Productivity Commission
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By email: info@productivity.govt.nz

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Regulatory Institutions and Practices: Submission on the Issues Paper

Thank you for the opportunity to provide a submission on the Commission's Issues Paper on Regulatory Institutions and Practices.

ANZ Bank New Zealand Limited (**ANZ**) is in a unique position to respond to the Commission's inquiry. We are the largest financial institution in New Zealand and provide a full range of financial services to retail, commercial and institutional customers across New Zealand, including banking, insurance, wealth management and financial advisory services. We also participate in debt and equity markets in New Zealand, the United States and Europe. The breadth of our business activities means that we understand consumers and industry, and have direct experience operating under a wide range of New Zealand's laws and regulations.

This experience has led us to the view that modern economies need effective regulation to support growth, investment, innovation, market transparency, market efficiency and other socially beneficial outcomes. ANZ is, therefore, concerned to promote high-quality regulation for the wider benefit of New Zealand. We believe that the Commission's inquiry presents a genuine opportunity for New Zealand to target higher quality regulation.

We would like to specifically draw your attention to the key messages set out below.

Key messages

- Overlapping regulatory oversight ought to be reduced.
- Regulatory accountability should be strengthened.
- Engagement with regulated businesses needs to be early, tailored and meaningful.
- Credible regulation is not driven by individual personalities.
- Regulatory and policy decisions should be kept distinct.
- Better use could be made of discretionary exemption powers.

We have discussed each of these key messages in detail in Schedule 1 of this letter.

Our specific responses to the Commission's questions are set out in Schedule 2 of this letter. Given the number and broad coverage of the Commission's questions, we have selected the most relevant questions to respond to directly.

Contact for submission

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Yours sincerely

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SCHEDULE 1

KEY MESSAGES

1 Reduction in overlapping regulatory oversight

Recommendation

The Commission should investigate the potential to consolidate overlapping or duplicate mandates into a single regulatory structure. Where there are both specific and general regulatory requirements that seek to promote the same broad objective, these should be identified and the general requirements should be suspended in favour of the specific, tailored requirements. Only where there is a compelling reason should two or more regulators have jurisdiction over a particular business activity.

It is important to ensure regulation is efficient by centralising regulatory functions and ensuring clear demarcation between different regulatory roles. This avoids ambiguity over regulatory thresholds or the identity of the responsible agency.

Our overall impression is that the regulatory landscape is too complex for the comparatively small size of the New Zealand economy. In some sectors, multiple regulators enforce a broad spread of regulations. These can overlap and lead to duplication in reporting requirements, contradictory requirements and excessive compliance burdens. There are many factors that can cause this scenario, such as:

- new regulators or regulations have come into being that overlap with those already in place;
- business practices have changed making some regulation unnecessary or irrelevant; and
- alternative methods of supporting compliance have developed.

The regulation of financial services provides an excellent case study of this issue as the Reserve Bank, Financial Markets Authority, Serious Fraud Office, Commerce Commission, NZX and Companies Office each have sector-specific responsibilities. Some of these regulators are long-established, while others are new or are faced with fresh regulatory responsibilities. Financial products and markets have continued to evolve as the stock of regulation and the number of regulators has increased. As a result, many of the factors that promote redundant regulation are likely to be present.

We recognise that, in some circumstances, dual regulators (or regulatory regimes) may be necessary. For example, in financial services prudential and market conduct regulation each have distinct rationales under an orthodox "twin peaks" model so they ought to be separate to maintain the coherency of the broader regulatory system. Such situations are, however, likely to be rare. More often, regulatory overlap will involve different regulators with similar responsibilities for the same broad conduct. Redundant regulation necessitates costly over-compliance, reduces transparency, impedes market efficiency and inhibits regulator accountability for specific policy outcomes.

If for some prudent policy reason overlapping regimes cannot be consolidated, significantly greater guidance should be provided to affected parties on where ultimate responsibility lies (such as through mandating memorandums of understanding between regulators or shared guidance notes to the sector). The aim should be to promote coordination, simplification and harmonisation across regulatory structures.

2 Regulatory accountability should be strengthened

Recommendation

We recommend that the Commission identify regulatory decisions that currently have no grounds for appeal and examine the importance of appeal frameworks, such as merits reviews, that can provide consistency and meaningful accountability across New Zealand's regulatory regimes.

The Commission's review should extend to non-judicial review frameworks that are more accessible to affected parties. Review processes should be flexible enough to provide meaningful accountability for the full range of a regulator's decision-making conduct.

Regulator accountability ensures incentives are in place to achieve high-quality regulatory outcomes. A focus on accountability is important because most regulators exercise discretion in discharging their functions. Regulators may be responsible for significant strategic choices, including:

- determining the issues to focus on and establishing priorities;
- how proactive and responsive it should be to complaints and concerns (for example, the ability to not act on recidivist claims); and
- selecting particular cases for further investigation or enforcement action.

Effective accountability requires both clear objectives for regulatory action and formal periodic review of regulatory decisions to ensure those objectives are being met in practice and appropriate decisions are being made. This kind of transparency promotes accountability as it provides the relevant information to meaningfully assess the regulator's conduct.

An evidence-based approach also allows the likely economic impact of a regulator's work in both the short and longer term to be assessed, and that evidence can be presented to affected parties for scrutiny. This type of approach enhances public credibility and ensures enduring and consistent oversight.

Consistency with regulatory objectives goes beyond individual regulatory decisions. The rationale and evidence behind a regulator's allocation of resource and setting of priorities should be transparent in a regulator's business plan and expressly linked to the regulator's objectives. Clear regulatory objectives can be frustrated by:

- vague standards or principles set out in governing legislation, which the regulator itself is then left to interpret;
- competing or conflicting objectives in the governing legislation; or
- competing or duplicate regulatory responsibilities by multiple regulators.

We agree with the Commission that "[c]lear objectives assist regulators to understand the boundaries of their authority and prioritise areas of work". However, the current reality is that many regulators also have a role in managing trade-offs between a range of statutory duties or priorities – for example, to balance efficiency with stability in financial markets. Businesses need to be able to understand the focus and fundamental objectives of regulators, so they can adjust their behaviour to ensure compliance.

Regulatory systems need to allow for the proper exercise of independent judgement, but within a framework of overall regulatory accountability to regulated parties, the government and parliament. We agree with the Commission that "[r]egulated entities should have a right of appeal of decisions that have a significant impact on them, preferably through a judicial process. Regulators should establish and publish processes for arm's length internal review of significant delegated decisions", but note that regulators should seek to minimise the costly and time-consuming nature of these reviews.

Regulatory appeals in New Zealand have evolved differently across different sectors for different types of regulatory decisions. In particular, merits review of regulatory decision-making has not been standardised. A key function of effective accountability mechanisms is to remove the possibility of arbitrariness in regulatory decisions. To ensure effective accountability, reviews of regulatory decisions must include:

- clear jurisdiction for affected parties to seek review;
- easily accessible and timely review mechanisms; and
- sufficiently wide grounds of review on which to appeal to ensure probity in the decision-making process, including matters of substance.

Merits review of regulatory decision-making addresses each of these factors. Importantly, merits review address issues of substance as well as process. Review procedures that exclusively focus on the decision-making process do not provide the necessary incentives for accurate and effective decision-making in the first instance. Where regulators exercise broad discretionary powers, merits reviews ensure a sufficient level of accountability.

Appeal rights should not only allow for the correcting of regulatory mistakes, but also ensure regulators are behaving in a reasonable and consistent way. We note with interest that the U.K. Government is currently reviewing and consulting on appeal rights for regulators. It is looking to more clearly define the grounds of appeals for non-judicial reviews of regulatory decisions, including:

- material error of law;
- material error of fact;
- material procedural irregularity;
- unreasonable exercise of discretion; and
- unreasonable judgements or predictions.

An appeals framework needs to strike a careful balance between providing proper accountability and not inadvertently holding back growth or being open to gaming. However, the U.K. Government considers such an approach will help ensure that any appeals are more focussed on identifying material errors and those appeals heard are determined more consistently across sectors to provide greater certainty and better use of resources.

3 Engagement with regulated businesses as key stakeholders needs to be early, tailored and meaningful

Recommendation

We recommend that the Commission investigate how minimum consultation obligations can be built on to ensure consultation procedures are credible and effective. Regulatory regimes that give regulators wide discretionary powers are likely to require stronger obligations to engage with stakeholders than regimes that are comparatively prescriptive.

Meaningful engagement with regulated businesses and other key stakeholders is an essential part of best regulatory practice. In a highly effective regulatory environment, a regulator is able to reach robust and well-informed decisions; interested parties have confidence, and engage extensively, in the regulatory process; and there will not be undue incentives to appeal.

If a regulator is to be criticised from time to time, it will typically be for not being sufficiently transparent in its decision-making or for exhibiting confirmation bias – for example, not being willing to alter an initial view in the light of consultation responses.

It is important that the Commission's inquiry investigate ways of improving the quality of dialogue regulators have with their relevant stakeholders. For a regulator to be successful it needs to have strong, open relationships with its stakeholders. It should pursue interactive engagement with the type and scale of consultation proportionate to the potential impacts of the proposal or decision. An industry will commonly have a better understanding of issues, solutions, and causes than the regulator. For example, affected parties may be able to better identify legitimate risks, rather than distractions, to allow a better allocation of regulator resources.

Modern communications technologies enable regulators to gather information and to consult more quickly and in a more targeted way than before. This may mean that the traditional formal written consultation is not always the best way of getting the right evidence.

Commonly used 'notice and comment' processes are an important, basic aspect of good regulatory engagement. However, these processes can, at times, prove insufficient to ensure an appropriately informed or responsive regulator. They may not encourage open and informed dialogue.

More meaningful engagement results in the four principal benefits set out below.

- Regulators are better informed about the factual context of the sector where regulation will be applied. Even sector-specific regulators need to recognise the inherent limits of their specialised knowledge. They should draw on the practical experience of affected individuals and businesses. Effective engagement also provides the opportunity to test interim conclusions and understand the effects of proposed decisions.

- An active engagement strategy that goes beyond formal 'notice and comment' procedures will allow affected parties to better prepare for and comply with proposed regulation and will improve the quality of submissions. The regulator may gain early warning of potential problems within the regulatory regime. Concerns about 'regulatory capture' are important, but should not be overplayed at the expense of the benefits of meaningful engagement.

- It ensures that regulatory decision-making is perceived to be credible by affected parties. Responsiveness is not always seen as a regulator's priority, but it is critical to the regulator's

on-going credibility and (therefore) a regulated business' appetite to engage in consultations. Regulated parties need to see their views and submissions reflected in regulatory decisions and be provided with clear reasons if their submissions are not been accepted. Generic justifications for decisions may be sufficient to forestall formal legal challenge, but is unlikely to go far enough to enhance the credibility of the regulator.

- It supports change being undertaken in a timely fashion. Genuine consultation with affected parties on regulatory proposals will provide the means to more accurately identify and target regulatory issues. It will then be possible to make incremental amendments to existing regulatory structures, rather than the wholesale replacement of regulatory frameworks.

4 Credible regulation is not driven by individual personalities

Recommendation

We recommend that the Commission examine where individual departures from good process prevent regulators from achieving their objectives. This issue emphasises the importance of ensuring effective accountability mechanisms where there is a need for formal regulatory independence. It is important to "[empower] staff to make difficult calls", but this needs to be balanced against commercial realities and the cost of compliance on affected businesses.

Regulatory systems and institutions ought to be designed to minimise the impact of individuals on substantive regulatory outcomes. Where individual personalities impact on regulation, both processes and outcomes can be unpredictable, inconsistent and contingent.

Ministers, Chief Executives, Commissioners and senior personnel in regulatory bodies may directly influence substantive regulatory outcomes. This influence should be exercised in a way that promotes the pre-determined policy objectives of a regulatory regime, rather than an individual's concerns.

On a day-to-day basis, the approach of particular officials (at all levels) can influence the ease or difficulty of engaging in regulatory processes. This highlights that personality politics can impact on matters of process as well as substance, and will often manifest as a failure to engage with affected parties (a key stakeholder group) in an open and genuine manner. We address this issue specifically in more detail below, but note here that such issues are often difficult to observe other than by interested parties who are engaged in the process of regulatory decision-making on an ongoing basis.

The effect of the individual approach of particular officials is similar in practice to the issue of regulatory capture. Regulatory capture is usually understood to involve affected parties gaining a close working relationship with a regulator, resulting in a disproportionate influence in determining regulatory outcomes. In a case where an individual's approach has a disproportionate influence over regulatory processes, a particular regime or process has effectively been "captured" internally to the regulator.

One way this type of issue can drive regulatory requirements to the detriment of the regulated sector is through the promotion of a culture of risk aversion. As the Commission notes, "[a] culture of risk aversion is also likely to lead to a more heavy-handed approach by regulatory staff, which can undermine the cost-effectiveness of the regulation for the community." An individual's overly conservative approach can prevent affected parties' views on the likelihood and extent of risks from getting through. Further, there can be significant economic cost of a slow or 'safe' decision as regulated parties may be forced to forego business opportunities.

5 Regulatory and policy decision-making should be kept distinct

Recommendation

We recommend that the Commission investigate the distinction between regulatory and policy-making functions in a New Zealand context in some detail. In order to provide useful guidance, the Commission's investigation could examine the circumstances in which it is inappropriate to delegate policy-making functions to a regulator expressly, and how regulatory policy objectives can help to restrict the focus of the regulator to its core task.

It is challenging for a regulator to exercise policy-making responsibilities. Regulation is primarily concerned with the implementation of specific policy objectives. While a regulator may need to develop a workable policy programme at an operational level, substantive policy objectives may be better left for political officials who are directly accountable to the electorate.

This approach conforms to fundamental legal principle underpinning our system of government. Substantive policy is a matter that is reserved for legislation, not regulation.[1] Further, given our comparatively open and responsive governing and legislative institutions, there is unlikely to be a need for significant policy-making power to be devolved to the regulator. Parliament is able to effectively discharge its policy-making function.

However, our primary concern is to ensure that policy-making and regulation are kept distinct in order to improve regulatory processes and outcomes. Where a regulator has a significant role in developing the policy objectives it is also required to implement, this creates a need to ensure appropriate checks and balances are in place. The risks where a regulator has such a role include a number of regulatory shortcomings:

- it affords a regulator discretion as to the objectives it should achieve and how it should achieve those objectives, which can promote unpredictable and inconsistent regulation;
- it limits the role of external accountability mechanisms as regulatory objectives have not been set by an external party to which the regulator is directly responsible; and
- it can frustrate parties that engage in regulatory processes as consultation on policy decisions may not be as open and transparent as for regulatory decisions where the primary concern is implementation to a particular factual context.

The concern is not just where policy functions have been delegated to the regulator expressly, but where legislative policy objectives are ambiguous, overlapping or otherwise call for a degree of interpretation. Where a regulator is required to both interpret its policy objectives and meet those objectives, an important element of policy-making has entered the regulatory process that may not be wholly appropriate.

[1] Cabinet Manual (Cabinet Office: 2008) at paragraph [7.77].

6 Better use of regulatory exemptions

Recommendation

ANZ encourages the Commission to investigate better use of exemptions from generic or 'catch-all' regulatory schemes that are not fit for specific purposes or are duplicative. Use of exemptions requires significant discretion to be afforded to a regulator. The principles guiding the use of that discretion need to be carefully prescribed in governing legislation to ensure that the discretion is used appropriately.

One of the key reasons regulation fails is because it is not fit for purpose: either a particular regulatory initiative does not properly address the market failure it was designed to resolve, or its coverage is too broad. Over-regulation generates additional compliance costs and has a chilling effect on productive activities that would otherwise be undertaken.

While there should be an appropriate degree of emphasis on tailoring the scope and effectiveness of regulatory regimes, governments will often lack the detailed information necessary to do so efficiently. Even if governments could do so, particular concerns may abate over time. As a result, empowering regulators to grant exemptions from generic, catch-all regulation is likely to be the most efficient and responsive approach to ensuring fit-for-purpose regimes in a number of cases.

The key benefit of regulatory discretion is that it can better align the operation and effect of regulation with the specific factual context in which it applies. The benefits of prudent use of formal exemption discretion include:

- the ability to mitigate over-compliance with an economy-wide regime that is not crafted for a particular firm or industry;
- the opportunity to draw on a regulator's superior knowledge of the sector in which regulation will apply, which in turn draws on the knowledge of industry participants; and
- policy-makers and regulators can set the boundaries of regulation wider knowing that appropriate solutions can be reached in individual cases.

Exemptions also allow regulators with conflicting objectives to reconcile their practices as an affected party can be exempted from one set of requirements. In the financial markets sector, regulated businesses can face layers of overlapping regulation that add significant time and cost to regulatory compliance. For example, multiple variants of financial reporting documents may be needed to comply with different regulators' standards. If a business is able to demonstrate compliance with one set of standards, this could usefully form the basis for granting an exemption from similar requirements, significantly reducing the compliance burden on that business.

The key issue is that there are no incentives on individual regulators to accept alternative compliance standards, despite the potential benefits. Regulators may view the scope of their mandate narrowly, or simply be unaware of the wider regulatory context in which they operate. It is natural for a regulator to insist on prescription in such circumstances, but greater flexibility would lead to a more efficiency regulatory environment overall.

SCHEDULE 2

ISSUES PAPER QUESTIONS

Issues Paper Question	Submission
Q5: What other ways of categorising New Zealand's regulatory regimes and regulators would be helpful in analysing their similarities and differences? How would these categorisations be helpful?	It is more important to focus on the function of different regulatory regimes, rather than their subject matter. Categorisation according to function may help identify potentially overlapping regulatory regimes, but if the function of the regime is different then there may be a valid case to maintain two distinct regimes. For example, prudential and market conduct regulation of financial markets have the same subject matter (financial markets) but promote quite different regulatory objectives.
Q9: Can you provide examples of where a single agency is responsible for both industry promotion and the administration of regulations?	Both the NZX (promotion and regulation) and the FMA (guidance and enforcement) are examples of regulators with two distinctive functions. The NZX in particular is an example of a dual capacity regulator having both policy and enforcement roles. The Reserve Bank is another example as it carries out both policy-making and enforcement roles in respect of Conditions of Registration/NBDT and insurance licensing regimes.
Q11: Can you provide examples of where two or more regulators have been assigned conflicting or overlapping functions? How, and how well, is this managed?	The financial markets sector is subject to a number of overlapping regulatory regimes, including those governed by the Reserve Bank, Financial Markets Authority, Serious Fraud Office, Commerce Commission, NZX and Companies Office. Often these sector-specific functions overlap and it can be unclear how these organisations work together (or defer responsibility). This creates uncertainty and cost (in the form of efficiency losses) for affected businesses. An example is the overlap between the NZX and the FMA. NZX firms are regulated under the NZX Participant Rules. The same firms are also 'brokers' for the purposes of the Financial Advisers Act and must comply with the broking requirements in the legislation. Currently, the rule sets (and each regulator's interpretation) conflict with each other, so that compliance with one set out rules could potentially be a breach of the other. It is unclear which regulator's views will prevail in the event of conflicts between the NZX and the FMA. Another example is the overlap between the FMA and the Commerce Commission. Under the Financial Markets Conduct Act, both the FMA and Commerce Commission have power to take enforcement action in respect of misleading and deceptive conduct. In addition, the Commerce Commission may have jurisdiction to take enforcement action in respect of breaches of the Financial Markets Conduct Act instead of the FMA (if the FMA agrees). However, it is unclear how this will work in practice as the relevant provisions are not yet in force. We note there is a specific technical legal reason for the Commerce Commission's inclusion that, if administered correctly, may not result in dual regulation. The FMA and the Reserve Bank also have overlapping functions in respect of NBDT/insurance policy and enforcement.

Issues Paper Question	Submission
Q17: What should be the limits of regulator independence? What sorts of regulatory decisions should be the preserve of Ministers rather than officials?	Independence as a broad concept exists to ensure regulators are free to pursue defined policy ends. Where statements of policy objectives are ambiguous or unclear (e.g. they call for policy trade-offs to be made) then independence should not be invoked as a way of insulating the regulator from close scrutiny of its decisions. If regulator independence is desirable, then steps should be taken to ensure that appropriate controls and accountability mechanisms are in place. Formal independence can obscure poor regulatory processes in some cases.
Q26: How effective and consistent are the review and appeals processes provided for in New Zealand regulatory regimes?	The consistency and effectiveness of the mechanisms available to review regulatory decision-making in New Zealand needs to be reviewed. Review of the substantive merits of a decision is not widely available, for instance, and judicial review proceedings are rarely used for practical reasons. Merits reviews are of particular importance because they are recognised as an effective tool for promoting "transparency, accountability, and consistency in regulators' decisions" and ensuring that "regulatory outcomes are consistent with policy intentions" (Round "The Merits of Merits Review" (2006)). Effective review is important as it provides the incentives for credible and accurate regulatory decision-making. Review and appeal mechanisms need to be low cost and able to be carried out quickly and effectively, without negative repercussions on the business's relationship with the regulator.
Q41: What sort of regulatory regimes are suited to more (or less) discretionary enforcement?	Regulatory discretion (as long as it is appropriately limited) is likely to be useful where the same regulatory requirements apply across a range of sectors or different businesses. In these situations, regulation is likely to need to be tailored so that costs are minimised and regulation is effective.
Q43: Can you provide examples of where risk-based approaches have been used well? What are the critical pre-conditions for effective implementation of risk-based approaches to compliance monitoring and enforcement in New Zealand?	We generally support a risk-based approach to compliance monitoring and enforcement. Such approaches have the benefit of preventing "willing compliers" from being targeted. Often where regulators have scare resources, a risk based approach will go some way towards assisting the regulator in discharging its obligations. We agree with the Commission that "[t]he central feature of a risk-based approach is the targeting of inspection and enforcement resources based on an assessment of the risk that a person (or firm) poses to the regulatory outcome being sought. This involves evaluating the risk that a person will not comply with a regulation and calculating the impact that noncompliance would have on regulatory outcomes ... Such an analysis allows scarce enforcement resources to be targeted at areas with the greatest benefit."
Q50: How well do regulatory agencies ensure consistency of approach between or amongst regulatory staff, so that individual variations are minimised?	This can vary significantly among different regulators. It is important that individual staff members have accountability to ensure that they are performing consistently with the expectations of the sector or the regulator. A greater focus on internal accountability mechanisms may be useful in this context.
Q53: Can you provide examples of where a regulator places too much value on managing risks to itself, relative to other priorities (such as the regulatory objective, or customer service)? What are the consequences?	In some cases a culture of risk aversion within the regulator can affect regulatory outcomes. Rather than seeking to understand the relevant risks, the regulator adopts a conservative approach that attempts to eliminate these risks altogether for the regulator but does not assist the industry to address the matter the regulator has been asked to address . This can result in a failure to engage genuinely with affected parties and raise compliance burden on businesses that is out of proportion to the risk the regulator has targeted. This can impede commercially prudent outcomes.