decision is the move by the Reserve Bank to impose loan-to-value ratios (LVRs). In making this policy decision the Reserve Bank has not provided detailed information on what the criteria will be for removing the restrictions, has not explicit provided criteria by which it will assess whether the policy has been effective or not, and has not provided any information of whether or how the regulation will be reviewed.

29. Another example of a lack of accountability and transparency in a regulators' actions was the process taken by the then Ministry of Economic Development (MED) in deciding the levy structure to be placed on industry to fund the newly formed Financial Markets Authority (FMA) in 2011.

30. With little warning MED issued a brief proposal which was heavily criticised by industry participants. Little rationale was provided by MED as to how they arrived at this model and the justification for imposing disproportionate costs on large banks, who were already prudentially regulated and least likely to require FMA attention. Despite extensive feedback from the many different industry participants on how the proposal could be made more equitable, the regulator did not accept or address any challenge to the principles upon which the levy allocation was based.

31. The approach taken by the regulator had minimal transparency and accountability and this is unacceptable in the development of a policy that resulted in significant costs being imposed upon the regulated organisations.

Clarity of regulator role and objectives

32. One of the common frustrations that NZBA and our members encounter in dealing with regulators is a lack of clearly defined objectives for what they are trying to achieve, and a general confusion from the regulator about their exact role. We have alluded to this problem earlier in our submission.

33. Regulatory regimes established without clear objectives generally make it very difficult for regulated parties to understand their obligations, undermine confidence in the regulator, and unnecessarily increase compliance costs and burden on affected organisations. They also make it difficult to hold the regulator accountable for the success or otherwise of the regulatory measures.

34. A recent case study for the Productivity Commission to consider in this area is the ongoing development of consumer credit law contained in the Credit Contracts and Financial Services Law Reform Bill.

35. Key aspects of the Bill aim to establish a new regime for unreasonable fees and responsible lending requirements. However, due to a lack of clearly defined

objectives and a non-existent problem definition (in regards to unreasonable fees) these key provisions are poorly drafted, and not targeted at the specific problems they are meant to be addressing. Rather if they were to be implemented they would place a significant compliance burden on a range of organisations that are not the intended target of the regulation.

36. A further example to consider is the process followed by officials in developing the Consumer Law Reform Bill and in particular the unfair contract provisions.

37. At no stage over the last six years have officials put forward a clear evidence-based argument of the need to have these provisions in New Zealand's consumer law. The majority of submitters both in 2006 and 2010 strongly opposed the introduction of enforcement provisions for various valid reasons; and beyond the Ministry for Consumer Affairs, other key government departments such as Treasury did not believe there was sufficient evidence to introduce such provisions.

38. We along with other business groups were therefore at a complete loss when the Ministry persisted in introducing the unfair contract provisions when numerous submitters had outlined strong and valid reasons why these should not proceed. The process to date is a prime example of regulation being developed with no clear objectives or a problem definition of what exactly is trying to be 'fixed'.

39. We would be happy to discuss regulatory development in either of these areas in more detail with the Productivity Commission.

40. Another issue is when a regulator has such a broad and non-specific mandate that it enables them to pursue a wide-range of regulatory measures with little recourse available to the regulated parties. An example of this is the Reserve Bank's mandate of 'maintaining financial stability'. This mandate provides them as regulator the ability to implement a vast range of potential regulatory measures with little or no ability for affected parties to provide feedback or challenge the regulations being put in place. Clearly, in the case of the Reserve Bank it is vital that monetary policy independence is maintained, however even within these constraints there is arguably potential for a greater clarity of role and objectives.

Regulatory independence

41. The desirability of regulatory independence is unquestionable. Independence from both government and from those being regulated is essential for ensuring fairness and impartiality, preventing a regulator being used for partisan purposes, promoting public confidence in the regulator, and to allow the regulator to work constructively with the sector it is responsible for regulating.

42. However, independence is not a binary condition and NZBA believes that there is merit in the Productivity Commission examining the best model of independence for a range of regulators.

43. An example to consider is the Reserve Bank. Its need for independence in regards to monetary policy is without question. However, there is a sense that this culture of independence also influences the way that the Reserve Bank has approached prudential policy and its role as a regulator. This has perhaps understandably resulted in a culture where at times the regulator appears reluctant to engage with the banking industry (as per the examples given earlier).

44. This is a matter of concern, given that there is no official departmental oversight of the Reserve Bank and, with the exception of Disclosure Statement Orders in Council, its prudential policies are not subject to the scrutiny of the Regulations Review Committee.

45. In Australia this issue has been addressed by focusing the Reserve Bank of Australia's mandate on monetary policy, and splitting the macroprudential function out to a new organisation (the Australian Prudential Regulation Authority) which is subject to different level of independence and oversight.

46. The effectiveness or not of these different approaches would be worthy of further consideration by the Productivity Commission.

Reduction of regulatory overlap

47. In a jurisdiction as small as New Zealand regulatory overlap should be a relatively rare occurrence and the objectives and functions of regulators should be unambiguous and well defined.

48. However, in NZBA's experience this is not the case and all-too-often there is an unnecessary overlap between regulators operating in a similar regulatory area.

49. This is clearly inefficient, leads to blurred boundaries of responsibility, duplication of effort by the regulator, and an unneeded level of regulatory burden being placed upon the regulated organisations. Importantly, it also leads to confusion amongst the general public over what regulator has oversight for that particular sector.

50. An example for the Productivity Commission to consider in this area is the overlap between the Financial Market Authority and the Commerce Commission in the area of consumer law enforcement.

51. Both regulators have mandated responsibilities that incorporate aspects of consumer law enforcement. However, the reality is that the overlapping responsibilities do not work in anyone's interests, and a much more productive regulatory regime could potentially developed by giving one regulator a clearly defined mandate for consumer law enforcement.