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Strengthening economic relations between Australia and New Zealand – Vero

Vero Insurance New Zealand (Vero) welcomes the opportunity to comment on the Australian and New Zealand Productivity Commissions' September 2012 discussion draft, *Strengthening Trans-Tasman Economic Relations (the Draft).*

The Vero comments are made from the perspective of a New Zealand general insurance company that can trace its local heritage back to 1878, as well as that of a member of a major Trans-Tasman financial services Group, Suncorp.

The Suncorp Group includes leading general insurance, banking, life insurance and superannuation brands. The Group is a Top 25 ASX listed company with approximately 16,000 employees; relationships with nine million customers; and over NZ$100 billion in assets. Vero is the second largest general insurer in New Zealand. The Suncorp businesses are the largest composite insurance group in New Zealand with revenue of over NZ$1.2 billion.

National Disaster Management and CER

The Draft notes that while Closer Economic Relations (CER) initiatives have achieved much during the past 30 years, barriers to integration remain and new issues will emerge. The Draft also notes the "untapped potential" for governments in policy development and service delivery.

While the CER activities initially focused on reduction of merchandise trade and regulatory barriers, more recently there have been important initiatives impacting the trade in services, taxation and government procurement. This expansion of the breadth of CER activities has been consistent with the European Union "four freedoms" framework covering trade in goods and services, as well as the movement of capital and labour. As the Draft notes, this framework can also encompass "knowledge transfers and the integration or interaction of government functions".

Vero contends that the recent experience of insurers in New Zealand and Australia highlights the fact that there remains untapped potential in the area of natural disaster funding, mitigation and recovery management. The impacts of natural disasters such as earthquakes, floods and cyclones are of such a magnitude that they pose threats to government fiscal and monetary policies; as well as corporate sustainability.

Given the already high level of trans-Tasman integration amongst general insurers and related financial services sectors, there is scope for greater knowledge transfers amongst companies and governments in relation to natural disasters. There is also scope to integrate the proposed New Zealand-Australia Framework for Crisis Management Cooperation into a broader range of CER initiatives that address the economics of natural disaster management.

The damage costs from the five major earthquakes in Christchurch since 2010 are currently estimated at NZ$20 billion or the equivalent of 10% of New Zealand's GDP; the costs could rise to NZ$30 billion. Over 80% of the earthquake rebuilding cost will be met by global reinsurers and national insurers. Without that insurance, the debt, taxation and expenditure burdens would be a long term drain on New Zealand's finances and economic health.

There has already been one major New Zealand corporate collapse as a result of the earthquakes, as well as the cessation of business by other insurers.

Australia's economy is substantially larger and the financial costs of natural disasters are met by insurers, as well as Federal and State government budgets. Despite that, natural disasters in the State of Queensland alone in 2010/11 resulted in nearly AU$4.0 billion of insurance claims and the imposition of a national income tax levy to assist meet the Federal Government share of disaster recovery costs.

Vero contends that the frequency and economic impact of natural disasters in Australia and New Zealand justify consideration of natural disaster, funding, mitigation and management being added to the 'Policy areas requiring further investigation' outlined in the Draft.

Consideration should be given to using vehicles such as the New Zealand-Australia Framework for Crisis Management Cooperation and the Australia New Zealand Leadership Forum to better integrate government and corporate efforts to reduce the economic impacts of natural disasters.

Capital management and regulatory harmonisation

The Draft notes that integrated financial systems have been important for the economic growth of Australia and New Zealand. It also notes that "sound allocation of capital has enabled funding of economic opportunities".

The impact of natural disasters on corporate and government balance sheets and capital reserves of natural disasters is a matter Vero believes should be included in the CER agenda. Ultimately, it will be decisions about the sound allocation of capital that will decide the future shape of the New Zealand general insurance sector. There is also scope for the CER agenda to consider the impact of regulatory harmonisation on capital management and transaction costs for general insurers.

Both Australia and New Zealand will need to address a looming issue of insurance affordability and, in particularly high risk areas, capacity. Provision of insurance is influenced by a range of factors including risk assessment and the capital reserves required by insurers to underpin the risks they write.

Any operational or regulatory matter that increases the transaction costs or capital reserve requirements of insurers ultimately decreases insurance capacity. That is why Vero believes there are potential national and corporate benefits from consistency in matters ranging from solvency standards through to broker regulation and taxation.

There is close and valuable cooperation between the Australian Prudential Regulation Authority (APRA) and the Reserve Bank of New Zealand (RBNZ). Vero believes one matter that should be reviewed is the disparity in current APRA and proposed RBNZ solvency standards for general insurers. General insurers in Australia require reinsurance to cover each ‘1 in 250 year’ event. The proposed New Zealand requirement is reinsurance to cover each ‘1 in 1000’ year event. Imposing the cost of an additional capital burden for general insurers in New Zealand does not seem prudent at a time when insurance affordability is a growing issue.

The imposition of discriminatory taxes on general insurance companies to fund public agencies such as fire services is also questionable. Australian States have recognised the discriminatory and impractical nature of levies on insurance premiums to fund fire services. They are progressively switching to broader taxes on property owners. Vero believes there should be a similar change in New Zealand.

Australia has conducted a long and comprehensive review of financial planner and broker regulation. There has been agreement between government and business that increased disclosure about matters such as broker commissions benefits customers and companies. Importantly, in a CER context, it has been recognised that disclosure of broker commissions paid by insurers and other financial services companies can lower transaction costs.

Vero is a leader in intermediated insurance in New Zealand and recognises the key role played by brokers in the local insurance sector and national economy. Vero is also an active proponent of measures designed to improve overall industry efficiency. While there are many areas of potential insurance industry reform, Vero believes the New Zealand Government should adopt broker commission disclosures requirements similar to those operating in Australia.

Conclusion

As a business with a long and successful history in New Zealand Vero recognises the national and corporate benefits gained from nearly 30 years of CER activities. There is considerable scope to build on what has been gained and Vero's comments on the Draft are a contribution to the ongoing growth of CER benefits for Australia and New Zealand.

Yours sincerely

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