REGULATION

WHO GUARDS THE GUARDS?

Regulatory Governance in New Zealand

Roger Partridge and Amy Thomasson
Foreword by Gary Banks AO

THE NEW ZEALAND INITIATIVE

© The New Zealand Initiative 2018

Published by
The New Zealand Initiative
PO Box 10147
Wellington 6143
New Zealand
www.nzinitiative.org.nz

Views expressed are those of the author and do not necessarily reflect the views of The New Zealand Initiative, its staff, advisors, members, directors or officers.

ISBN
978-0-9951009-4-7 (print)
978-0-9951009-5-4 (online)

RR47

Designed and typeset by Angela Whitney, www.angelawhitney.com

Printing arranged by True North New Zealand Ltd

Attribution 4.0 International (CC by 4.0)

WHO GUARDS THE GUARDS?

Regulatory Governance in New Zealand

Roger Partridge and Amy Thomasson
Foreword by Gary Banks AO

About the New Zealand Initiative

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We develop and contribute bold ideas that will have a profound, positive, long-term impact.

ABOUT THE AUTHORS

Roger Partridge
Roger is Chairman of The New Zealand Initiative and a Senior Fellow in its research team. He led law firm Bell Gully as Executive Chairman from 2007 to 2014, after 16 years as a commercial litigation partner. Roger was Executive Director of the Legal Research Foundation, a charitable foundation associated with the University of Auckland, from 2001 to 2009, and was a member of the New Zealand Law Society Council, the governing body of the legal profession in New Zealand, from 2011 to 2015. He is a chartered member of the Institute of Directors and a member of the Editorial Board of the New Zealand Law Review. Roger has Bachelor of Commerce (Economics) and Law degrees from the University of Auckland, and a Master's degree in law from the University of Cambridge.

Amy Thomasson
Amy is a Research Assistant at The New Zealand Initiative, focusing primarily on regulatory governance. Amy was a Mannkal Foundation Scholar at the Initiative in 2017, and re-joined the Initiative as a Research Assistant later that year. She has a Bachelor of Arts degree from the University of Western Australia, majoring in Political Science & International Relations and Law & Society.

ACKNOWLEDGEMENTS

We have had enormous assistance with this report in terms of time and comments from many people. There are too many for us to name all of them here, but they include current and former public servants, board members, lawyers and economists, politicians, and business and community leaders. We would particularly like to acknowledge the willingness with which the chairs and CEOs of the Commerce Commission, Financial Markets Authority and Reserve Bank of New Zealand provided both their time and frank feedback on the issues addressed in our report. We would also like to acknowledge Professor Gary Banks AO for the foreword, and our colleagues, Drs Oliver Hartwich, Eric Crampton and Bryce Wilkinson, for their thoughtful advice and assistance. Notwithstanding the help we have received, the authors are solely responsible for the views expressed in this report, and for any errors or omissions.

CONTENTS

Foreword 04
Introduction 06

CHAPTER 1
Regulatory governance – principles and practice 11

CHAPTER 2
New Zealand's regulatory hotchpotch 23

CHAPTER 3
What does business think of its regulators? 33

CHAPTER 4
What a difference a change of governance can make 41

CHAPTER 5
Applying the learnings from the FMA: two case studies 51

CHAPTER 6
Conclusions and recommendations 75

Bibliography 80
Appendices 83

Foreword

While it is generally accepted that productivity growth is the key determinant of a country's living standards over time, it is not always appreciated how important government regulations are to this. Government spending on infrastructure and R&D programs tends to get top billing. But regulations can reduce the incentives for firms to be innovative and cost-conscious, as well as inhibiting management capacity to make productivity-enhancing changes. It is very important to an economy's performance, therefore, that regulations secure (legitimate) policy goals in the most cost-effective ways possible.

This is only partly a matter of formal regulatory design. How well regulations are administered and enforced can be just as important. A regulator may use the discretion available to it in ways that ameliorate costs or compound them, that enhance benefits or diminish them. In practice, how it performs depends not just on resourcing, skills or experience but, more fundamentally, on the incentives and disciplines to 'get it right'. As argued in this innovative study, 'governance' – accountability structures within and around organisations – plays a crucial role.

The study draws on detailed survey-based information from business about the performance of New Zealand's key regulators. The authors' conclude from the responses that the (non-executive) board model of governance needs to be more widely adopted, particularly for corporate cops with an economy-wide beat.

Any study that relies on business views about the performance of regulators is susceptible to the 'Mandy Rice Davies defence': 'they would say that wouldn't they?' Moreover, the number of survey respondents, while impressive, is not large, increasing the potential for response bias. But the findings of this study cannot be so easily dismissed. They are backed by detailed OECD work that finds the preferred governance model to be the 'gold standard' for independent regulators. And they accord with both theory and evidence from other countries, including my own.

One should not underestimate the challenges faced by regulators who, as Harvard Kennedy School's Malcolm Sparrow has observed, often are expected to meet unrealistic and competing objectives. However regulators have not always risen adequately to the challenge. Indeed, in reviews undertaken for Australian governments, and latterly my experience on the board of a global financial company, I have been astounded at the imposed reporting burdens, the degree of intrusiveness and prescription, and signs of an adversarial 'them and us' culture deep within regulatory bodies. What is the explanation?

Part of it reflects understandable risk aversion. As an *Australian Financial Review* headline once put it, 'It's risky being a regulator!'. When things go wrong, regulators generally cop the flack and the blame. So despite the academic attractions of 'responsive' and 'risk-based' regulation, it can make sense to regulators for them to concentrate on stopping any adverse events, even at considerable cost.

The behaviours and culture of regulators can also be influenced by various forms of 'capture'. In Australia, and I suspect New Zealand, these rarely include the standard form found in economic textbooks, whereby regulated entities subvert their regulator. More relevant are:

capture by *non*-regulated interests (such as environmental lobbies averse to certain business activities); capture by *staff* who self-select into regulatory organisations that accord with their personal interests or beliefs (e.g. pro social justice or anti big business); and capture by *politics*, or a natural wish to be *popular*. Most regulators are creatures of politics and they can rarely afford to be oblivious to the forces of the day.

At a more prosaic level, there is also capture by *precedent*, as admitting past error can be highly problematic for a business regulator, given the economic as well as reputational implications.

I would argue that these phenomena, which rarely feature in policy discussion, are inherent to the 'regulatory craft' and have been a major cause of regulatory costs and failures.

There are of course no simple solutions. But the universal tendencies just described constitute a strong case for systems of regulatory governance with robust checks and balances, such as the board model proposed in this study. As the study further argues, however, these need to be buttressed by expert external oversight, and by processes to help ensure that senior appointments are judiciously made. This last point deserves special emphasis. For in the end, as for companies and countries, the quality of leadership can be decisive.

Gary Banks AO
Professorial Fellow, Melbourne Institute
Senior Fellow, Centre for Independent Studies
Chair, OECD Regulatory Policy Committee

Introduction

Quis custodiet ipsos custodes?
— JUVENAL, SATIRES[1]

"Who will guard the guards?" has been a troubling question since Plato's *Republic*. More than two millennia later, it is regulatory agencies, rather than armies, who wield many of the powers of the state. And though these agencies focus on protecting consumers rather than defending citizens against external enemies, the question remains as relevant today as it was in ancient Greece.

The arsenals of our modern-day regulators are fully loaded. Whether it is the Commerce Commission, the Financial Markets Authority (FMA), or the Reserve Bank of New Zealand (RBNZ), they have powers to compel, powers to prohibit and powers to prescribe. And the regulators do not hesitate to use them.

Having power is one thing. Exercising it wisely, fairly and predictably is another. And that brings us to Juvenal's question: Who guards consumers against regulatory failure? It is an important question. Yet we give much less thought to how to *govern* our regulatory agencies than we give to how we should *arm* them.

Indeed, our regulators come with a pick-and-mix of different governance models. Some have governance boards, some do not. Some have a panel of commissioners, some have only one. Some are equipped with well-respected expertise and decision-making capability, and some are not.

As with the guards of old, confidence in the guardians of 21st-century commerce *matters*. If that confidence is misplaced, it can have disastrous consequences. We saw this only too clearly with the losses to retail investors from the collapse of New Zealand's finance company sector during the global financial crisis (GFC). Had the former Securities Commission been awake to the risks finance companies posed – and the extent of unlawful conduct within the sector – those losses would have been much less than the estimated $3 billion suffered by investors.[2]

Poor decision-making by regulators can also cause harm by stifling innovation or imposing unnecessary costs on regulated businesses. And if market participants lack respect for their regulators or lose confidence in their decisions, this may cause both uncertainty and risk aversion. The consequential impairment to economic efficiency may increase costs, harming the very consumers regulators are created to protect.

Of course, we can expect regulators to be unpopular at times with the businesses they regulate. It is, after all, their job to place boundaries on what businesses can and cannot do. And when businesses stray outside the boundaries – or appear to – it is the regulator's job to hold them to account.

But just as we expect communities to respect the police, we should also expect the regulators of commerce to have the respect of the businesses they regulate.

1. Satires VI, lines 347–348.
2. Commerce Committee, "Inquiry into Finance Company Failures" (Wellington: New Zealand Parliament, 2011), 7.

Unfortunately, this respect cannot be taken for granted. A poor regulator can take perfectly reasonable law and, at one extreme, make it ineffective or, at the other, oppressive.

It is not surprising some of our most important regulatory agencies earn little respect.

In its 2014 report, *Regulatory Institutions and Practices*, the Productivity Commission found a litany of shortcomings with regulatory agencies in New Zealand. Some, it said, placed significant weight on managing risks to themselves over efficiently managing social harm.[3] Others had poor internal communication, with employees feeling unable to challenge flawed practices, contributing to a perception that the regulators were unwilling to learn from their mistakes.[4]

More generally, the Commission found that regulatory workers in central government thought senior managers did not communicate a clear organisational mission.[5] It concluded that the governance structures of regulators were *ad hoc* rather than based on sound governance principles, with discrete appointment processes for governance roles.[6]

Unfortunately, the Commission did not identify the regulators with poor governance structures, or the necessary changes. This shortcoming reflects no failing on the part of the Productivity Commission, which can only answer the questions it is asked. And its terms of reference tasked the Commission with identifying *system-wide improvements*, not commenting on *individual regulators*.

This report picks up where the Productivity Commission left off. We met with New Zealand's major consumer groups to gain their views on leading commercial regulators. We surveyed New Zealand businesses and asked them to rate and rank the commercial regulators they deal with across a range of performance metrics. And we conducted follow-up interviews with those interested in sharing their views with us in more detail.

While this report is heavily informed by the perspective of *the regulated*, we also obtained several other perspectives. We interviewed chairs, past chairs, chief executive officers and other staff (past and present) of several important regulators, including the FMA, the RBNZ, the Commerce Commission, the Electricity Authority, and the Overseas Investment Office (OIO), along with officials from many government departments monitoring regulatory performance.

We have undertaken case studies on three regulators – the FMA, the RBNZ, and the Commerce Commission. All three might be described as economic regulators, with their influence spanning the economy. If any business regulators are to be respected, it is these three. Yet our research found comparatively poor levels of respect for the latter two and the FMA scoring comparatively well. This aligns with anecdotal evidence from the business community that the board governance model has markedly improved the FMA's performance compared to its predecessor, the Securities Commission.

Two aspects of the FMA's *internal governance* arrangements, both copied from the private sector, are particularly thought to contribute to the authority's higher ratings. First, the governance and management functions were separated by re-designating the 'chair' role under the Securities Commission to a part-time position, and delegating substantial regulatory

3. Productivity Commission, "Regulatory Institutions and Practices" (Wellington: Productivity Commission, 2014), 5, 96.
4. Ibid. 94.
5. Ibid. 5, 102.
6. Ibid. 9, 257.

decision-making responsibility to a high-powered chief executive.[7] Second, the executive 'commissioner' positions were transformed into non-executive board roles. In tandem, these two factors appear to contribute to greater levels of accountability by the executive decision-making organ of the FMA and also to better expertise at the board level.

Our research evaluates this anecdotal evidence. We then consider whether there are lessons to be learnt from these changes for the governance of other regulators, including the Commerce Commission and the RBNZ.

We also looked at the *external governance* of regulatory agencies, including monitoring by ministers, departments, and central agencies, and the processes for appointing high-level agency leaders.

In the corporate world, shareholders conduct the external monitoring of a firm's board and management, and financial analysts for listed companies. This is a critical accountability mechanism, involving highly motivated experts. In situations of conflict, the courts can also play an important role.

With regulatory agencies, ministers and departments play the role of a company's shareholders in monitoring whether regulators are effective and efficient, and follow due process. And the courts play an even more important role in monitoring the exercise of regulatory power through the appeals and review processes.

But just how realistic is it to expect department officials and typically non-expert ministers to hold specialist regulators like the FMA, the Commerce Commission, or the Electricity Authority to account?

Not surprisingly, the Productivity Commission found variable effectiveness of external monitoring.[8] It identified issues with capability and resourcing, role confusion, and compliance-based monitoring, but did not report enough on a regulator's performance and strategy.[9]

The Productivity Commission's solution was to introduce peer review within the Crown's Performance Improvement Framework (PIF) run by the State Services Commission.[10] The government did not accept this recommendation. Our research suggests an even better alternative to peer review based on Germany's Monopolies Commission.

Finally, our research examines options to strengthen the processes for appointing board members to regulatory agencies. In a real sense, this is the most important element of external governance. If ministers do not select the right people for the job, the benefits of good institutional design will be wasted. Good governance on its own is worthless.

This report is divided into six chapters.

Chapter 1 explains what regulatory governance is, why it matters, what good regulatory governance looks like, and also explores the role of institutional design in ensuring market participants retain confidence in the regulatory agencies they interact with.

Chapter 2 describes the hotchpotch of institutional form and governance models that characterise New Zealand's commercial

7. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission" (Wellington: KPMG, 2009), 7.
8. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 11, 353.
9. Ibid.
10. Ibid. 455.

regulatory agencies, shortcomings in the governance and performance of agencies the Productivity Commission identified in 2014, and the steps the government has taken to remedy them.

Chapter 3 sets out the results of our survey of New Zealand businesses on the performance of the agencies that regulate their business activities.

Chapter 4 examines the policy reforms to financial markets regulation in the wake of the GFC. Among other changes, those reforms saw the governance arrangement of the principal financial markets regulator transform from the 'commission model' of the Securities Commission, to the FMA's 'board governance model', Drawing on the results of our survey, we also evaluate the effects of the transformation.

Chapter 5 studies two key financial regulators: the Commerce Commission and the RBNZ. It then recommends reforms based on the results of our survey and one-on-one interviews with survey respondents, past and present leaders, and staff of the three regulatory agencies we have studied.

Chapter 6 recommends reforms for New Zealand's regulatory governance structures in light of our findings.

CHAPTER 1
Regulatory governance – principles and practice

Governance and leadership are key vehicles to drive culture, talent, evaluation and performance towards high-quality regulatory decision making.
— CHORUS LIMITED[11]

1.1 What is regulatory governance?

References to 'governance' are usually preceded by the word 'corporate'. Indeed, forests worth of paper have been consumed with writings on best practice corporate governance. Much less has been written on regulatory governance. Yet the modern-day powers regulators wield over everyday commerce mean good *regulatory governance* is also vital.

Many of the principles are similar too. As Michel Prada and Neil Walter noted in their 2009 *Report on the Effectiveness of New Zealand's Securities Commission*:

> A large volume of research suggests that the basic principles of corporate governance – including a split of governance and management functions – are likely to be of benefit to all organisations.[12]

And though regulators have broader accountabilities than private sector companies,[13] the principles of corporate governance help explain the critical accountabilities.[14] Agency theory, for example, is applicable in the regulatory sphere, where the regulator (rather than a company) is the agent, and the minister (rather than the shareholder) is the principal. Departments and central government agencies act in a similar way to shareholders (or investment analysts on their behalf), monitoring regulators on behalf of the minister.

Regulatory governance refers to both:

a. **Internal governance** – the system of direction and control within an organisation that determines who makes decisions and how they are made;[15] and
b. **External governance** – the mechanisms that exist both to:
   - appoint the leadership of the regulators; and
   - monitor the regulators and hold them accountable to Parliament through the authority exercised by the central organs of the state, such as the executive and the legislature and associated central ministries, or other authorities responsible for the control and supervision of public organisations.[16]

---

11. Chorus Limited, "Submission on the Productivity Commission's Draft Report on Regulatory Institutions and Practices," DR 91 (2014), 4.
12. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 24.
13. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy" (Paris: OECD Publishing, 2014), 70.
14. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 24.
15. Rob Laking, "Distributed Public Governance: Principles for Control and Accountability of Agencies, Authorities and other Government Bodies," in OECD, *Distributed Public Governance: Agencies, Authorities and Other Government Bodies* (Paris: OECD Publishing, 2002), 268; Productivity Commission, "Regulatory Institutions and Practices," op. cit. 9.
16. Ibid. 268.

1.2 Why regulatory governance matters

While the content of regulations is undeniably important, it does not exist in a vacuum. Efficient and effective regulators are needed to administer and enforce regulations to achieve their policy goals.[17]

The behaviour of regulators in their application and enforcement of regulations has an enormous effect on outcomes.[18] As Malcolm Sparrow observed in *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance*, "Regulatory agencies, by their conduct, can take perfectly reasonable law and produce oppressive outcomes."[19] History tells us they can also do the reverse, and make reasonable laws ineffective.[20]

The behaviour of regulatory agencies is shaped by their governance arrangements.[21] A well-governed public sector organisation will enhance public and stakeholder confidence in the organisation in much the same way as a well-governed company.[22] And it is critical that all stakeholders have confidence in a regulator's exercise of decision-making power.

'All stakeholders' means not just the politicians from whom a regulator derives its power, but also the public whose interests the regulations are designed to protect. It means those *being regulated*. And for the regulatory agencies charged with regulating commerce, it means the businesses themselves.

If public trust in regulators is poor or misplaced, consumers may suffer. The losses of retail investors from the finance company failures during the global financial crisis illustrate this only too well. Investors' reliance on the Securities Commission's policing of the finance company sector proved misplaced. Had the Commission been awake to the risks posed by the behaviour of finance companies, the $3 billion loss suffered by retail investors would doubtless have been smaller.

Regulators also need to have the confidence of the market participants they regulate – or risk stifling innovation, creating uncertainty, and increasing risks and costs for business. As Vector noted in its submission to the Productivity Commission in 2013, "… regulatory design that allows or incentivises poor regulatory practice undermines confidence in the regime and distorts investment decisions."[23] This not only impedes productivity but also passes on higher costs to consumers.

1.3 Characteristics of good governance

As with corporate governance, there is no universally accepted best practice for public governance.[24] There are however broad principles of good practice endorsed in most OECD countries.[25]

17. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 3.
18. William Kovacic, "Distinguished Essay: Good Agency Practice and the Implementation of Competition Law," in Christoph Hermann, Markus Krajewski and Jorg Philipp Terhechte, eds. *European Yearbook of International Economic Law* (New York: Springer, 2013), 3–22, 4.
19. Malcolm Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance* (Washington, DC: Brookings Institution Press, 2000), 6.
20. The example of the Securities Commission's ineffective regulation of finance company disclosure is a good example of this (see Chapter 4).
21. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 2.
22. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 22.
23. Vector, "New Zealand Productivity Commission Inquiry into Regulatory Institutions and Practices: Submission on Draft Report," DR 98 (2013), 16.
24. Rob Laking, "Distributed Public Governance," op. cit. 268. For corporate governance principles in New Zealand, see the Institute of Directors, "The Four Pillars of Governance Best Practice" (Wellington: Institute of Directors, 2017).
25. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 3

Good governance involves a system of checks and balances that ensure three things. First, regulators are *effective* – that is, they achieve their regulatory mandate. Second, they are *efficient* – that is, they achieve their mandate in the most cost-effective and least intrusive way. And third, they have appropriate *standards of behaviour* – by acting according to the rule of law and the principles of natural justice, and, predictably, transparently and with proportionality.[26]

The characteristics of good governance include:

a. Effective *internal governance* systems to ensure the organisation:
   - sets appropriate strategies, policy frameworks, priorities and objectives;
   - sets appropriate standards of behaviour, including in relation to conflicts of interest;
   - has an appropriate delegation framework to ensure clear allocation of decision-making and other responsibilities within the organisation;
   - has appropriate systems of internal control;
   - has the resources and capabilities it needs to be effective;
   - consults with all stakeholders and is accountable to them; and
   - regularly evaluates its regulatory performance against the strategies, policies and objectives, and other relevant performance criteria it has defined; and
b. Effective *external monitoring* systems to:
   - ensure the agency is complying with its legislative mandate(s);
   - hold the regulator to account for its strategy and substantive performance;
   - evaluate its procedures and management methods; and
   - undertake periodic reviews of its strategic objectives, decision-making, and institutional framework; and
c. Robust *appointment processes* informed by high-quality analysis of the skills needed by those appointed to governance and leadership roles; and
d. An appropriate level of *political independence* and robust, formalised systems to ensure any political involvement in regulatory decision-making is transparent.

1.4 Alternative internal governance models – Strengths and weaknesses

Regulatory agencies come with a range of governance models. The OECD identified the three most common internal governance models for independent regulators in its report titled *Best Practice Principles for Regulatory Practice: The Governance of Regulators*:[27]

a. the board governance model;
b. the commission model; and
c. the single-member regulator.

The board governance model

The board governance model has been described as the "holy grail of accountability mechanisms for regulators."[28] It derives from corporate governance, and is becoming increasingly prominent among independent regulators in OECD countries.[29] Prominent commercial regulators favour it in the United Kingdom,[30] as do most statutory Crown entities in New Zealand (including the FMA).

26. Arie Freiberg, *The Tools of Regulation* (Sydney: Federation Press, 2010), 258–268.
27. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 69.
28. Joanna Bird, "Regulating the Regulators: Accountability of Australian Regulators," *Melbourne University Law Review* 35:3 (2011), 739–772, 771.
29. Ibid.
30. The Financial Services Authority and Competition Markets Authority in the United Kingdom both have governance boards.

Box 1: The United Kingdom's Competition Markets Authority (CMA)

The United Kingdom's principal competition regulator, the Competition Markets Authority (CMA), has a hybrid board governance model. The CMA was formed in 2014, following a merger between two competition regulators, the Competition Commission and the Office of Fair Trading.

The CMA is led by a board that comprises the Chair, the Chief Executive, three Executive Directors, and several Non-Executive Directors. The non-executive members are drawn from varied backgrounds and appointed for the skills and experience they bring, rather than as representatives of particular interests. They include members with expertise in industry and commerce.[31]

The CMA has two delivery directorates: an Enforcement Directorate and a Markets and Mergers Directorate.[32] These are headed by the Executive Directors responsible for the management and delivery of the cases and projects in their areas.[33]

The premise for the delegation from the board to the executive is it is neither practical nor desirable for the CMA board to make individual enforcement decisions that require detailed analysis of evidence and applying relevant legislation. Similarly, though it adopts and publishes prioritisation principles, which are needed for transparency and demonstrating consistency, the board does not decide which cases to pursue.[34]

Instead, for the most part, the board's role is governance:

a. It determines and guides how decisions are made, the processes involved, and the resources drawn on to analyse the evidence and inform the decisions; and[35]
b. It is responsible for setting the strategic direction of the CMA.

As a consequence, the CMA's board is accountable for most decisions of the organisation without actually being the key decision-maker – it is directly responsible for some key operational decisions reserved to it.[36]

The board delegates almost all its functions to committees or sub-committees, and variously delegates decision-making powers to senior individuals in the CMA, usually to the Executive Directors. The Executive Directors in turn delegate power to other 'director level' staff for what are called Phase 1 decisions. These can include merger clearance decisions.

Complex cases requiring more detailed analysis are referred to an Independent Panel, who begin a fresh assessment of the merits.[37] These are referred to as Phase 2 decisions.

These layers of internal safeguards enhance the independence and credibility of the CMA's decision-making process.[38] The CMA board is well placed to monitor its own the performance; most of its members are non-executive, so they are both parts of the leadership team and hold the executive to account.[39]

31. David Currie, Alex Chisholm and Tim Jarvis, "Institutional Design and Decision-Making in the Competition and Markets Authority," *CPI Journal* 10 (2014), 13.
32. Ibid. 15.
33. Ibid.
34. Ibid. 14.
35. Ibid. 15
36. Ibid. 14.
37. Annetje Ottow, *Market and Competition Authorities: Good Agency Principles* (OUP, 2015).
38. David Currie, et al. "Institutional Design and Decision-Making in the Competition and Markets Authority," op. cit. 14.
39. Ibid.

Under this model, governance and executive functions are carried out separately. The board is responsible for governance, and the CEO and management team for executive functions. For obvious reasons, an empowered board – one with the power to appoint the CEO,[40] set strategy, and 'say no' to management – is critical to the model's success.[41] The board, rather than the statute that established the entity, is the source of the CEO's delegated powers. Without this, the CEO is unlikely to be fully accountable to the board.

The board governance model comes in both 'pure' governance and 'hybrid' forms. In the pure model, all regulatory decision-making is delegated to the chief executive. In the hybrid model, the board delegates most executive functions to the CEO, but may reserve some powers for itself in high risk, technical or sensitive areas.

Separating the governance and executive roles institutionalises a strong internal accountability mechanism. And inserting a board between executive decision-makers and politicians gives the regulator several outside perspectives and specialist expertise.

The disadvantages of the model – or at least the perceived disadvantages – are it has the potential to blur the lines of accountability between the regulator and the relevant Minister,[42] and having part-time outside governors increases the risk of conflicts. However, the first concern is misplaced. While the presence of a board will dilute the accountability of the *CEO* to the Minister, the *board* will be fully accountable. The concern about conflicts may also be overstated. In practice, the number of board members can be set at a level to allow a potentially conflicted board member to step aside.

The commission model

The commission model also involves multi-member decision-making. Executive and governance functions are typically vested in a panel of commissioners.[43] In the board governance model the 'chief' executive is accountable to the board, in the commission model the CEO is typically the chair of the commission.

As in board governance, the commission model brings the advantage of multiple perspectives and specialist expertise to regulatory decision-making. Commissioners are typically engaged full-time, or near-full-time, reducing the risk of conflict between their commission duties and outside interests.

The main disadvantage of the commission model is it lacks the inherent internal accountability mechanism of board governance. As the commissioners are both the cooks and the bottle-washers, it is difficult for them to hold themselves to account. The requirement that commissioners perform executive functions in addition to their governance role also reduces the pool of candidates with current, specialist expertise (especially industry expertise) willing to put their hand up for the job.

The single-member regulator

Under the single-member regulator model, decision-making power is vested in one person responsible for most of the substantive regulatory decisions.[44] While he or she may consult internally (or externally where necessary and appropriate), or delegate other decisions to the

40. Rob Laking, "Distributed Public Governance," op. cit. 276.
41. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 68.
42. See John Urhig, "Review of the Corporate Governance of Statutory Authorities and Office Holders" (Canberra: Department of Finance, 2013), 65.
43. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 69.
44. Ibid.

staff, ultimate decision-making power rests with the individual.

The advantages of the single-member regulator model are obvious. It is a cost-effective model. And with only one (usually full-time) decision-maker, there are both clear accountabilities and minimal risks of conflicts with outside interests.

However, the model reduces the potential for diversity of views and increases the potential for error or 'maverick' decision-making both in setting strategies, priorities and objectives, and in regulatory decision-making.[45] The model also precludes objective internal monitoring and accountability, making effective external monitoring all the more necessary.

1.5 The role of institutional form

Institutional form is crucial in determining the available internal governance options. If the regulator has been constituted within a government department, rather than as a statutory Crown entity,[46] it is unlikely to have an independent board. The OIO, a regulatory unit within Land Information New Zealand (LINZ),[47] is an example.

In practice – at least in New Zealand – the legislature's decision about institutional form is a precursor to any consideration of governance models.

As the Productivity Commission noted in its 2014 report, there is widespread agreement on the importance of regulation by regulators acting independently of political control.[48] The OECD notes that some of the consequences of regulatory independence are:[49]

- more credible commitments from government to administer regulation over the long term;
- more consistent and stable decision-making;
- avoiding potential conflicts of interest; and
- developing expertise in the regulatory field.

We agree with the Productivity Commission that it is better to establish regulatory agencies independent of government where:[50]

- the costs are long-term, and likely to be undervalued due to a focus on electoral cycles;
- significant private interests have to be weighed against dispersed public interest; and
- substantial technical expertise or expert judgment of complex analysis is required.[51]

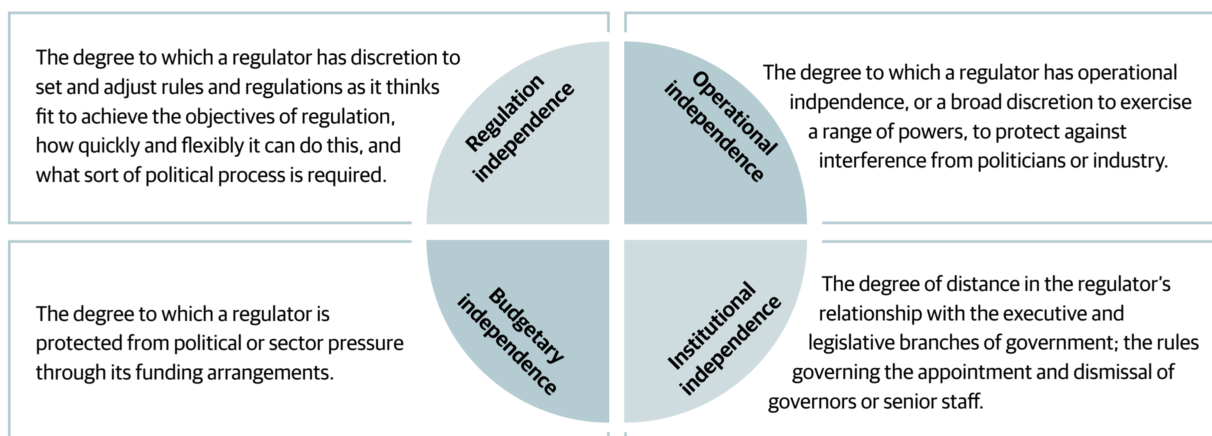
Regulatory independence is achieved through a combination of institutional, operational, budgetary and regulatory independence.[52] Figure 1 illustrates how these factors interact.

Those who design regulatory agencies must therefore carefully weigh the arguments in favour of political control against providing an impartial, apolitical regulatory regime.[53]

---

45. Stephen Bainbridge, "Why a Board? Group Decisionmaking in Corporate Governance," *Vanderbilt Law Review* 55 (2002), 1–55, 1.
46. In New Zealand, that means a Crown agent, an autonomous Crown entity, or an independent Crown entity. See State Services Commission, "New Zealand's state sector –The organisations," Website.
47. Land Information New Zealand, "Legislation, Ministers & Delegated Powers," Website.
48. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 8 *and 215.*
49. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 51.
50. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 220.
51. The Productivity Commission also suggested that regulatory agencies should be established as independent entities where the causal relationship between the policy instrument and the desired outcome is complex or uncertain. We are not convinced by this. There is a good case for leaving decision-making in the hands of elected politicians where causal relationships (and accountabilities) are uncertain.
52. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 48.
53. Ibid.

Figure 1: Dimensions of regulator independence



Source: Productivity Commission, "Regulatory Institutions and Practices" (Wellington: Productivity Commission, 2014), 222.

In practice, choices about institutional form are more important for what they signal about expected independence, rather than the legal constraints and freedoms associated with particular agency forms.[54]

1.6 External monitoring

In New Zealand, the executive and the legislature have a range of both *ex ante* and *ex post* mechanisms to oversee and monitor the regulatory agencies for which they are responsible.

Examples of *ex ante* mechanisms include:

- instruments like New Zealand's Letters of Expectation,[55] Statements of Performance Expectations,[56] and Statements of Intent;[57]
- controlling the appointment of members to regulatory agencies that are statutory Crown entities; and
- managing an agency's funding.

Ex post oversight and monitoring mechanisms include:

- ministerial and departmental monitoring of regulatory agencies;
- periodic requirements for regulatory agencies to report to the legislature or to select committees against their stated objectives and specified expectations;
- specific accountability mechanisms like New Zealand's Performance Improvement Framework run by the State Services Commission; [58] and
- audit processes.

Of course, the courts also play a significant role in monitoring regulatory power.[59] Unfortunately, evaluating the availability and effectiveness of appeals and review is beyond the scope of this report.

External monitoring processes help ministers ensure the regulators for whom they are

54. Ibid. 8.
55. *Crown Entities Act 2004*, s 27.
56. *Crown Entities Act 2004*, s 149B.
57. *Crown Entities Act 2004*, s 147.
58. State Services Commission, "Performance Improvement Framework," Website.
59. The merits of regulatory decision can be re-evaluated by the courts where Parliament has provided for appeals rights. In the absence of appeals rights, the courts may still assess the process and legality of a decision through judicial review.

responsible act to achieve their statutory goals. When the monitoring process indicates intervention is necessary, ministers have a variety of levers to fix this. These include revising the terms of instruments covering agency expectations, changing the leadership of the agencies and, if necessary, addressing any weaknesses in the legislative framework.

// External monitoring processes help ministers ensure the regulators for whom they are responsible act to achieve their statutory goals

The list of available external governance mechanisms is long, but how effective are they? Not sufficiently, according to many commentators.[60] There are many problems, including:

- the need for highly specialised knowledge to understand complex regulatory regimes like those regulating competition, financial markets, and the banking system;[61]
- the difficulty of attributing an unfavourable outcome to regulatory failure – or a favourable outcome to regulatory success;[62] and
- the opacity of many regulatory processes difficult for outsiders to penetrate.[63]

Further, complex regulatory mandates hinder setting meaningful performance measures or standards for regulators and actually measure their substantive, as opposed to procedural or financial, performance.[64] This often leads to a disproportionate focus on process over outcomes.

These concerns with current external governance practices have led to calls for a 'super regulator' with specialist expertise to monitor regulatory agencies managing some of the most complex – and important – regulatory regimes. In *Guardians of Finance: Making Regulators Work for Us*, James Barth, Gerard Caprio, and Ross Levine made the case for a 'super regulator' of financial regulatory agencies, which they called the Sentinel.[65]

Citing several examples of where financial regulators were aware of the problems associated with their policies, and had the power to fix them but chose not to,[66] Levine suggested that such an institution would enhance trust and confidence in regulators as regulatory policy would be more accessible and open to public debate.[67] The sole purpose of the Sentinel would be to provide an "annual report to the legislative and executive branches of government assessing the current and long-run impact on the public of financial regulatory and supervisory rules and practices."[68]

60. See, for example, Julia Black, "Calling Regulators to Account: Challenges, Capacities and Prospects," LSE Legal Studies Working Paper No. 15/2012 (London: London School of Economics, 2012); Productivity Commission, "Regulatory Institutions and Practices," op. cit. 356–357.
61. Ibid. 10.
62. Ibid. 9.
63. Ibid. 11.
64. Joanna Bird, "Regulating the Regulators," op. cit. 745.
65. Gerard Caprio, James Barth, and Ross Levine, *Guardians of Finance: Making Regulators Work for Us* (Cambridge: MIT Press, 2012), 230.
66. Ross Levine, "The Governance of Financial Regulation: Reform Lessons from the Recent Crisis," BIS Working Papers 329 (2010), 8.
67. Ibid.
68. Ibid. 9.

Box 2: Germany's Monopolies Commission

Germany's answer to the challenge of evaluating the substantive performance of a regulator responsible for one of its most complex regulatory regimes was to establish a 'super regulator'. The German Monopolies Commission is charged with both *ex ante* analysis and *ex post* review of competition policy and decisions, oversight of the Federal Cartel Office (FCO), and advising government on competition.[69] It is an independent expert committee of five with experience in economics, business administration, social policy, technology, or commercial law.[70] The Commission is required to report biennially to Germany's Federal Parliament on the FCO's application of the rules and legislation on merger control, and on other topical issues of competition policy.[71]

The Commission has been uniquely vocal in its criticism of competition policy and regulation within Germany and the European Union.[72] Its reports and comments are often widely reported in the media, and it staunchly defends the separation of regulatory and political power in competition policy and regulation.[73]

It has become the main source of analysis and advocacy on competition regulation in Germany.[74] Where the FCO frequently commented on policy matters throughout the 1990s, it now focuses on enforcement and infrastructure issues, leaving a gap for the Commission to fill.[75] The FCO is now much more isolated from the general debate on competition policy. This supports the impartial and independent application of competition law and lends credibility to the FCO's enforcement activities. The Commission thus fulfils the role of analyst and reform advocate.[76] Perhaps owing to this structure, both the FCO and the Commission are widely respected.[77] The Commission has also called for a similar body for Germany's network-based industries.[78]

1.7 Appointment processes

While effective internal and external governance is needed for sustained high performance by regulatory agencies, it is no cure-all. The best governance systems will count for little if an organisation does not have capable leadership with the right mix of skills.[79] For this, the processes used to appoint board members must be robust. Appointments should be informed by a high-quality analysis of the skills needs and gaps in regulatory boards.[80] However, this is often not the reality, especially where appointments are influenced by political patronage.[81]

69. Monopolkommission, "Mission," Website.
70. Monopolkommission, "Commissioners," Website.
71. Monopolkommission, "Mission," Website.
72. OECD, "OECD Reviews of Regulatory Reform: Germany 2004" (Paris: OECD Publishing, 2004), 98.
73. Ibid.
74. Ibid. 103.
75. Ibid.
76. Ibid.
77. Ibid. 104.
78. Ibid. 155.
79. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 265.
80. Ibid.
81. Ibid. 263; Office of the Controller and Auditor-General, "How Government Departments Monitor Crown Entities (Wellington: OAG, 2009).

In response to various scandals involving political appointments, the United Kingdom and Canada both adopted processes that subject public sector appointments to parliamentary scrutiny.[82]

// The best governance systems will count for little if an organisation does not have capable leadership with the right mix of skills

Short of this, central agencies can provide support to Ministers throughout the process to guide the appointment of suitable candidates for leadership roles in regulatory agencies.[83]

In the next chapter we move from theory to practice, and examine the governance arrangements of regulatory agencies in New Zealand.

Box 3: The UK Commissioner for Public Appointments

Loss of public confidence in regulatory agencies in the early 1990s prompted the UK government to establish an independent commissioner to provide assurance on regulatory board appointments.[84] The Commissioner for Public Appointments is tasked with ensuring "the best people get appointed to public bodies free of personal and political patronage".[85] It does so by applying the Principles of Public Appointments (the principles) outlined in the Cabinet Office's Governance Code on Public Appointments, providing independent assurance of a transparent and robust process.[86] The Commissioner is a vital safeguard against actual and perceived undue influence by the government in independent regulators.[87]

Ultimate selection of and responsibility for those appointed remains with the responsible Minister, who is "accountable to Parliament for their decisions and actions".[88] Before the application process opens, the relevant Minister is asked for names of potential candidates, and must agree to the job description for the role, the length of tenure and remuneration, and the composition of Advisory Assessment Panels.[89] The Minister is also kept informed throughout the process to help determine what form these updates should take.[90]

The Minister must meet the candidates listed by the Commissioner before and/or after the interviews.[91] The Minister then decides whom to appoint.[92] A Minister may choose not to appoint any of the candidates and re-run the process.

This process ensures the principles are consistently and accurately applied, without diluting ministerial accountability for regulatory appointments.

82. Meredith Edwards, John Halligan, Bryan Horrigan, and Geoffrey Nicoll, "Public Sector Governance in Australia" (Canberra: ANU Press, 2012), 217.
83. Ibid.
84. Kristin Mednis, "Integrity Plus 2013 New Zealand National Integrity System Assessment: Crown Entitles," Supplementary Paper (2013), 5.
85. David Currie, et al. "Institutional Design and Decision-Making in the Competition and Markets Authority," op. cit. 13.
86. Cabinet Office, "Governance Code on Public Appointments" (Wellington: New Zealand Government, 2016), 6.
87. David Currie, et al. "Institutional Design and Decision-Making in the Competition and Markets Authority," op. cit. 13.
88. Cabinet Office, "Governance Code on Public Appointments," op. cit. 6.
89. Ibid. 7.
90. Ibid.
91. Ibid.
92. Ibid. 8.

CHAPTER 2
New Zealand's regulatory hotchpotch

The institutional arrangements and regulatory practices that constitute the architecture of regulatory regimes shape the behaviours of regulators, the quality of decision making, behaviours of those regulated, and ultimately the success of regulatory regimes in achieving the desired outcomes.[93]

New Zealand's regulatory landscape is complex. We have a lot of regulators, and they come in a variety of forms. Indeed, the Productivity Commission noted in its 2014 report that the variety of internal governance arrangements and allocation of decision-making rights among regulators appeared to be "*ad hoc* rather than based on sound governance principles."[94]

While the Commission was precluded by its terms of reference from undertaking a review of *individual* regulators, its report details a litany of problems with our regulatory agencies *generally*. The Commission identified a number of key themes:

- the culture of regulators places significant weight on managing the risks to the organisation at the expense of the efficient management of the social harm;[95]
- regulatory workers in central government do not believe senior managers convey a clear organisational mission;[96]
- appointment and reappointment processes for regulators are of variable quality; and
- current practices for monitoring regulators do not pay enough attention to the effectiveness of a regulator's strategies and practices.[97]

Yet, despite the Productivity Commission finding distinct dissatisfaction with regulatory performance among stakeholders, the National-led Government's response to the report was modest at best.

To build a platform to evaluate regulatory performance, this chapter classifies New Zealand's main regulatory agencies. It then examines in more detail the differing arrangements adopted by our regulators for internal governance, external monitoring, and governance and appointments.

2.1 Taxonomy of institutional form

New Zealand has more than three dozen commercial regulatory agencies comprising a mixture of:[98]

- government departments;
- Crown agents;
- autonomous Crown entities;
- independent Crown entities; and
- agencies with a unique institutional form.[99]

If occupation-specific regulators are included in the hotchpotch, the number is even greater.[100]

---

93. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 22.
94. Ibid. 9, 269.
95. Ibid. 5, 98.
96. Ibid. 5, 102.
97. Ibid. 11, 353.
98. See Table 2.
99. For example, the RBNZ and the Gas Industry Company.
100. Examples of occupation-specific regulators range from the New Zealand Law Society to the Plumbers, Gasfitters and Drainlayers Board.

The number of regulatory agencies has multiplied in recent decades due to a combination of increasing regulatory complexity and an international trend towards devolution.[101] In New Zealand, this has seen many central government powers delegated to Crown entities.[102]

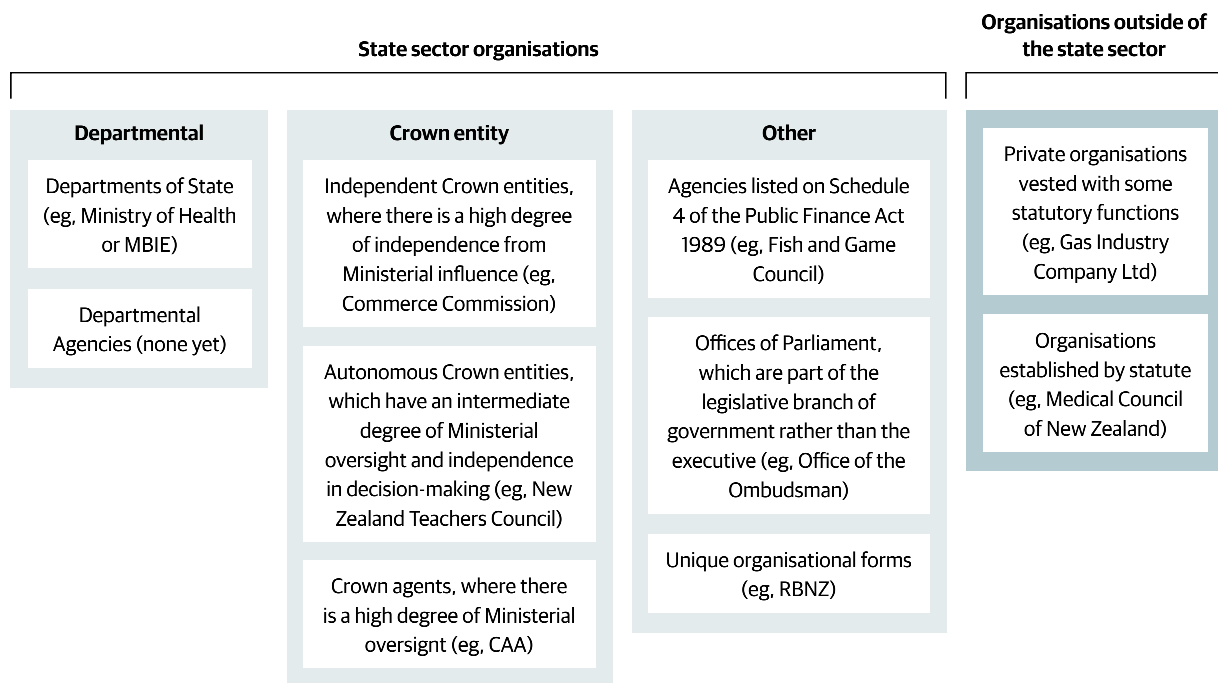
New Zealand's regulators are differentiated both by institutional form and by governance model.

Figure 2, taken from Productivity Commission's report, helpfully summarises the options for institutional form.

The key distinction between the entity types is between departments and statutory Crown entities. Departments are legally part of the Crown, with the governance arrangements centred on a direct Minister-CEO relationship.[103] Statutory Crown entities are independent of the Crown and required to have a board.[104] Typically, the board's role is *governance*, but in some cases, board members have *executive* roles. And in some instances, the distinction is acknowledged by board members being described as 'commissioners'. The Commerce Commission is the best-known example of this.[105]

The governance arrangements for Crown entities are centred on a Minister-board relationship. This relationship is 'arm's length', and interactions are more formalised than those between a Minister and a department. This means Crown entities

Figure 2: Typology of institutional forms for a government regulator



Source: Productivity Commission, "Regulatory Institutions and Practices" (Wellington: Productivity Commission, 2014), 240.

101. David Coen and Mark Thatcher, "The New Governance of Markets and Non-Majoritarian Regulators," *Governance: An International Journal of Policy, Administration, and Institutions* 18:3 (2005), 329–346, 330.
102. Derek Gill, "New Zealand," in OECD, *Distributed Public Governance: Agencies, Authorities and Other Government Bodies* (Paris: OECD Publishing, 2002), 133–161, 134.
103. State Services Commission, "Reviewing the Machinery of Government" (2007), 13.
104. *Crown Entities Act 2004*, s 25(1) and (2).
105. *Commerce Act 1986*, s 8A(3).

are not subject to the direction of a Minister on individual regulatory decisions.[106]

As the Productivity Commission noted, in many situations it may be appropriate for regulatory regimes to be established independently of political control.[107]

Although legislators should decide the institutional form after appraising the arguments for and against independence,[108] this principled approach is often neglected in practice.[109] As a result, while regulatory independence is the norm, it is not an invariable rule, and many regulatory agencies that might be expected to operate independently of government are in fact departments.

The government's decision in 2005 to place the OIO within Land Information New Zealand is a good example of this. Like the FMA, the OIO has quasi-judicial functions, the former in its licensing and enforcement capacity and the latter in granting applications but with entirely different institutional forms (see Table 1).[110]

Despite the proliferation of regulatory agencies due to increased devolution, there is now a trend towards agency consolidation.[111] Recent examples include the merger of the Charities Commission with the Department of Internal Affairs and the merger of New Zealand Food Safety Authority with the Ministry for Primary Industries. The creation of the FMA in 2011 is another example of consolidation, where several functions dispersed across the Ministry of Economic Development, the Securities Commission, and the NZX were combined in one regulator.[112]

// Although legislators should decide the institutional form after appraising the arguments for and against independence, this principled approach is often neglected in practice

Applying the framework for regulatory independence to the major types of institutional form reveals these forms are not strongly differentiated.[113]

In 2016, the State Services Commission issued a supplementary 'due diligence' guidance note to aid departments when setting up or restructuring agencies.[114] The note contains detailed questions for officials to consider on the appropriate institutional form for a new or restructured agency. However, it does not direct officials to apply a coherent set of principles like those identified by the Productivity Commission to guide a decision.[115] It remains to be seen whether the note will result in a more coherent approach by Parliament to the institutional form adopted for regulatory agencies.

---

106. OECD, "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy," op. cit. 47.
107. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 8, 217–222.
108. Ibid. 8.
109. Murray Horn, *The Political Economy of Public Administration: Institutional Choice in the Public Sector* (London: Cambridge University Press, 1995), 24.
110. Financial Markets Authority, "How we regulate," Website.
111. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 249.
112. Office of the Minister of Commerce, "Creating a Financial Markets Authority and Enhancing Kiwisaver Governance and Reporting" (Wellington: New Zealand Government, 2010), 1.
113. This table is modelled on Table 9.2 of the Productivity Commission' 2014 report. Productivity Commission, "Regulatory Institutions and Practices," op. cit. In addition to the regulators listed by the Commission, we have added the following: IRD, SFO, External Reporting Board, ACC, WorkSafe, Heritage NZ, Human Rights Commission, and the Earthquake Commission. We have also amended the names of regulators where they have changed since the Productivity Commission published its report.
114. State Services Commission, "Machinery of Government Supplementary Guidance Note: 'Due Diligence' on Proposed Machinery of Government Changes" (2016).
115. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 220, F9.2.

Table 1: Institutional forms and dimensions of independence

Dimension of independence	Department	Departmental agency	Crown agent	Autonomous Crown entity	Independent Crown Entity
Regulators	• Customs • Department of Internal Affairs • Inland Revenue Department • Land Information New Zealand (including the Overseas Investment Office) • Ministry for Business, Innovation, and Employment • Ministry for Culture and Heritage • Ministry for Primary Industries • Ministry for the Environment • Ministry of Education • Ministry of Health • Serious Fraud Office • Statistics New Zealand	• Social Investment Agency	• Accident Compensation Corporation • Civil Aviation Authority • Earthquake Commission • Energy Efficiency and Conservation Authority • Environmental Protection Authority • Fire and Emergency New Zealand • Maritime NZ • New Zealand Qualifications Authority • New Zealand Transport Agency • New Zealand Walking Access Commission • WorkSafe	• Commission for Financial Capability • Heritage New Zealand • Lotteries Commission	• Broadcasting Standards Authority • Commerce Commission • Drugfree Sport New Zealand • Electricity Authority • External Reporting Board • Financial Markets Authority • Health and Disability Commissioner • Human Rights Commission • Office of Film Literature Classification • Privacy Commissioner • Takeovers Panel
Institutional independence	Governed by chief executive, appointed and removed by State Services Commissioner	Governed by chief executive (separate from chief executive of host department), appointed and removed by State Services Commissioner	Governed by board, which can be appointed and removed at minister's discretion	Governed by board, which can be appointed and removed for just cause by minister	Governed by board, which can be appointed and removed for just cause by Governor-General on advice of minister, after consulting Attorney-General
Operational independence	Required to follow any lawful ministerial direction	Required to follow any lawful ministerial direction	Operationally independent; must give effect to government policy when directed	Operationally independent; must have regard to government policy when directed	No ministerial powers of direction[116]
Regulation independence	Each organisation has whatever powers are provided for by Parliament				
Budget independence	Usually parliamentary appropriation, except where Parliament provides otherwise, such as the power to issue levies and charges.				

Source: Productivity Commission, "Regulatory Institutions and Practices" (Wellington: Productivity Commission, 2014), 248.[116]

116. Except for whole of government directions.

2.2 Internal governance

Independent regulators generally have one of three internal governance models: single-member decision-maker, multi-member commission, or board governance (see Chapter 1).

The majority of New Zealand's independent Crown entities operate with a governance board with some exceptions. For example, the FMA has a governance board, but the Commerce Commission is constituted as its name suggests – as a multi-member commission. The differing internal governance arrangements are more *ad hoc* than based on sound governance principles.[117] Indeed, there are differing decision-making models even among similar regulators, such as those regulating financial markets. So, for example, even though it has a board, the RBNZ's prudential regulatory powers are delegated directly to its Governor under the single-member decision-maker model. Conversely, the FMA has a governance board, whereas its predecessor, the Securities Commission, had the commission model.

There is also nothing incontrovertible about internal governance structures. For example, the Takeovers Panel notionally has a commission model, but the panel effectively acts as a governance board supported by a secretariat with executive responsibilities.

The result is a pick-and-mix of internal governance structures across the regulatory landscape and of variable quality. And while some of New Zealand's regulators have robust governance structures that provide the requisite internal checks and balances, as we will see from the results of our survey in Chapter 3 and our case studies in Chapter 5, it appears some do not.

// The result is a pick-and-mix of internal governance structures across the regulatory landscape and of variable quality

Many issues thrown up by our survey results also align with those relating to internal governance as identified by the Productivity Commission. These include the following issues:

- The allocation of decision rights between those responsible for governance and the regulator's executive;[118]
- The evidence supporting the proposition that multi-member bodies have the potential to produce higher quality decisions than individuals because of the wider range of skills and perspectives;[119]
- The challenge for internal accountability where the decision-making body is also the governance body (as is the case with the Commerce Commission);[120] and
- The capability and skill set of board members and the variability of appointment processes.[121]

These issues of internal governance really *matter*. As we saw in Chapter 1, "Governance and leadership are key vehicles to drive culture, talent, evaluation and performance towards high-quality regulatory decision making."[122] And robust internal governance is doubly important if external monitoring is weak – which, as we will see in the next section, it all too often is.

117. Ibid. 9.
118. Ibid. 268–270.
119. Ibid. 272–273.
120. Ibid. 274.
121. Ibid. 257.
122. Chorus, "Submission on the Productivity Commission's Draft Report on Regulatory Institutions and Practices," op. cit. 6.

2.3 External monitoring

External monitoring of regulatory agencies in New Zealand is largely the responsibility of Ministers and their departments. Ministers are in turn responsible to Parliament. Where regulators are Crown entities, they are also directly responsible to Parliament.

The state sector financial and performance management processes in the *State Sector Act 1988, the Public Finance Act 1989*, and the *Crown Entities Act 2004* apply to almost all regulators. These processes operate on a cycle, and include requirements for:

- Statements of Intent and Statements of Performance Expectations, setting out the agency's direction and objectives;[123]
- Information Supporting the Estimates as part of the budget documents;[124]
- Annual Reports, which must be presented to Parliament;[125] and
- The more recent PIF reviews, which review an agency's fitness-for-purpose (see below).[126]

Other requirements may include Output Plans or Agreements,[127] Letters of Expectations,[128] and Ministerial Directions.[129]

Ministers have a range of other mechanisms for holding regulatory agencies to account, including:

- appointing and removing board members of Crown entities (the State Services Commission has a similar power in relation to departmental chief executives);[130]
- commissioning external reviews of regulatory performance, including Commissions of Inquiry;[131] and
- undertaking expenditure reviews.[132]

Parliament also has a range of monitoring mechanisms, including:

- holding regulators or their Ministers to account through the Select Committee process;[133] yearly reviews of Budget Estimates, and Financial Reviews;[134]
- auditing by the Office of the Controller and Auditor-General, which can include an audit of an agency's financial statements, as well as performance audits examining its efficiency and effectiveness;[135] and
- asking the responsible Minister oral or written questions in Parliament.[136]

In addition, regulatory agencies are subject to oversight by the courts, by the wider public through the *Official Information Act 1982*, and by the media.

Despite these extensive accountability mechanisms, the Productivity Commission's report highlighted a litany of shortcomings with monitoring and oversight of regulatory agencies. These included:

- insufficient support from departments for regulatory Crown entities;

123. *Crown Entities Act 2004*, ss 138 and 139.
124. *Public Finance Act 1989*, ss 13–19.
125. *Crown Entities Act 2004*, ss 150–156.
126. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 128.
127. The Treasury, "Managing for Outcomes: Output Plans Guidance for Departments," Website.
128. State Services Commission, "Resource for Preparation of Governance Manuals – Guidance for Statutory Crown Entities," Website.
129. *Crown Entities Act 2004*, ss 114–115A.
130. State Services Commission, "Statutory Crown Entities – A Guide for Ministers" (29 April 2015), Website.
131. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 495.
132. Ibid.
133. Ibid.
134. Ibid. 496.
135. *Public Audit Act 2001*, s 18(1).
136. New Zealand Government, "Standing Orders of the House of Representatives," Standing Order 383(1) (2017).

- role confusion, where some departments tried to influence how a Crown entity was run;
- inadequate capability; and
- too much reporting sought from regulators, and insufficient focus on reporting on the regulator's performance and strategy.[137]

The last two of these shortcomings are a particular concern for complex regulatory regimes like competition and financial markets regulation. It is vain to believe that staff in a government department can replicate the expertise of a specialist regulator like, for example, the Commerce Commission or the FMA. This means departments have only a limited ability to monitor the effectiveness of a regulator's strategic approach to the exercise of its discretionary regulatory powers. The fact that the regulator's board or commissioners are likely politically appointed and senior experts in their field, makes effective departmental monitoring all the more challenging.

As a result, the Productivity Commission found that monitoring departments tend to focus more on an entity's financial performance and processes rather than assessing its substantive performance based on outcomes.[138] This means poor performance often remains unidentified, and therefore unaddressed.[139]

In response to this concern, the Productivity Commission recommended the government establish a peer review process through which panels of senior regulatory leaders would review the practices and performance of individual agencies.[140]

However, it is also doubtful a panel of senior regulatory leaders would have the expertise needed to evaluate the substantive performance of specialised regulatory agencies like those identified in the preceding paragraph. An economist with expertise in competition policy would be needed to evaluate the strategies and substantive performance of the Commerce Commission, and these skills are unlikely to exist in other regulatory agencies. In the event, the government did not accept the Productivity Commission's recommendation.

Regulators may nevertheless choose to undergo a PIF Agency Review. However, the PIF does not capture the requisite key performance indicators (KPIs) of effectiveness, efficiency and standards of behaviour needed to evaluate a regulator's performance in the terms articulated in Chapter 1.[141]

As a consequence, performance evaluations of some of our institutions managing specialist regulatory regimes are most likely to occur only in response to "'alarms raised by unhappy constituents."[142] Prada and Walter's review of the Securities Commission in the aftermath of the GFC and attendant finance company failures is an example of one such evaluation.[143]

This *ad hoc* approach to external governance increases the risk of poor regulatory performance going unchecked, creating risks for consumers and inefficiencies and costs for the regulated businesses. This makes strong internal governance even more critical. Without it, our regulatory agencies may be left without effective oversight.

137. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 11.
138. Kathy Spencer, "Accountability and Performance Monitoring of Regulatory Crown Entities" (Wellington: Productivity Commission, 2014), 11.
139. Murray Horn, *The Political Economy of Public Administration*, op. cit. 69.
140. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 12, 366–372.
141. For example, nowhere in the PIF are concepts like regulatory predictability, proportionality, and fairness evaluated.
142. Murray Horn, *The Political Economy of Public Administration*, op. cit. 70.
143. See discussion in Chapter 4.

2.4 Appointment processes

The Productivity Commission found that the appointment processes for governance roles to New Zealand's regulatory agencies are highly variable.[144]

> **// While guidance on correct appointment process is provided by the State Services Commission, Treasury, and CabGuide, in practice the ministerial certification that proper process has been followed is generally a mere formality**

Appointments to regulatory boards are made either by Ministers or by the Governor-General on ministerial advice. But the process is generally managed by policy analysts in the responsible government department, who then make a recommendation to their Minister.[145] For regulatory agencies, there is no equivalent to the Commercial Operations group within Treasury (formerly called the "Crown Operations Monitoring Unit" or "COMU"), which ensures appointments to the boards of Crown companies are managed expertly and consistently.

Some appointments are, nevertheless, subject to more thorough and extensive processes than is the norm. For example, the FMA's board appointment process involves the Ministry of Business, Innovation and Employment (MBIE) filtering applications, which are then reviewed by a panel comprising the FMA Chair, a senior figure at MBIE, and an independent person. Their decision then goes to the Minister for approval.

The Office of the Auditor-General identified a number of deficiencies in appointment processes in its 2009 paper on Crown entity monitoring,[146] including:

- departments not carrying out satisfactory planning for appointment processes;[147]
- a department, in one case, not identifying that a board member's term had expired until five months after the event;[148]
- review processes not occurring in a timely way;[149]
- departments disregarding the conventions constraining appointments in the pre-election period;[150]
- variable quality work by departments in assessing the knowledge, skills and experience needed on boards;[151]
- departments not collecting all the disclosure information required under the *Crown Entities Act 2004*; and[152]
- one department doing little to ensure new board members received induction information.[153]

While guidance on correct appointment process is provided by the State Services Commission, Treasury, and CabGuide,[154] in practice the ministerial certification that proper process has been followed is generally a mere formality.[155]

---

144. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 9, 262.
145. Ibid. 263.
146. Office of the Controller and Auditor-General, "How Government Departments Monitor Crown Entities, op. cit.
147. Ibid. 55.
148. Ibid. 56.
149. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 263.
150. Ibid.
151. Ibid.
152. Office of the Controller and Auditor-General, "How Government Departments Monitor Crown Entities, op. cit. 59.
153. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 263.
154. Department of Prime Minister and Cabinet, "The appointments process and Cabinet appointment papers," CabGuide (7 July 2017), Website.
155. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 264.

In relation to this finding, the Productivity Commission recommended creating a "centre of expertise" within either the State Services Commission or Treasury to support departments in managing appointments and reappointments to regulatory Crown entities.[156]

The government did not accept this recommendation. It simply directed the State Services Commission to send a letter to Crown entities on behalf of the Minister for Regulatory Reform requesting they "consider any additional steps necessary to ensure a capable and diverse cohort of potential appointees."[157]

Interestingly, the Productivity Commission did not support establishing a process similar to the United Kingdom's Commissioner for Public Appointments.[158] The Commission's concern was that reducing the input of ministers in the appointment process could weaken political/ministerial accountability for entity performance.[159] However, this reservation is weak. Where Ministers retain the ultimate decision-making responsibility for regulatory appointments, as they do in the United Kingdom, there is no reason in principle why ministerial accountability should be lessened merely because the appointment is made after a more rigorous selection process.

156. Ibid. 265.
157. The Treasury, "Quarterly Report on Implementation of the Government Response to the Productivity Commission Report on Regulatory Institutions and Practices" (Wellington: New Zealand Government, 2016), 6.
158. See Box 3 for more information about the United Kingdom's Commissioner for Public Appointments.
159. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 263.

CHAPTER 3
What does business think of its regulators?

A poorly-performing regulatory system is a significant drag on New Zealand's economy and society; there are heightened risks of regulatory failure; and, ultimately, there is a risk that society's trust in the integrity of the New Zealand regulatory system will be severely compromised.[160]

In Chapter 1 we learned why it is important that regulators are respected by those they regulate.[161] When businesses lack confidence in regulatory decision-making, both risk and costs increase, impeding efficiency and ultimately harming consumers.

To assess how well our regulators are respected, we surveyed New Zealand's 200 largest businesses by revenue, together with those members of The New Zealand Initiative not otherwise included as members of the 'top 200'. In practical terms, this approach allowed adding a sample of New Zealand's leading professional services firms – accountants, lawyers and investment bankers – into the pool of businesses covered by our survey. Only one response per organisation was permitted.

3.1 What we asked

We asked survey respondents both to:

a. *rank* the regulators they interact with based on their overall respect for them; and

b. *rate* the performance of the three regulators most important to their respective businesses against a range of KPIs.

The KPI indicators fell into eight categories and comprised 23 questions in total (see Table 2).

In each case, survey recipients were asked whether they 'strongly agreed', 'agreed', 'disagreed' or 'strongly disagreed' that the regulator met the KPI, or were neutral in this regard. Recipients were also given a 'don't know/ not applicable' option (which was considered a non-response for the purposes of our data analysis).

The KPIs were based on a combination of the best practice principles identified by the Australian Productivity Commission's Regulator Audit Framework, and from a similar survey to our own commissioned by the New Zealand Productivity Commission for its 2014 report.[162] The questions were designed to obtain a broad view of regulatory performance, and as such did not enquire into the merits of individual regulatory decisions or the fitness-for-purpose of individual regulators.

Rather, the KPIs cover issues like commerciality, communications, consistency, predictability, accountability, and so on.

160. Steven Bailey and Judy Kavanagh, "Regulatory Systems, Institutions and Practices," *Policy Quarterly Journal* 10:4 (2014), 1–16, 15.
161. See page 13.
162. Australian Productivity Commission, "Regulator Audit Framework" (2014); Colmar Brunton, "Research Findings from a National Survey of New Zealand Businesses" (Wellington: Productivity Commission, 2013).

Table 2: KPIs used in the NZI survey

Category	KPI number	Question
Objectives and actions	1	The relevant people in your business are readily able to understand the regulator's objectives
	2	The regulator's objectives and actions make sense to you having regard to the regulator's statutory purpose
	3	The regulator's actions are motivated by the goal of efficiently achieving its statutory objectives and not for ancillary or arbitrary objectives (such as self-protection of the regulator, its leaders or other staff, or for other political or personal goals)
Communications	4	The regulator communicates its objectives and reasons for its actions clearly to businesses in your industry
	5	Staff within the regulator appear to understand the regulator's overall statutory objectives and act consistently with them
Expertise and respect	6	The leaders of the regulator are skilled, knowledgeable and well-respected by businesses in your industry
	7	Staff within the regulator are skilled, knowledgeable and well-respected by businesses in your industry
	8	The processes for appointing the leaders of the regulator are transparent and robust
Commerciality	9	The regulator understands the commercial realities facing your industry
	10	Your interactions with the regulator are generally constructive
	11	The regulator is willing to listen to the views of your business and take them into account
Predictability and transparency	12	The regulator's compliance and monitoring approaches are streamlined and coordinated
	13	The regulator's actions are consistent and predictable
	14	The regulator clearly articulates the justification and reasons for its actions
	15	You are not hindered or deterred from taking action to improve the profitability of your business by any lack of predictability in the regulator's decision-making
Fairness and proportionality	16	Businesses across your industry are treated fairly and consistently by the regulator
	17	Action taken by the regulator is proportionate to the regulatory risk being managed
Consultation and engagement	18	The regulator effectively consults and engages with you and businesses in your industry to ensure that good regulatory processes are being followed
	19	The regulator effectively consults and engages with other important stakeholders to ensure that good regulatory processes are being followed
Accountability	20	The regulator learns from its mistakes
	21	There are effective accountability mechanisms within the regulator to enable participants in your industry to voice concerns about mistakes
	22	There are effective appeal and judicial review rights to challenge the decisions of the regulator in the courts
	23	The regulator is readily held to account for the quality of its work (including any mistakes) by its responsible government department, minister or some other effective external accountability mechanism

As well as obtaining feedback on the performance of individual regulators, we were also interested in evaluating the impact (if any) of the change in the governance arrangements of New Zealand's financial markets conduct regulator. This came about in 2011, when the multi-member Securities Commission was superseded by the FMA with a board governance model.

To assist with this evaluation, we asked survey recipients regulated by the FMA *who had previously been regulated by the Securities Commission*, to rate the FMA against the Commission on all the 23 KPIs, using the same rating scale.

We evaluate the results from this comparative assessment in Chapter 4.

3.2 Overview of results

We received a good response from survey recipients, with completed responses from 60 separate businesses from just over 200 survey recipients, evaluating 24 regulators. The results, summarised in **Appendix 1**, are ranked from highest to lowest by reference to the average of the percentage of respondents who 'agreed' or 'strongly agreed' that the regulator met the 23 KPIs.

The results show a wide disparity in overall ratings for the 24 regulators, with the External Reporting Board taking the top slot[163] and the OIO rating the worst overall. However, both have very small sample sizes so our discussion here will focus on regulators most frequently rated by survey participants.

The survey results include regulators with differing institutional forms and governance models, including:

- six government departments;[164]
- 13 with board governance models;[165]
- three with a single-member decision-making model;[166] and
- two with a commission structure.[167]

The percentages of survey respondents 'agreeing' or 'strongly agreeing' that the regulators meet the 23 KPIs are set out in **Appendix 2**. Across the 23 KPIs, on average, the regulators *rated best* on the KPIs relating to:

- **Clarity of objectives**: with 68.6% of respondents either 'agreeing' or 'strongly agreeing' they could readily understand the regulators' objectives;[168]
- **Constructiveness:** with 61.5% of respondents either 'agreeing' or 'strongly agreeing' that their interactions with the regulators were generally constructive;[169] and
- **Acting in accordance with objectives:** with 56.3% of respondents either 'agreeing' or 'strongly agreeing' that the regulators' actions were motivated by achieving their statutory objectives. (See Figure 3.1)[170]

While the average scores across *all regulators* are not high, the percentages for *some regulators* covered by the survey are high (see **Appendix 2**). The External Reporting Board and the Takeovers Panel, which occupy the top two slots in the averages, are good examples of this.

Conversely, some regulators perform very poorly – even on these three KPIs. These regulators include the OIO, Heritage NZ, the Environmental Protection Authority, and the Human Rights Commission.

The high ratings for *some* regulators indicate survey respondents were willing to give credit where it was due, and to give frank criticism where it was not.

Turning from the KPIs where the regulators performed well on average to those where they performed poorly, the results were weighted towards KPIs relating to accountability. The three worst overall ratings were for:

163. See Appendix 1.
164. The Department of Conservation, Inland Revenue Department, Ministry for Primary Industries, Ministry for Business, Innovation, and Employment, Ministry of Transport, and Land Information New Zealand (including the Overseas Investment Office).
165. The Accident Compensation Corporation, Broadcasting Standards Authority, Civil Aviation Authority, Earthquake Commission, Electricity Authority, Energy Efficiency and Conservation Authority, Environmental Protection Authority, Heritage New Zealand, New Zealand Transport Agency, Takeovers Panel, and WorkSafe.
166. The Office of Film Literature and Classification, Privacy Commissioner, and Reserve Bank of New Zealand.
167. The Commerce Commission and Human Rights Commission.
168. Appendix 2, KPI 1.
169. Appendix 2, KPI 10.
170. Appendix 2, KPI 2.

- **External accountability**: where only 23.6% of respondents either 'agreed' or 'strongly agreed' that the regulator was readily held to account by a responsible government department, Minister or some other effective external accountability mechanism, and 43.3% of respondents 'disagreed' or 'strongly disagreed';[171]
- **Internal accountability**: where only 33.1% of respondents either 'agreed' or 'strongly agreed' there were effective accountability mechanisms within the regulator to enable concerns to be voiced, and 40.2% of respondents 'disagreed' or 'strongly disagreed';[172] and
- **Commercial understanding**: where only 38.4% of respondents either 'agreed' or 'strongly agreed' that the regulator understood the commercial realities facing business, and 33.8% of respondents 'disagreed' or 'strongly disagreed' (see Figure 3.2).[173]

Figure 3.1

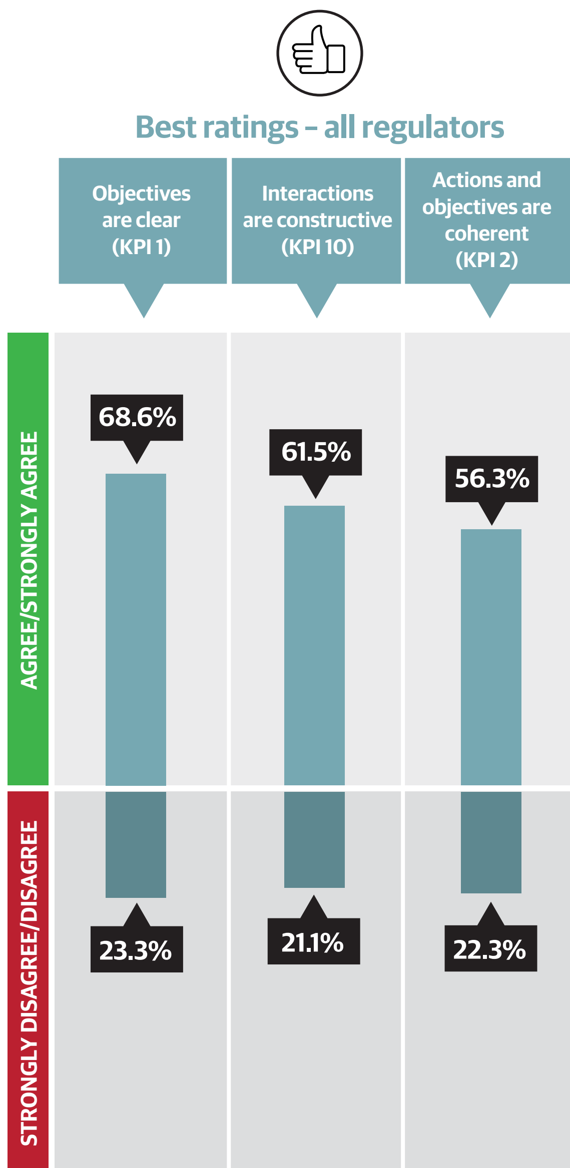
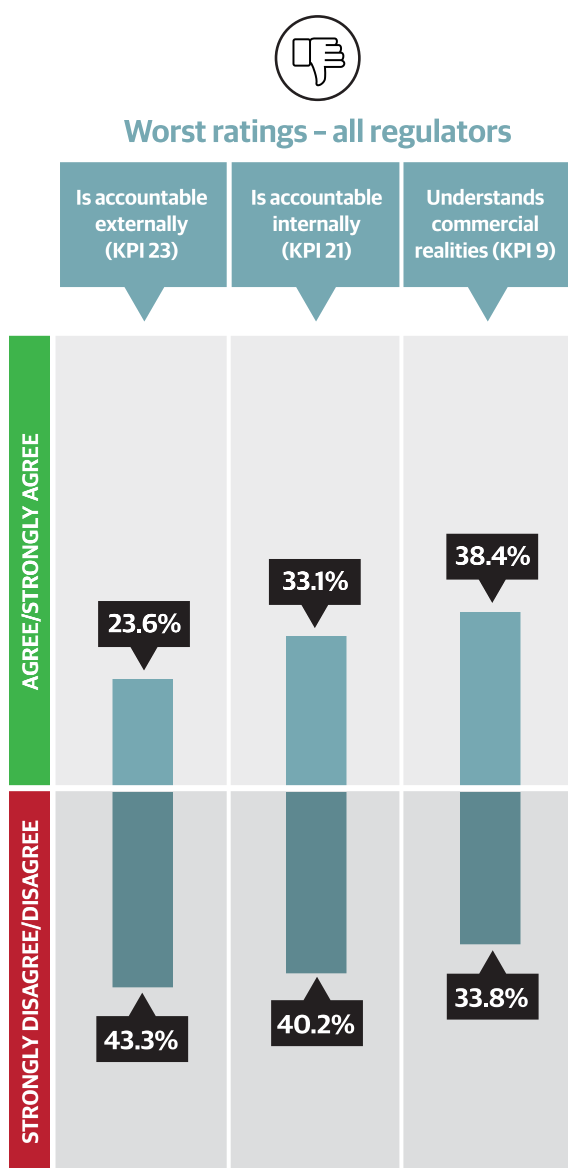


Figure 3.2



171. Appendix 2, KPI 23.
172. Appendix 2, KPI 21.
173. Appendix 2, KPI 9.

The next worst ratings were for:

- "the regulator learns from its mistakes";[174]
- "the regulator's compliance and monitoring processes are streamlined";[175]
- "the regulator's actions are consistent and predictable";[176] and
- "there are effective appeal or review rights to challenge the regulator's decisions". [177]

Overall, the areas in which regulators performed poorly were not surprising. What was surprising was that the KPIs relating to accountability were so consistently the worst. This underlines the importance of identifying the options available to strengthen regulatory governance.

Turning to the rankings, **Appendix 3** ranks the regulators identified by survey participants from the most to the least respected. It also shows the number of times they were ranked in total, and the number and percentage of times they were ranked either most or least respected regulator.

3.3 Case studies on individual regulators

Space constraints and the small sample size of survey results restrict us from analysing in detail each regulator for which we received responses.

The results also cover different types of regulators. Some are part-regulator, part-government department. And several of these – like the Inland Revenue Department (IRD) and the New Zealand Transport Agency (NZTA) – are more on the revenue and spending side of the government than the regulatory side. The balance are statutory Crown entities (of one form or another).

Because considerations of alternative governance arrangements are primarily relevant to the statutory Crown entities, we focus on them in the balance of this report. Our approach here mirrors that of the Productivity Commission.[178]

Table 3: Average percentage scores for each regulator across 23 KPIs

Regulator	No. of Times Rated	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum Agree and Strongly Agree	Sum Disagree and Strongly Disagree
Financial Markets Authority	17	12.8	48.0	28.9	9.2	1.1	60.8	10.3
Worksafe	18	2.2	45.7	29.1	21.7	1.3	48.0	23.0
Electricity Authority	9	2.2	39.4	27.9	27.9	2.7	41.5	30.6
Commerce Commission	38	6.0	33.9	34.3	22.4	3.3	39.9	25.8
Reserve Bank of New Zealand	8	6.5	22.0	35.4	23.8	12.2	28.6	36.0

Source: Authors' calculations.

174. Appendix 2, KPI 22.
175. Appendix 2, KPI 12
176. Appendix 2, KPI 13.
177. Appendix 2, KPI 22.
178. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 258.

Table 3 sets out a summary of the results for the five statutory Crown entities rated more than five times in our survey. They are the Commerce Commission, the Electricity Authority, the FMA, the RBNZ, and WorkSafe New Zealand (WorkSafe).

The results show the *average* percentage scores for each regulator across the 23 KPIs. The table is sorted from the highest ratings to the lowest based on the average percentage of respondents 'agreeing' or 'strongly agreeing' that the regulator met the KPI.

Of these five, the three top-rated regulators all have the board governance model. The fourth, the Commerce Commission, has a multi-member commission governance model. The RBNZ, which rates last, has the single-member decision-maker model.

In Chapter 4, we undertake a detailed case study on the FMA's performance, and use comparative data to study the FMA against its predecessor, the Securities Commission.

Then in Chapter 5, we evaluate the performance of the Commerce Commission and the RBNZ, and assess any lessons to be drawn from the comparatively better performance of the FMA for the governance arrangements for these two regulators.

We are conscious, though, that we have been given a wealth of information and feedback by survey recipients on many other regulators. We will share the feedback – on an anonymised basis – with the concerned regulators. Where appropriate, some of the material will also feature in our future research notes and other publications. We now turn to the transformation of New Zealand's financial markets regulator.

CHAPTER 4

What a difference a change of governance can make

This [the FMA] is the leading example of a regulatory governance structure. A well-respected diverse board holding a CEO to account and answerable to the Minister. It gives industry participants significant confidence in the effectiveness and fairness of the regulator. Compared with the former Sec Comm which had the Chair as the CEO (and effectively appointing the board) the FMA is light years ahead.

— SURVEY RESPONDENT

4.1 The global financial crisis, 2006–12

The GFC had many casualties. Around the world, banks, investment banks, and other financial institutions collapsed as financial markets froze. Fortunately for New Zealand savers, our banking sector withstood the global meltdown. Not a single depositor's dollar was lost.

It was a different story for non-bank deposit takers. During the GFC New Zealand's finance company sector was crushed. More than 60 New Zealand finance companies collapsed. Some of the noted casualties were Bridgecorp, South Canterbury Finance, and Hanover.

The 2011 parliamentary inquiry into this collapse estimated losses of more than $3 billion borne by 150,000 to 200,000 depositors.[179] The RBNZ estimated that pre-GFC, non-bank lenders had assets of approximately $25 billion comprising about 8% of lending by all financial institutions. By the time the last finance company failed, in 2013, finance companies accounted for only 3% of all lending.[180]

4.2 The demise of the Securities Commission

It was not just the finance companies that failed. New Zealand's principal financial markets regulator, the Securities Commission, was an early casualty too. As early as 2009, the Ministry of Economic Development encouraged the Securities Commission to establish an independent review panel to assess the Commission's overall effectiveness.[181]

The report that followed, prepared by Prada, former chair of France's securities regulator, and Walter, former senior New Zealand civil servant, signed the Securities Commission's death warrant.[182] The following year, the Minister of Commerce introduced legislation to scrap the Commission and replace it with a new regulator, the FMA.[183]

Remarkably, the Minister regarded the institutional reform of the Securities Commission sufficiently important to do it before completing a systematic review of New Zealand's securities

179. Commerce Committee, "Inquiry into Finance Company Failures," op. cit.
180. Reserve Bank of New Zealand, "Report for the Minister of Finance on the operation of the prudential regime for Nonbank Deposit Takers" (2013).
181. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 3.
182. Ibid.
183. *Financial Markets Authority Bill 2010.*

regulations. Reforming the *regulator* was apparently even more urgent than reforming the *regulations*.

What *was* the need for such haste? The answer is clear in the Minister's Cabinet Paper seeking approval for creating the FMA:[184] the Minister believed speed was critical to restoring public confidence in New Zealand's financial markets. This was to be achieved – at least in part – by addressing two problems with the agencies regulating the financial markets. The first was the fragmented nature of the regulators – with responsibilities split among several agencies. The second concerned the "perceived lack of proactive investigation and enforcement" by the Securities Commission.[185]

At its heart, the concerns related to the Commission's failure to act on a series of shortcomings in the finance company sector. A common theme in many of the finance company failures was irregular related-party lending from the finance companies to borrowers associated with finance company owners.

In a Discussion Document from the Securities Commission released *before* the GFC, the Commission raised concerns about finance company disclosure.[186] Then, in 2005, the Commission announced it had identified areas where disclosure by finance companies of related party lending needed to improve to ensure finance companies offered documents that complied with the law.[187] The Commission went on to say, "If breaches of the law are found, we will raise these matters with the finance companies concerned and, if necessary, take appropriate enforcement action."[188]

While the Commission did take some action between April and August 2006, it was too little and too late. The Commission had been fiddling while Rome burned.

4.3 The Prada and Walter recommendations

Prada and Walter's recommendations included reforming the commission's governance structure. First, they recommended separating the Commission Chair's governance role from the chief executive officer's management role. This, they said, "would bring the Securities Commission into line with what is now the standard arrangement for all but the smallest of Crown Entities."[189]

In making this suggestion, Prada and Walter acknowledged that practice varied widely among counterpart bodies in other jurisdictions. But they pointed to the large volume of research suggesting that the basic principles of corporate governance – including splitting governance and management functions – were likely to be of benefit to all organisations.[190] And they pointed out specific advantages for the Commission "in separating the two roles in terms of the checks and balance that accompany a split between governance and management."[191]

Another governance recommendation concerned the skill set of commissioners.

184. Office of the Minister of Commerce, "Creating a Financial Markets Authority and Enhancing Kiwisaver Governance and Reporting," op. cit. Henceforth referred to as "FMA Cabinet Paper."
185. Ibid. 1.
186. Securities Commission Discussion Document, "Disclosure by Finance Companies," (April 2005).
187. Securities Commission, "Review of Finance Company Disclosure," (August 2006).
188. Ibid.
189. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 24.
190. Ibid.
191. Ibid. 25.

While acknowledging the calibre of existing commissioners, Prada and Walter said the stakeholders found that "the Commission does not have quite the level of recent current commercial or securities market experience it needs,"[192] and recommended increasing the number of commissioners.

Prada and Walter made several other recommendations, most notably that:

- the Commission take a more proactive approach to exercising its existing powers, and that consideration be given to increasing its powers;[193]
- the roles of New Zealand's various financial markets regulatory bodies be reviewed with a view to consolidating their functions;[194]
- steps be taken to improve the resourcing of the Commission and the capabilities of its staff;[195] and
- the Commission needed to strengthen its stakeholder engagement and communications strategies.[196]

All these recommendations were adopted in the legislation creating the FMA in 2011.

4.4 The Financial Markets Authority

The FMA came into existence on 1 May 2011 with a mandate to strengthen the public's confidence in New Zealand's financial markets, promote innovation, and grow New Zealand's capital base.[197] New securities regulations followed two years later with the passage of the *Financial Markets Conduct Act 2013* (FMCA), replacing the *Securities Act 1978*.

Like its predecessor, the FMA was established as an independent Crown entity. It operates with a board of up to nine members, led by a chair, and up to five more associate members.[198] All board members, including the chair, are appointed by the Governor-General on the recommendation of the Minister of Commerce. In practice, the FMA board and chair are closely involved in board appointments. The board first identifies the skill set the board needs. The chair then discusses the board's view with MBIE officials, who filter applications for the position based on the agreed criteria. Both the chair and MBIE participate in candidate interviews and then put together recommendations for the Minister.[199]

The FMA has a wide range of regulatory powers and responsibilities. These include:

- monitoring compliance by financial markets participants with the FMCA;
- investigating and enforcing non-compliance;
- prosecutorial decision-making;
- quasi-judicial decision-making (including granting consents or exemptions of various types);
- rule-making; and
- advising officials on policy.

From the outset, the FMA board delegated extensive decision-making powers to its CEO. This modus operandi was a break both from the

---

192. Ibid.
193. Ibid. 15.
194. Ibid. 17.
195. Ibid. 30.
196. Ibid. 37–38.
197. Financial Markets Authority, "Statement of Intent 2017–2020" (2017).
198. Note: The current FMA Chair, Murray Jack, is a board member of The New Zealand Initiative. Along with the chairs of several regulators – including the Commerce Commission, the Electricity Authority, and the RBNZ, he was interviewed as part of our research. However, he has played no role in our research other than in his capacity as chair of the FMA.
199. Murray Jack, Personal interview (1 September 2017).

commission model of its predecessor, and from its closest peer, the Australian Securities and Investment Commission (ASIC).

The FMA board has nevertheless reserved for itself decision-making powers for sensitive matters, as well as those powers the board is required to exercise under the FMCA.[200] In this regard, it operates like a corporate entity. The executive is largely responsible for managing the core functions of the organisation (albeit regulatory, rather than profit-maximising). The board is responsible for setting strategy and performance measures against which to hold the executive accountable.[201]

When exercising its reserved decision-making powers, the board generally acts in divisions of three board members. Divisions meet more frequently than the full board and exercise all the powers of the FMA. In this respect, the FMA operates similarly to the former Securities Commission – and to the current Commerce Commission.

However, it is different from both in two key respects. First, the majority of the FMA's regulatory decision-making power is delegated to the CEO. And second, the divisions work closely with the CEO, who attends all – or nearly all – division meetings.[202] In a real sense, the CEO is the fulcrum through whom the FMA exercises its regulatory powers.

4.5 Have the reforms worked?

During both its first two years, the FMA undertook stakeholder engagement surveys to gain feedback on its performance.[203] These surveys were all overwhelmingly positive. Their essence is captured by the following quotation from the FMA's media release relating to the third survey:

> Overall, stakeholders recognised FMA as a capable, credible and professional regulator which has established a significantly stronger and improved regulatory framework. They were highly satisfied with FMA's achievement of a significant cultural turn-around from the Securities Commission through its collaborative, engaged and proactive working style including the attraction of good talent and strong leadership and market presence.[204]

These observations align both with the responses to our survey and in interviews conducted with interested stakeholders following the survey period. As Consumer NZ said in an interview,[205] "… they are a million times better than the Securities Commission. We never agreed the Securities Commission lacked the necessary tools. The FMA is doing a much better job."

In our survey, we asked those respondents who had interacted with both the Securities Commission and the FMA to assess the FMA *compared with* its predecessor. Respondents were asked to do this using the full range of performance metrics used to evaluate the regulatory agencies earlier in the survey. These metrics included communication and coherence of the FMA's objectives, expertise and respect, commercial acumen, predictability, transparency, and fairness in decision-making, consultation and engagement, and accountability.

---

200. Financial Markets Authority, "Exercise and limits of delegated authority" *Regulatory Delegations Policy* (2015), 6.
201. Murray Jack, Personal interview (2 October 2017).
202. Rob Everett, Personal interview (27 September 2017).
203. Colmar Brunton, "Stakeholder survey – Final report: Financial Markets Authority" (2012); Oliver Wyman, "FMA Progress Review: Stakeholder Feedback Report" (2013).
204. Financial Markets Authority, "FMA releases stakeholder feedback report," Media release (5 December 2013).
205. Suzanne Chetwin, Personal interview (21 November 2017).

On average, 81.1% of survey respondents either 'agreed' or 'strongly agreed' that the FMA performs better than its predecessor across the 23 performance metrics.[206] No respondents 'strongly disagreed' and, on average, across the 23 KPIs, only 2.3% of respondents 'disagreed' (see Figure 4.1). This is a remarkably strong endorsement of the new regulator.

While the overall results are impressive, responses to some of the individual questions are even more striking. More than three-quarters of respondents 'agreed' or 'strongly agreed' that the FMA outperforms the former Securities Commission on *18* out of the 23 KPIs (see Figure 4.2).[207]

The FMA's own ratings, that is, where it was rated *in its own right*, rather than *compared with the Securities Commission*, were also strong.[208] Overall, 60.8% of responses 'agreed' or 'strongly agreed', 28.9% were 'neutral', and only 10.3% 'disagreed'.

Figure 4.1

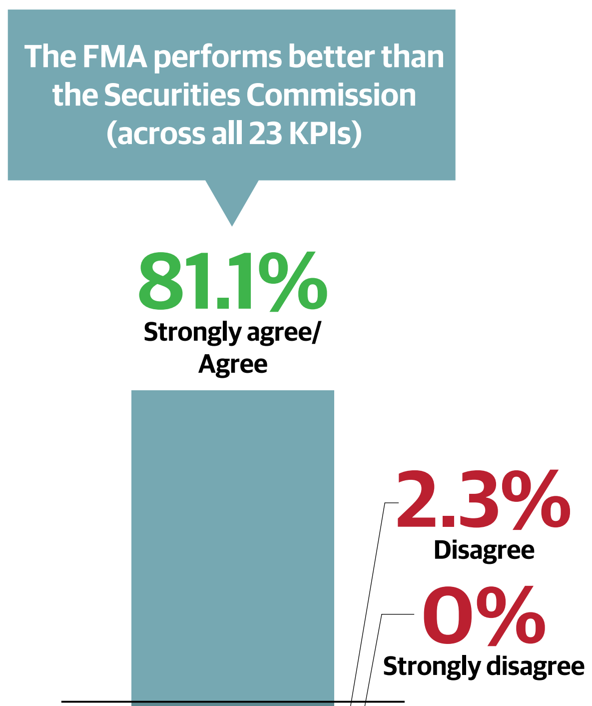
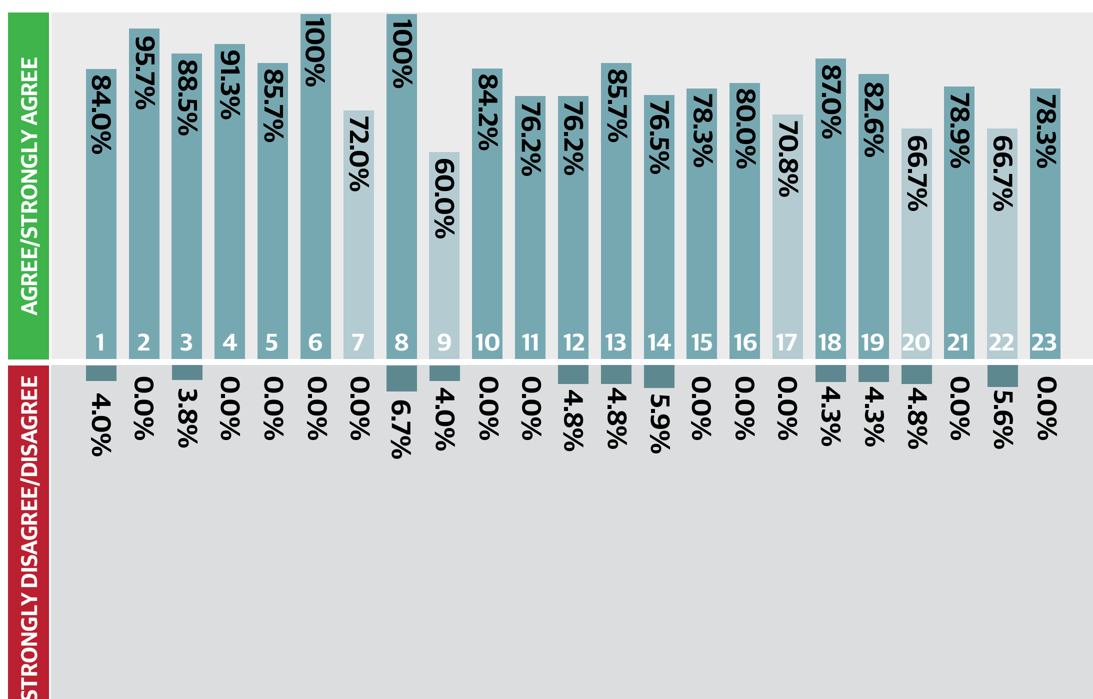


Figure 4.2

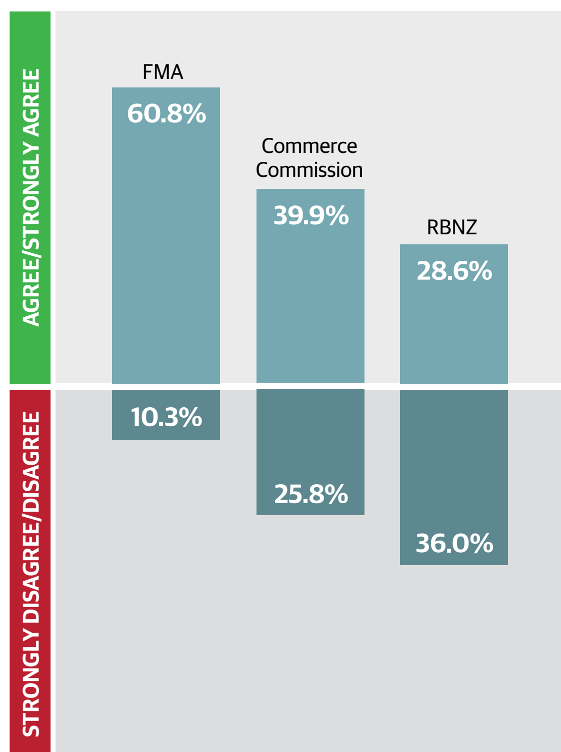


206. The results of this comparative assessment are set out in Appendix 6.
207. The exceptions were KPIs 7, 9, 17, 20 and 22. Even with these KPIs, between 60% and 72% 'agreed' or 'strongly agreed' that the FMA outperforms its predecessor, and only 0% to 5.6% 'disagreed'.
208. See Appendix 6.

The FMA's average of 60.8% compares very favourably with the ratings of the other regulators in our case studies (see Figure 4.3).

Figure 4.3

Average percentage responses across the 23 KPIs



The FMA received more 'agree' and 'strongly agree' responses to *all* 23 KPIs than *each* of the Commerce Commission and the RBNZ (see Figure 4.4). Responses on coherence of objectives, constructiveness, predictability, consultation, learning from mistakes, and internal accountability were significantly stronger for the FMA than for the other two regulators.[209]

We also asked respondents to rank the regulatory agencies with whom they interacted based on the level of respect they had for them. Of the agencies ranked 25 times or more, the FMA received the fewest 'worst place' rankings – one out of 27 respondents – equating to just 3.7%.

Comments from survey respondents add some colour to the numerical results.

- **Governance and accountability**
  "The FMA governance structure has two distinct features. There is clear management-board separation. The board represents a diverse range of industry stakeholders. Both features are unusual in NZ regulators."
  "This is the model that should be applied to the Commerce Commission and the Reserve Bank."
  "The FMA … appears to be subject to more active review by … the MBIE than seems to be the case with most other regulators."
- **Expertise**
  "Governance is only part of what has made [the FMA] successful. Its culture and level of market expertise also matter."
- **Consultation**
  "FMA consults well. They listen well. The leaders understand the issues. Delivering through their staff ranks is their major challenge."
- **Engagement**
  "Overall I have found the FMA … surprisingly easy to deal with… [They] do appear to take a more collaborative approach to compliance than their predecessor and engage better with businesses."

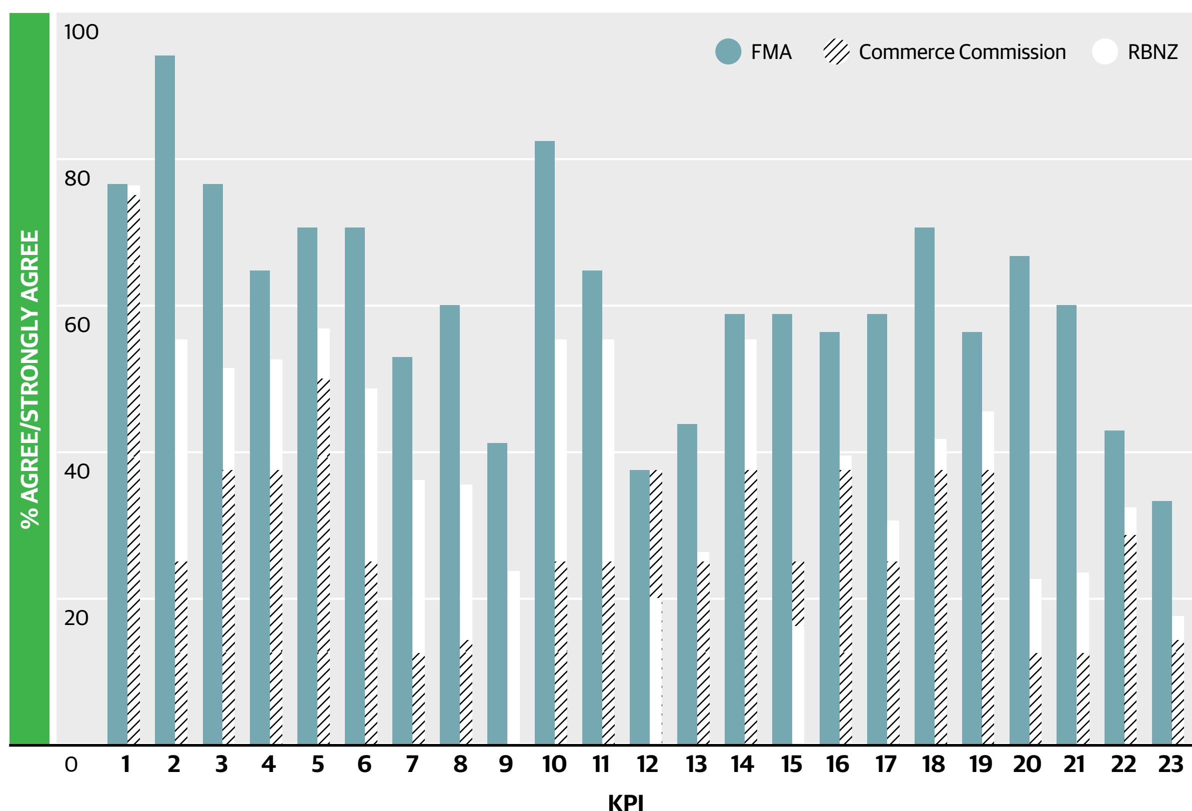
While there were some critical comments expressing reservations about the expertise of the FMA's staff, the responses were overwhelmingly positive. The comment below perhaps best sums them up:

> The FMA firstly has a well-comprised and well-respected Board. It has a CEO that has both commercial and regulatory experience. Whilst they have struggled to build expertise in their lower ranks there is a well-balanced

209. See responses to questions 2, 10, 13, 19, 20, and 21 in Appendix 6, setting out the comparative survey responses to the 23 KPIs for the FMA, the Commerce Commission and the RBNZ.

Figure 4.4

Comparative ratings for FMA, Commerce Commission and RBNZ across the 23 KPIs



approach between endeavouring to support growth in markets and ensuring poor behaviour is well regulated.

4.6 What can we learn from these results?

At one level, the results of our survey tell us that institutional reform has been successful. No doubt, there are many factors contributing to the FMA's performance. But we suggest that the FMA's internal governance arrangements are critical. As we saw in Chapter 1, organisational governance and leadership are key in driving culture, talent, evaluation and performance towards high-quality regulatory decision-making.

Two particular features of the FMA's governance arrangements appear to promote high-quality performance. First, separating the roles of chair and chief executive means the board is largely independent from the day-to-day executive performance of the organisation. It is therefore well-placed to hold the FMA's executive to account. This is in stark contrast to an organisational structure where the executive powers reside either in the chair of the board, or in the board itself. Even with the best will in the world, a board with executive powers will struggle to hold itself to account.

Second, feedback from the interviews we have conducted suggests the FMA board role appeals to a wider range of candidates than membership of the former Securities Commission. Importantly, the role appeals to more candidates with current financial markets expertise.

It is not hard to understand why. Holding an executive chair to account is an invidious task. More candidates are thus willing to take on a

governance role under the board governance model where they have a greater chance of being effective.

Indeed, both factors work in tandem. Separating governance and executive responsibilities enables greater accountability and assists the appointment process by attracting more expert candidates for board positions. Such individuals are, in turn, able to show higher levels of performance.

Of course, other factors *might* have an equal – or even greater – bearing on the FMA's performance.

Before its demise, the Securities Commission claimed its performance had been hamstrung by a lack of enforcement tools and the resources it needed to be effective. But not one of the 23 KPIs against which we asked survey recipients to rate the comparative performance of the Securities Commission and its successor related to the breadth of the agencies' enforcement powers.

Additional powers of compulsion are not a prerequisite to communicating objectives clearly, or to reaching consistent decisions, or to having respected expertise. Yet these are all hallmarks of a well-run organisation, with strong internal governance.

Survey recipients were asked to focus on the *conduct* of the two regulators, rather than the scope of their *powers*. And it was on that metric that the FMA beat the Securities Commission hands down.

The FMA's leadership would agree it is better resourced than the Securities Commission. Resourcing may partly explain the FMA's superior ratings, but many well-resourced organisations fail. Adequate funding may be a prerequisite to organisational success, but good governance is critical to sustaining it. That is the principal lesson we can learn from the FMA.

Of course, this is not to say the FMA is perfect. Enough survey respondents raised concerns about staff expertise for the regulator to need to take notice of this. And survey respondents clearly felt there was room for strengthening the FMA's external accountability mechanisms. But if the aim of public sector governance is to ensure an organisation achieves its overall outcomes in such a way as to advance public and stakeholder confidence,[210] then the FMA is achieving that objective.

210. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 22.

1965.00
14840.0
3860.00
1427.00
723.50
717.75
4768
2480
2492
18.81
92.57

CHAPTER 5

Applying the learnings from the FMA: two case studies

To take the risks that come with such a drastic renovation makes sense only if the new regime promises marked improvements upon the performance of its… predecessor.[211]

Are there governance lessons from the FMA experience for other regulators? In this chapter, we examine the governance arrangements of two other important regulators, the Commerce Commission and the RBNZ. Both play critical roles in our economy. Yet our inquiry has revealed performance issues with both – and that both would benefit from FMA-like reform.

5.1 The Commerce Commission

The Commerce Commission is New Zealand's primary trade practices regulatory agency. The Commission was originally conceived as a competition regulator. But in the 30 years or so since its inception, its responsibilities have mushroomed. It is now tasked with multiple regulatory functions under multiple statutes.[212] These include:

- enforcing legislation that promotes competition;
- industry-specific regulation of markets where competition is regarded as weak (in the telecommunications, electricity, gas pipeline, dairy, and airport services sectors);
- enforcing fair trading laws that prohibit misleading and deceptive conduct by traders; and
- enforcing credit contracts and consumer finance laws.

In many countries, the Commerce Commission's roles would be split among several agencies. The concentration of these roles means the Commission has a more significant and far-reaching influence over businesses in New Zealand than almost any other regulator.

Like the FMA, the Commission has a wide range of regulatory powers and responsibilities, including:

- monitoring compliance with the legislation it is charged with enforcing;
- investigating and enforcing non-compliance, including prosecutorial decision-making;
- performing quasi-judicial decision-making (including granting clearances and authorisations of mergers, business acquisitions, and restrictive trade practices);
- using sector-specific regulatory and enforcement powers; and
- advising officials on policy.

These powers cover the full spectrum from policy advice to regulation-making, and from quasi-judicial to prosecutorial decision-making.

211. William Kovacic and David A. Hyman, "Competition Agency Design: What's on the Menu?" *The George Washington Law School* 2012:135 (2012), 1–14, 2.
212. In addition to the *Commerce Act 1986*, the Commerce Commission enforces the *Fair Trading Act 1986*, the *Credit Contracts and Consumer Finance Act 2003*, the *Dairy Industry Restructuring Act 2001*, and the *Telecommunications Act 2001*.

Commerce Commission's governance and accountability mechanisms

The Commission is an independent Crown entity. It is accountable to the Minister of Commerce and Consumer Affairs. It must present an annual report to Parliament and a Statement of Intent every three years, and is subject to oversight by MBIE and Treasury and scrutiny by a parliamentary select committee. It also produces an annual Statement of Performance Expectations outlining its priorities, forecast financial statements, and performance measures for the next financial year.

Unlike the FMA, it has a Commission structure and is governed by full and part-time commissioners. In this regard, it is similar to the former Securities Commission.

The Commission is permitted to have four to six commissioners, including a Chair, a Deputy Chair, a Telecommunications Commissioner appointed under the *Telecommunications Act*, and up to three other Commissioners. It may also have Associate Commissioners appointed to act on a particular matter or class of matters.[213] Commission members are appointed by the Governor-General on the recommendation of the relevant Minister.[214] The current Commissioners and Associate Commissioners comprise four lawyers, three economists, and an accountant.[215]

The Commission's powers are vested in the Commissioners in much the same way as a company's management powers are vested in its board. In practice, the Commission typically delegates its decision-making powers to Divisions comprising three Commissioners.

Like the FMA, the Commissioners have a broad ability to delegate their regulatory decision-making powers to staff.[216] The only exceptions are its power to grant, revoke or vary authorisations, which must be made by Commissioners,[217] and certain powers normally exercised by the Telecommunications Commissioner, which may only be delegated with his or her consent.[218]

However, unlike the FMA, the Commissioners delegate only limited powers to staff. As well as the powers specifically reserved for them, the Commissioners retain all powers to grant clearances of business acquisitions, all industry-specific regulatory powers under Part 4 of the *Commerce Act* and related industry-specific legislation, and all decisions to commence civil proceedings or criminal prosecutions.

Powers delegated to staff are limited to:

- triage of complaints;
- low-level enforcement responses, such as warnings, infringement notices, or compliance advice letters;
- conduct of litigation (though not decisions to initiate proceedings); and
- some statutory investigative powers.

As a consequence, the Commissioner's role is more *executive* than *governance*. And while in recent times only the Chair and the Telecommunications Commissioner have been engaged as fulltime members, all Commissioners have substantial executive responsibilities, typically working two to four days *per week*. This is in stark contrast to the workload of the FMA board members who, apart from the Chair,

213. The Commission also has two "Cease and Desist Commissioners" appointed under s 74AA(1) of the Act, but the cease and desist powers have been used only rarely, and the Cease and Desist Commissioners do not play any wider role in the governance or management of the Commission.
214. The Telecommunications Commissioner is appointed on the recommendation of the Minister for Communications and Information Technology. Other members are appointed on the recommendation of the Minister of Commerce and Consumer Affairs.
215. See Commerce Commission, "Commission members," Website.
216. The power to delegate derives from s 73 of the *Crown Entities Act 2004*.
217. *Commerce Act 1986*, s 105(1).
218. *Telecommunications Act 2001*, s 7.

typically work a similar number of days *per month*.

Although the Commission has a CEO, no regulatory power is delegated by the Commission to the CEO. Consequently, the regulatory decision-making powers of the Commission staff, who report to the CEO, do not derive from the CEO. Rather, they are delegated directly to staff by the Commissioners.

These arrangements have a profound effect on the nature and status of the Commission's CEO. In contrast with the FMA CEO, the Commission's CEO is *not* the fulcrum for the Commission's regulatory decision-making function. Rather, it is the Commission's Chair who performs this role.[219]

While an executive commissioner structure is not unusual for competition authorities around the world, it is not the only model for competition regulators. Indeed, the regulatory governance model of the CMA in the United Kingdom,[220] which bears the most resemblance to the board governance model, more closely aligns with emerging theories of regulatory governance best practice.[221]

Commerce Commission's regulatory performance

The Commission's five-year strategic plan recognises it is important that consumers and businesses alike are "confident market participants."[222] The Commission notes specifically in relation to businesses that they "need to be confident that the regulatory regime we are responsible for is predictable in order to continue to invest and innovate."[223] Unfortunately, our survey results suggest the Commission is not succeeding with this objective.

The Commission performed comparatively poorly both in respondents' *ratings* of the Commission's own performance and in respondents' *rankings* of regulators from the most to the least respected.

As we saw in Chapter 3, in the ratings, the Commission's average overall performance across the 23 KPIs was just 39.9%.[224] This says little on its own. But compared with the FMA, with whom the Commerce Commission has some shared regulatory responsibilities, the scores are of real concern.

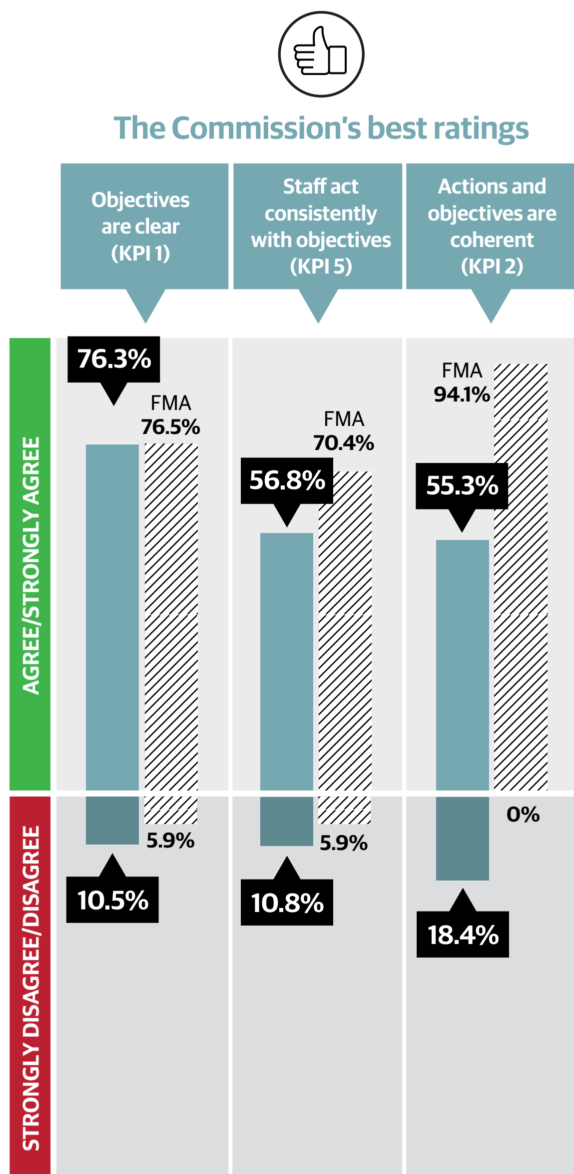
The FMA outperformed the Commission on all 23 KPIs.[225] On average, only 39.9% of respondents 'agreed' or 'strongly agreed' that the Commission met each of the KPIs, compared with the FMA's 60.8%.

The Commission's best rating was for clarity of objectives,[226] where 76.3% of respondents 'agreed' or 'strongly agreed' that they were readily able to understand the Commission's objectives. This result was comparable with the FMA's rating of 76.5% (see figure 5.1).

---

219. The current governance arrangements which leave the CEO to one side of decision-making power is a relatively recent development. Under the former Commission Chair, the Commission's General Manager (the predecessor title to the current CEO), along with the Commission's General Counsel and Chief Economist were directly involved in regulatory decision-making. Sometimes dubbed "the three wise men," they were the fulcrum around whom regulatory power within the Commission was exercised.
220. See Box 1 for more information about the CMA.
221. See for example, Joanna Bird, "Regulating the Regulators," op. cit. 771.
222. Commerce Commission, "Our Vision and Strategy 2017–2022" (2017), 9.
223. Ibid.
224. This figure represents the average percentage of survey respondents who agreed or strongly agreed that the Commission met the 23 KPIs. It compares with the FMA's score of 60.8% (see Chapter 4).
225. See Appendix 6 setting out a table of comparative results from survey for each of the FMA, Commerce Commission and the RBNZ for each of the 23 KPIs.
226. See Question 1, Appendix 6. The ranking of 'best' to 'worst' results, has been assessed by assigning a score of 5 to a 'strongly agree' response, 4 to 'agree,' and so on, to the lowest score for 'strongly disagree,' and calculating the mean rating by dividing the sum of these by the number of responses for each KPI. The KPIs for which the regulator scores 'best' are those for which it receives the highest mean score.

Figure 5.1



The Commission's next best ratings were for:[227]

- Question 5, where 56.8% of respondents 'agreed' or 'strongly agreed' that "Staff within the Commission appear to understand the Commission's overall statutory objectives and act consistently with them," and 10.8% 'disagreed' or 'strongly disagreed'. However, this result was comparatively poor compared with the FMA's equivalent percentages of 70.4% and 5.9%, respectively.
- Question 2, where 55.3% of respondents 'agreed' or 'strongly agreed' that "The regulator's objectives and actions make sense to you having regard to the regulator's statutory purpose," and 18.4% 'disagreed' or 'strongly disagreed'. This result was also comparatively poor compared with the FMA's equivalent percentages of 94.1% and 0%, respectively.

On many of the other questions, the gap between the two was stark. These included questions relating to transparency of appointment processes, commercial knowledge, consistency and predictability, proportionality, consultation, learning from mistakes, and accountability.[228]

Among the Commission's worst comparative scores were those relating to commerciality, predictability and expertise of leadership (see Figure 5.2):[229]

- In response to Question 6, "The leaders of the Commission are skilled, knowledgeable and well-respected by businesses in your industry," 48.6% of respondents 'agreed' or 'strongly agreed', and 18.9% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 70.6% and 0%, respectively.
- In response to Question 9, "The Commerce Commission understands the commercial realities facing your industry," 23.7% of respondents 'agreed' or 'strongly agreed', and 57.9% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 41.2% and 11.8%, respectively.

227. See Appendix 6.
228. See comparative results to questions 6, 9, 15 in Appendix 6.
229. The Commission's worst comparative scores are identified as those where the difference between the Commission's mean score for a KPI and the FMA's equivalent scores are the greatest.

Figure 5.2

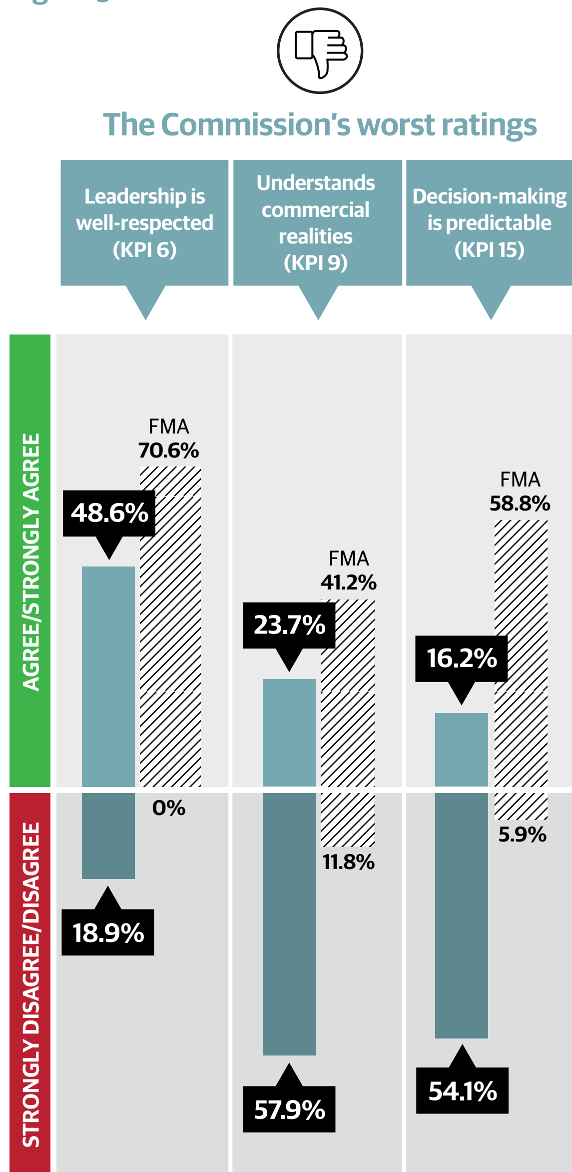
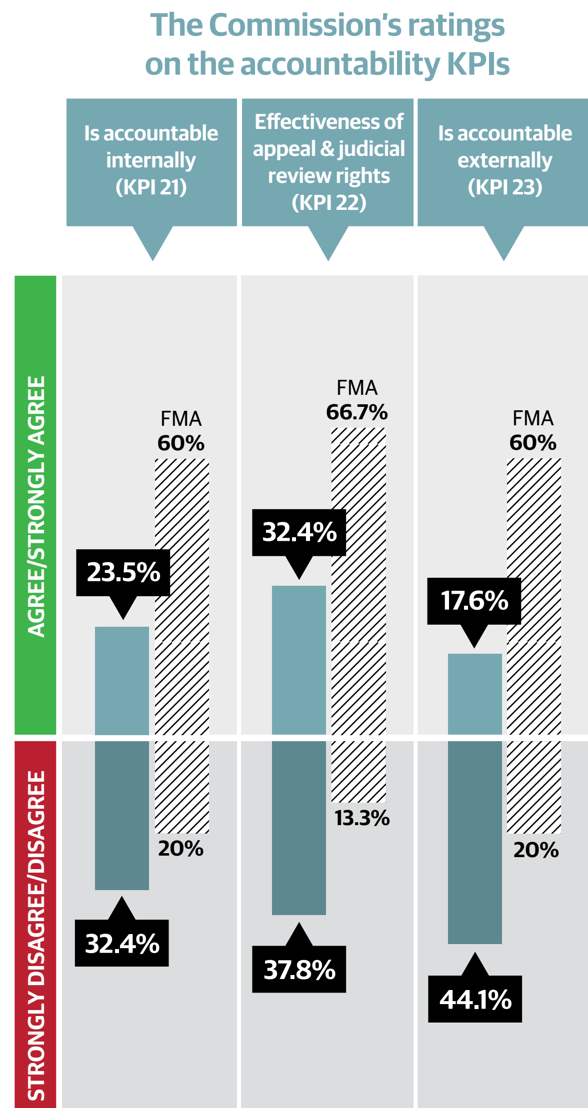


Figure 5.3



- In response to Question 15, "You are not hindered or deterred from taking action to improve the performance of your business by any lack of predictability about the regulator's decision-making", only 16.2% of respondents 'agreed' or 'strongly agreed', and 54.1% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 58.8% and 5.9%, respectively.

In relation to the accountability KPIs, the differences were also stark (see Figure 5.3):[230]

- In response to Question 21, "There are effective accountability mechanisms within the regulator to enable participants in your industry to voice concerns about mistakes," only 23.5% of respondents 'agreed' or 'strongly agreed', and 32.4% 'disagreed' or

230. See Appendix 6.

'strongly disagreed'. The comparative figures for the FMA were 60% and 20%, respectively.
- In response to Question 22, "There are effective appeal and judicial review rights to challenge the decisions of the regulator in the courts", only 32.4% of respondents 'agreed' or 'strongly agreed', and 37.8% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 66.7% and 13.3%, respectively.
- In response to Question 23, "The Commerce Commission is readily held to account for the quality of their work (including any mistakes) by its responsible government department, minister or some other effective external accountability mechanism," only 17.6% of respondents 'agreed' or 'strongly agreed', and 44.1% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 60% and 20%, respectively.

The Commission's comparatively low ratings were supported by comments from survey respondents in the survey comments and during interviews. Notable comments included the following:

a. **Objectives and actions:** There was widespread concern about the clarity of the Commission's objectives and the consistency of its actions with its stated goals. As one respondent said, "The Commerce Commission lacks strategic direction. There is a disconnect between its stated enforcement priorities and what happens day to day. Its decisions often do not relate to what it avows are its strategic goals." Another said, "Like the Electricity Authority and the OIO, the Commission lacks clarity about what it is trying to achieve." And another said, "Not sure it is always focussed on the most important things."
b. **Appointment processes**: "There is no obvious consultation by MBIE/Minister as to industry views about what skills or capabilities ComCom's commissioners need. Conversations with Ministers about the Commissioners have largely drawn the response 'it's very hard to get anyone interested who has the right skills'. There is no response to my follow up 'if you can't get good people to apply maybe you should look at the organisation and role.'"
c. **Commercial expertise**: This was another area of concern. As one respondent said, "We find it hard to communicate commercial realities to Commission staff."
d. **Willingness to listen:** Several respondents commented on this. One said, "They have a black and white view of the world. Their default position is scepticism and distrust." Another contrasted the Commission with the FMA, who they said were, "less arrogant than the Commission, and much more willing to consult and take things on board." Others referred to the Commission's "high level" communications, but that "hosting talks as a method of engagement is not as beneficial as one-on-one meetings."
e. **Accountability: "**Being held to account by appeal to the Courts is not an effective external mechanism in some cases given the costs (time and financial) involved."

Although not addressed *directly* in the survey, two further common concerns were**:**

a. **Communication – *who speaks for the Commission?*** A frequent area of comment from respondents was the lack of clarity about who among the Commission's staff could "speak for the Commission". As one respondent observed, "The Commission's staff often make a certain commitment and then it goes to the Commissioners themselves, and you end up with a completely different outcome."
b. **Lack of rigorous cost-benefit analysis**: "A market intervention should evenly balance the possible benefits (wrongs averted) and the costs (good things impeded) but it's apparent that ComCom places much greater weight on the former than the latter."

> "ComCom's door is open and stakeholder communication definitely occurs. They do follow 'good regulatory processes' except as regards real assessment as to the cost/benefit of their regulation. If their goals were permanently ideal their approach would be fine, but they are not ideal and industry and other changes mean that goals should be reviewed, which is not an obvious part of [the Commission's] modus operandi."

There were some positive comments, too. One survey recipient commented favourably on the more relationship-driven approach of the Commission's Regulation branch, which is responsible for industry-specific regulation. Others commented positively on the Commission's experiment with relationship managers for major customers in the Competition and Consumer branch.

However, our survey results and interviews identified serious shortcomings in the Commission's overall performance as a regulator. These comparative shortcomings in turn inform the rankings of survey participants' levels of respect for the Commission.

They resulted in the Competition and Consumer branch of the Commission being ranked the *least respected* regulator by just under a third of the businesses who interacted with it.[231] The Commission's rankings compare very unfavourably with those of the FMA, at one worst place ranking out of 27 (3.7%).

Observations and recommendations

Both the survey results and the feedback from survey recipients suggest the Commerce Commission suffers from poor governance. Respondents do not have a strong sense that the Commission's actions align with its stated objectives. Its expertise and commercial acumen are not well-respected. Respondents think the Commission's decision-making lacks predictability. And the internal and external mechanisms for holding the Commission accountable are not regarded as effective.

There are two features of the Commission's internal governance arrangements that stand out as shortcomings.

First, the Commissioners' approach to delegating their regulatory powers directly to staff means the CEO is not responsible for any exercise of decision-making power by the Commission. He is the chief executive of everything within the Commission *other than* its core function: the exercise of regulatory power. He is neither responsible for making regulatory decisions, nor accountable for those made by the staff. As one respondent said, "The [Commission] CEO is actually a COO… The role is administrative. Where the FMA CEO has decision-making power and regulatory responsibility, the Commission has separated the CEO and Chair roles into two people, but the roles are wrong." Or as another said, "The CEO is not working alongside the Commissioners. The [actual] CEO role is embedded in the Chair role, but the Chair isn't acting as a CEO."

A consequence of this arrangement is the Commission lacks a key internal accountability mechanism that is a feature of the FMA's board governance model: the accountability of the CEO to the board for regulatory decision-making. It also explains the repeated feedback we heard from survey recipients that they often feel there is no one accessible to them within the Commission to speak *for the Commission* on matters before a division of Commissioners. With no 'CEO for decision-making' – other than

231. We asked survey recipients to rank separately three constituent parts of the Commerce Commission: competition and consumer, non-telecommunications price regulation, and the Telecommunications Commissioner. The respective divisions were ranked 'least respected' by 32.3%, 17.4% and 11.1% of survey respondents who interacted with them: see Appendix 3.

the Commission Chair, who does not consider himself to have such responsibilities – the Commission's management arrangements have an obvious hole.

The second consequence is a corollary of this. As the Commissioners are the key decision-makers, if there is to be any internal accountability, they must hold *themselves* to account.

The multi-member nature of the Commission provides them with *some* basis to bring external judgment to their decision-making. So too does the fact that they tend to operate within divisions. But as they are the Commission's key decision-makers, they cannot be expected to bring the critical, independent perspective of a governance board.

The Commission's external governance also has clear shortcomings. This is hardly surprising. While the Commission is accountable to MBIE, the Minister of Commerce, and Parliament's Commerce Select Committee, none of them have in-depth expertise in competition law. While each can monitor the performance of the Commission against budget, or take notice of any significant losses by the Commission before the courts or any complaints or controversies involving the Commission, none of the three has the expertise to evaluate the strategic direction of the Commission.

As one survey recipient said, "MBIE monitors the ComCom in theory – but not in any substantive sense." This observation is consistent with the Productivity Commission's conclusion that external monitoring focuses too much on "reporting" and not enough on the regulator's "performance and strategy"[232] (albeit in relation to regulatory agencies *generally*, rather than the Commerce Commission *in particular*). But these observations should hardly be seen as a criticism of MBIE, the Minister, or the Parliamentary Select Committee process. These observations are simply a consequence of the complex and specialised nature of the Commerce Commission's regulatory role.

Both the principles of regulatory governance and the real-life experience with reforming the FMA suggest the Commerce Commission's performance would be improved by strengthening both its internal and external governance in three ways.

1. Strengthen the Commission's internal governance by introducing a substantial degree of separation between the principal regulatory decision-makers – whether preliminary or final – and those exercising oversight.
2. Broaden the Commission's skill set by recruiting more Commissioners/board members with industry expertise to address the concerns about the Commission's lack of commercial expertise and business acumen.
3. Create an effective external mechanism to monitor the Commission's discharge of its prudential regulatory powers.

In the next chapter, we return to the latter two objectives and outline how they might be achieved. In relation to the first objective, the Commission's internal governance could be strengthened either by:

- restructuring the Commission to introduce a hybrid board governance model – either like that of the FMA, or the more complex hybrid model of the United Kingdom's CMA discussed in Chapter 1;[233] or
- encouraging the Commissioners under the existing Commission model to delegate substantial power to a suitably qualified

232. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 454.
233. See page 14.

CEO (for onwards delegation to staff as appropriate). This would turn the commissioner role into one more akin to a governance role than an executive one.

In either case, the precise allocation of decision-making responsibilities between board members/Commissioners (on the one hand), and the executive (on the other) might not need to be precisely prescribed. Instead, this could be achieved through remuneration arrangements. These could encourage the delegation of sufficient decision-making power to staff to ensure the board members/Commissioners performed the internal oversight role of contesting and challenging the Commission's regulatory strategies and the exercise of regulatory decision-making power. As with the FMA's board, in their restructured role, board member/Commissioners could retain ultimate decision-making powers over sensitive matters (and, under the current legislation, board member/Commissioners would be required to exercise decision-making powers for merger authorisations.[234])

During our meetings, stakeholders raised three reservations about changing the Commission's governance. The first related to the potential for monitoring 'overkill' from introducing an additional external monitoring mechanism. The second related to the feasibility of the Commission delegating its complex regulatory functions to staff. The third concerned potential conflicts of interest for future Commissioners (or board members).

In relation to the monitoring issue, it is sufficient to note that existing external monitoring mechanisms are inadequate. Better mechanisms are clearly needed. Both the Productivity Commission's findings and our survey results make this clear.[235]

In the case of the Commerce Commission, the shortcomings are ameliorated *to some extent* by the availability of merits review of the Commission's exercise of *some of its decision-making powers* by the courts. The courts can overturn poor regulatory decisions and their court decisions can set precedents for the future exercise of regulatory power.

However, even where merits review is available, survey respondents expressed concerns about both the effectiveness and efficiency of appeals proceedings as an accountability mechanism.[236] The court process is slow and expensive. This can often deter aggrieved parties from exercising appeals rights even where they believe there are grounds to do so. Commerce sometimes needs to move more quickly than the court process. Consequently, merits review is not an adequate substitute for non-judicial *ex post* monitoring and review.

Turning to the second issue, it is legally permissible for the Commission to delegate to staff virtually all its decision-making powers.[237] As to the practicalities, the board of the UK Competition Markets Authority (CMA) delegates almost all regulatory decision-making powers to staff. While it does not have the Commission's industry-specific price regulatory functions, the powers delegated include merger clearance and enforcement. Delegation to the executive is based on the fact that it is neither "practical nor desirable for the CMA board to make… individual enforcement decisions that require a detailed analysis of the evidence in a

234. *Commerce Act 1986*, s 105(1).
235. Ibid. 353. Generally, regulators scored poorly on KPI 23: "The regulator is readily held to account for the quality of their work (including any mistakes) by its responsible government department, minister or some other effective external accountability mechanism" (see Appendix 2 for all results).
236. See Appendix 2, KPI 22, where only 32.4% of respondents agreed or strongly agreed that there are effective appeal and judicial review rights to challenge the decisions of the Commerce Commission in the courts.
237. *Crown Entities Act 2004*, s 73.

case and the potential application of the relevant legislation."[238] The CMA board is, consequently, for the most part a governance board. It determines and guides how decisions are made, the processes involved, and the resources drawn on to analyse the evidence and inform the decisions.[239] The CMA experience suggests there is nothing in principle or in practice to preclude the Commission from operating according to the board governance model.

The conflict of interest concern arises because converting the *executive* Commissioner role to a largely *governance* role could leave the new-style board members/Commissioners retaining or seeking other outside roles to fill their time (or pay their bills). To the extent that these outside roles might be for entities regulated *by the Commission*, that creates potential conflicts of interest.

But just how real is this concern? Experience with the FMA suggests not very. Most FMA board members have other outside roles – even the FMA Chair. The same is also true of the Takeovers Panel.[240] Both the FMA Chair and CEO advised us that, in practice, conflicts of interest are readily managed through a combination of comprehensive conflicts policies and procedures and the FMA's extended board of (up to) nine members and modus operandi of regulatory decision-making through divisions of three members.

Yet because the FMA board governance role appeals to a wider range of candidates with industry expertise, the FMA had access to more current financial markets expertise than if the role were an executive one. Survey respondents suggested that was a positive. It is likely this would also benefit the Commerce Commission, with one of the key criticisms raised by survey respondents being the Commission's lack of industry knowledge.

It might be argued that either conflicts are more acute in competition regulation (compared with financial markets regulation), or the market for potential Commerce Commission governance candidates is smaller, reducing the potential for conflict-free candidates. We doubt both concerns.

- The United Kingdom's CMA itself has at least one non-executive director with outside commercial roles on its board. This suggests that, if anything, the conflict of interest is a matter of *degree*, rather than *kind*; and
- Informal soundings from competition practitioners suggest there would be as many candidates who might be willing to take on a Commission *governance* role, but who are not interested in an *executive* Commissioner role, as there are candidates who might be ruled out by potential conflicts of interest.

For these reasons, we do not think the peculiarities of the Commerce Commission's regulatory functions preclude adopting the superior FMA board governance model. And for completeness, we note that if it did, this would make it all the more important to establish an effective external governance body to monitor the strategy and direction of the Commission. We return to this issue in the final chapter.

5.2 The Reserve Bank of New Zealand

The RBNZ is best known for its independent management of New Zealand's monetary policy. And since 1989, it has had a single monetary policy mission: to maintain price stability. At times – as now – the singularity of this goal has been controversial. Yet it is a job the RBNZ has done well.

238. David Currie, et al. "Institutional Design and Decision-Making in the Competition and Markets Authority," op. cit. 15.
239. Ibid.
240. The board of the Takeovers Panel comprises four practising lawyers, three investment bankers, two consultants, a professional non-executive director, and a corporate CEO.

But the RBNZ is not only responsible for monetary policy. It is also charged with:

- prudential regulation of banks, non-bank deposit takers, insurance companies;
- regulation of the payments system (jointly with the FMA); and
- supervision and enforcement of anti-money laundering legislation.[241]

The objective of the RBNZ's prudential regulatory role is to maintain a sound and efficient financial system.[242] With insurance companies, the RBNZ's regulatory role has the further purpose of promoting public confidence in the insurance sector.

The RBNZ's dual role is in contrast to its closest peer, the Reserve Bank of Australia, which has direct responsibility only for monetary policy. The prudential supervision of Australian financial institutions lies with a separate regulator, the Australian Prudential Regulation Authority (APRA).

Given our focus on regulatory governance, it is only the latter regulatory function of the RBNZ we address in this report. We will comment on the unique governance structures for the RBNZ's monetary policy responsibilities only to the extent they affect the RBNZ's regulatory responsibilities.

To enable the RBNZ in its prudential regulatory role, the *Reserve Bank of New Zealand Act 1989* (the Act) confers wide powers on the RBNZ. In relation to the banking sector, these include the power to:

- set and enforce conditions of registration for registered banks;
- authorise a change in ownership of a registered bank;
- recommend public disclosure requirements to the Minister;
- give directions to banks under certain circumstances; and
- recommend that a bank in financial distress be placed into statutory management.

In addition, the RBNZ monitors each registered bank's financial condition and compliance with its conditions of registration. This monitoring ensures the RBNZ is familiar with the financial condition and risk profile of each bank and that it maintains a state of preparedness to instigate corrective actions should it consider this necessary.

RBNZ's governance and accountability mechanisms

The RBNZ is a unique organisation. It has the appearance of an independent Crown entity but is not one, and therefore it is not subject to the *Crown Entities Act*. Instead, it is constituted under its own legislation and has its own, unique institutional form.

The RBNZ has a Governor (who in any other organisation would be called a CEO) and a board. However, the board does not exercise the powers of the RBNZ. The RBNZ's powers – for both monetary policy and prudential regulation – are directly vested by the Act in the Governor.

Compared with other critical regulatory regimes, this approach is unusual. But the RBNZ's governance arrangements reflect the policy objectives of the 1989 Act. At the time, achieving political independence for the RBNZ's monetary policy function was seen as paramount. It was, after all, the 1980s, and the New Zealand and global economies were still emerging from one of the most tumultuous periods of price instability in Western history.

241. In relation to anti-money laundering, the RBNZ has shared responsibilities, along with the FMA and the Department of Internal Affairs.
242. See section 1A, Reserve Bank of New Zealand Act, 1989.

Vesting the power of setting monetary policy directly in the Governor, while creating checks and balances relating to appointing the Governor, ensured the RBNZ's political independence.[243] It may have seemed only natural for the RBNZ's prudential regulatory powers to be vested directly in the Governor in the same way. And so they were, adopting what is now known as the single-member decision-maker model.

Consequently, the Governor has the sole power to determine – and enforce – the prudential requirements for all registered banks by controlling the conditions of registration and applicable prudential standards.[244] In practice, the RBNZ employs a committee-based decision-making process for regulatory policy decisions, with the Financial Systems Oversight Committee overseeing prudential regulatory strategy.[245] Nevertheless, with the ultimate decision-making power resting with the Governor, this is a remarkable concentration of both policymaking and regulatory decision-making power in a single individual.

With other policymaking powers, though, such as the prudential regulation of non-bank deposit takers (NBDTs) or bank disclosure rules, regulations are made by the executive council acting on the recommendation of the Minister of Finance (in turn, acting on the advice of the Governor).

This inconsistent approach to rule-making is unusual. Why should the RBNZ have discretionary rule-making power on significant policy issues like the *conditions of the registration* of banks, when changes to bank *disclosure requirements* must be made by the Executive Council? And why do the rule-setting requirements for banks, and those for NBDTs and insurers, differ?

This topic is beyond the scope of this report. But it is clear that at least in relation to the banking sector, the Governor's control over the banks gives him or her a level of discretionary power unparalleled in New Zealand.

Under Governor Graeme Wheeler, the RBNZ formalised diversifying decision-making by introducing a governing committee comprising the Governor, the two Deputy Governors, and the Assistant Governor under the chairmanship of the Governor.[246] However, given the committee comprises only the Governor's subordinates – and with the Governor retaining the right of veto – this arrangement does not change the fundamentally autocratic governance arrangements within the RBNZ.

There are, nevertheless, external governance mechanisms to hold the RBNZ to account.[247] The RBNZ must provide the Minister of Finance with a Statement of Intent each year.[248] And, since 2013 it has been subject to a Letter of Expectations from the Minister.[249] It is also subject to scrutiny by Parliament's Finance and Expenditure Committee and to audit by the Auditor-General. Treasury also provides a degree of oversight of the RBNZ's performance. And the RBNZ's twice-yearly Financial Stability reports also act as accountability mechanisms.[250]

However, as the RBNZ is responsible for advising the Minister on its own legislation, it is not subject to the same departmental

243. Reserve Bank of New Zealand, *Bulletin* 80:11 (December 2017), 14.
244. Reserve Bank of New Zealand, "Statement of Policy-Making Approach" (2017), 4.
245. Ibid. 5. Reserve Bank of New Zealand, *Bulletin*, op. cit. 18. The FSO is chaired by the Deputy Governor and head of financial stability. A similar committee, the Macro-Financial Committee, develops the RBNZ's macro-prudential framework.
246. Graeme Wheeler, "Decision making in the Reserve Bank of New Zealand," speech to the University of Auckland Business School (2013).
247. See section 4 of Reserve Bank of New Zealand, *Bulletin* op. cit. 2–30 for a more detailed summary of the RBNZ's accountability mechanisms.
248. *Reserve Bank Act 1989*, s 162A.
249. Reserve Bank of New Zealand, "Letters of Expectations," Website.
250. See Reserve Bank of New Zealand, *Bulletin*, op. cit. 22 and 25f.

oversight as other independent regulators. And, understandably, neither the Minister, nor the Auditor-General, nor the Finance and Expenditure Committee has the resources or expertise to evaluate the costs and benefits of the RBNZ's prudential regulatory regime.

Although the RBNZ has a board, the board's powers are much more limited than the FMA board (or, for that matter, a corporate board). This is largely because the RBNZ's regulatory powers are *vested directly* in the Governor by the Act, rather than being *delegated* to the Governor by the board.

This has profound consequences for the internal governance of the RBNZ's regulatory functions. While the board is charged with monitoring the Governor's performance, the Governor is not accountable to the board for exercising his or her powers in the way any other CEO would be. The board has no power to override a regulatory decision made by the Governor exercising a power delegated directly to him. And the Governor has no statutory duty – or need – to confer with the board before exercising the regulatory powers vested in him.

As a consequence, the board's role is primarily *ex post* monitoring of the Governor's performance, rather than *ex ante* approval of strategy (and holding the Governor to account for achieving that strategy). While the board may give advice to the Governor on any matter relating to the performance of the RBNZ's functions and the exercise of its powers,[251] the Governor is not obliged to follow the board's advice. Consequently, if the board is not happy with the Governor's use of his regulatory powers, it cannot step in and override those decisions.

And oddly, given the board's supposed monitoring role, the Governor sits on the board and supplies the board with its secretariat. Both features undermine the board's independence, and invariably compromise its effectiveness as a monitoring mechanism.

Recognising some of the oddities of the Reserve Bank's governance, in early 2017 Finance Minister Steven Joyce asked The Treasury to commission an independent report on possible changes to the governance of the RBNZ from former State Services Commissioner Iain Rennie. Following the 2017 general election, the new Minister of Finance, Grant Robertson, announced a two-stage review of the *Reserve Bank of New Zealand Act* and appointed an Independent Expert Advisory Panel to assist with the review.[252]

On 15 January 2018, Treasury released Rennie's report (the Rennie report) as background material for the review.[253]

The Rennie report recommends a move away from the RBNZ's single decision-maker model in favour of a complex 'committee-based' approach.[254] Three committees would be formed, each with external participants, to exercise the RBNZ's decision-making powers. One committee would deal with monetary policy, and the other two with micro- and macro-prudential regulation separately.[255] The RBNZ's board role would be modified to a monitoring one: It would not be tasked with the usual role of a regulatory agency's board of approving the agency's regulatory policy and strategy.[256]

---

251. *Reserve Bank Act 1989*, s 53.
252. Grant Robertson, "Review of Reserve Bank Act announced as Policy Targets Agreement re-signed," (Wellington: New Zealand Government, 7 November 2017).
253. Iain Rennie, "Decision-making and Governance at the Reserve Bank of New Zealand," The Treasury, Website.
254. Ibid. 12–14 and 19–22.
255. Ibid. 22–24.
256. Ibid. 16 and 37–40.

The RBNZ's response to the Rennie report was highly critical:

> … proposals to change the governance framework of the Bank should not be made lightly and need to be motivated by evidence that changes would improve upon the current framework… Much of the analysis underpinning the [Rennie] report was insufficient, and consequently the conclusions of the report are unreliable, or would require considerable further analysis."[257]

As a report commissioned by a prior government, the Rennie report is unlikely to dictate any changes to the RBNZ's governance. However, the Rennie report will be an important resource for the Labour-led Government's Independent Expert Advisory Panel, so we will comment further on the report at the conclusion of this chapter.

RBNZ's regulatory performance

The RBNZ's unusual governance structure would not matter if the bank's regulatory performance were consistently exemplary over time. However, our research has found reasons to believe it is not.

This is not to say the RBNZ's prudential regulation of the financial system has been lax or permitted excessive risks. Indeed, the International Monetary Fund's (IMF) most recent assessment of New Zealand's finance sector found our banking system was well placed to manage the risks and vulnerabilities associated with current developments in the housing sector, the high level of household debt, and low dairy prices.[258]

At the same time, though, the IMF was not entirely happy with the RBNZ's prudential regulatory approach, and recommended rebalancing the RBNZ's 'three pillars'[259] approach to prudential regulation towards a more rules-based approach, something the RBNZ is now considering.[260]

But whether or not the RBNZ accepts the IMF's recommendations, there is more to being a good regulator than simply avoiding the harm the regulations guard against. Regulatory interventions should be proportionate to the risks being managed, with costs and benefits carefully weighed. They should not impose unnecessary costs and burdens on the regulated entities. Regulators should also exhibit appropriate *standards of behaviour* – by acting in accordance with the rule of law and principles of natural justice fairly, predictably, transparently and proportionally (see Chapter 1).

Our survey suggests that on this latter dimension, relating to standards of behaviour, the RBNZ does not perform so well. We asked survey recipients to *rate* the performance of the three regulators most important to their businesses against 23 performance criteria. We also asked them to *rank* the relative levels of respect they had for all the regulators with whom they interacted (Chapter 3).

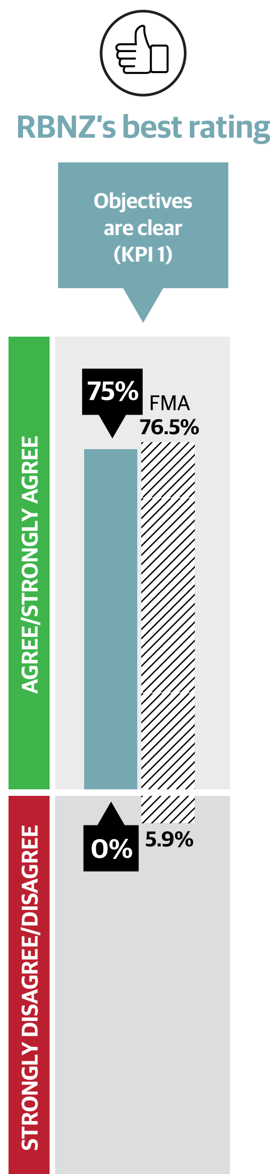
In the ratings, the RBNZ's overall performance across the 23 KPIs was poor. On average, just 28.6% of respondents 'agreed' or 'strongly agreed' that the RBNZ met the KPIs and 36% 'disagreed' or 'strongly disagreed'.[261] These figures compare very unfavourably with the FMA's

257. Ibid. 1.
258. International Monetary Fund, "New Zealand Financial System Stability Assessment" (2017).
259. The three pillars are self-discipline, market discipline, and regulatory discipline. See, for example, Toby Fiennes, "New Zealand's evolving approach to prudential supervision," Speech by Head of Prudential Supervision at the Reserve Bank to the New Zealand Bankers' Association in Auckland (2016).
260. Chris Hunt, "Outcomes of the 2016 New Zealand Financial Sector Assessment Programme" (2017).
261. This figure represents the average percentage of survey respondents who 'agreed' or 'strongly agreed' that the RBNZ met the 23 KPIs (see Appendix 1).

average scores of 60.8% and 10.3%, respectively. They also compare unfavourably (though less so) with the Commerce Commission's averages of 39.9% and 25.8%, respectively.

And where the FMA outperformed the Commerce Commission on all 23 KPIs, the commission in turn outperformed the RBNZ on 21 of the 23 KPIs.

Figure 5.4



While the number of businesses rating the RBNZ was smaller than for either the FMA or the Commerce Commission (8 businesses as opposed to 17 and 38, respectively), this sample included some of New Zealand's largest financial institutions.

The RBNZ's best rating was for clarity of objectives,[262] with 75% of respondents 'agreeing' or 'strongly agreeing' that they were readily able to understand the RBNZ's regulatory goals (see Figure 5.4). This result was comparable with the FMA's rating of 76.5%.

But on questions relating to almost all other KPIs, the gap between the performance of the prudential regulator and its financial markets conduct counterpart was cavernous.

The RBNZ's worst comparative scores related to expertise and respect, commerciality, constructiveness, proportionality, consultation and willingness to listen, learning from mistakes, and internal accountability (see Figure 5.5):[263]

- In response to Question 6, "The leaders of the regulator are skilled, knowledgeable and well-respected by businesses in your industry", only 25% or respondents 'agreed' or 'strongly agreed', and 37.5% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 70.6% and 0%, respectively.
- In response to Question 9, "The RBNZ understands the commercial realities facing your industry", *no* respondents 'agreed' or 'strongly agreed', and 50% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 41.2% and 11.8%, respectively.
- In response to Question 10, "Your interactions with the regulator are generally constructive", 25% of respondents 'agreed' or 'strongly agreed', and 50% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 82.4% and 5.9%, respectively.

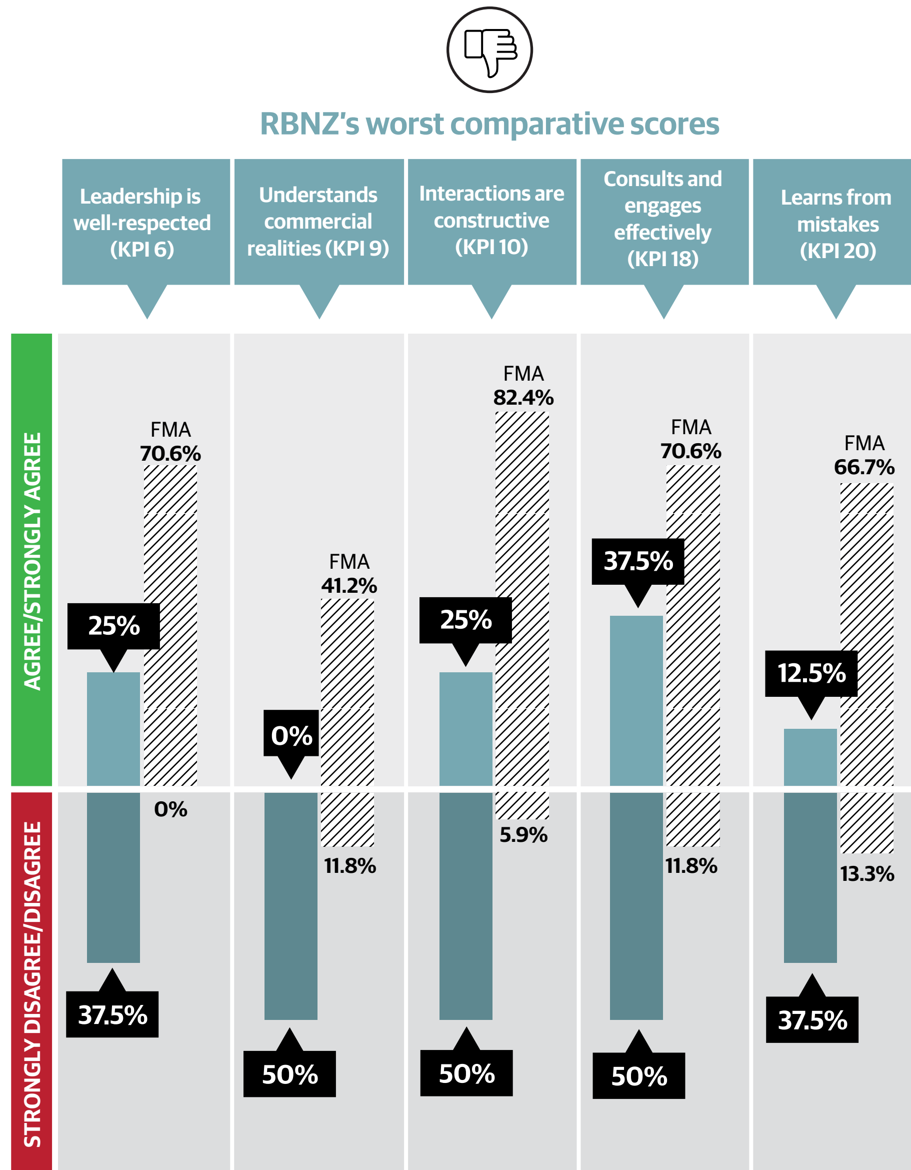
262. See Question 1, Appendix 6.
263. See comparative results to questions 6, 9–10, 12, 15, 17–18 and 20–21 in Appendix 6.

- In response to Question 18, “The RBNZ effectively consults and engages with you and businesses in your industry to ensure that good regulatory processes are being followed”, only 37.5% or respondents ‘agreed’ or ‘strongly agreed’, and 50% ‘disagreed’ or ‘strongly disagreed’. The comparative figures for the FMA were 70.6% and 11.8%, respectively.
- In response to Question 20, “The RBNZ reviews and learns from its mistakes”, only 12.5% or respondents ‘agreed’ or ‘strongly agreed’, and 37.5% ‘disagreed’ or ‘strongly disagreed’. The comparative figures for the FMA were 66.7% and 13.3%, respectively.

In relation to the accountability questions, the RBNZ’s results were also comparatively poor (see Figure 5.6):

- In response to Question 21, “There are effective accountability mechanisms within the regulator to enable participants in your industry to voice concerns about mistakes,” only 12.5% of respondents ‘agreed’ or ‘strongly agreed’, and 50% ‘disagreed’ or ‘strongly disagreed’. The comparative figures for the

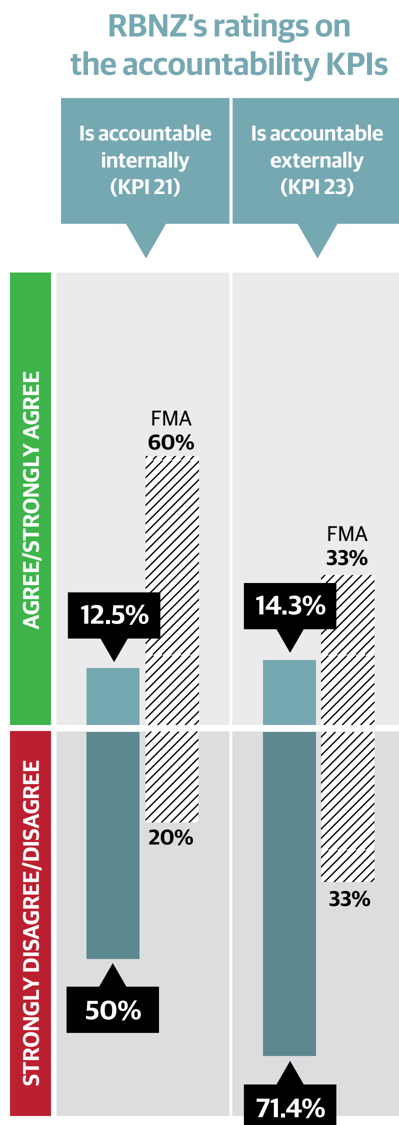
Figure 5.5



FMA were 60% and 20%, respectively.

- In response to Question 23, "The regulator is readily held to account for the quality of their work (including any mistakes) by its responsible government department, minister or some other effective external accountability mechanism," only 14.3% of respondents 'agreed' or 'strongly agreed', and 71.4% 'disagreed' or 'strongly disagreed'. The comparative figures for the FMA were 33% and 33%. While not great, these are significantly better than the RBNZ's ratings, respectively.

Figure 5.6



In the rankings, the RBNZ did not perform so poorly. It was ranked ten times by survey respondents. Of these it was ranked as the *least respected* regulator twice and the *most respected* once. But alongside the FMA's worst place ranking of once and best place ranking seven times (in each case out of 27 rankings), the RBNZ's ranking still compares unfavourably.[264]

Like the survey results, the views of interviewees were also largely negative. Some respondents were cautious to express criticism, noting that the RBNZ has been successful in achieving its financial stability goal. As one respondent said, "Significant positives, but room for improvement." Another was complimentary, noting that the RBNZ "did a good job with the resources available to it." While acknowledging that its governance structure gives rise to a potential lack of accountability, which could lead to questionable outcomes, one interviewee said the RBNZ's regulatory approach provides "flexibility and the ability to respond nimbly."

But most respondents were not so complimentary, and all expressed concerns about some aspects of the RBNZ's performance as prudential regulator.

The criticisms related both to the RBNZ's *capabilities and processes*, and the *substance* of its regulatory decision-making.

In relation to process and capability, criticisms included the following issues:

a. **Lack of consistency in process**: One respondent noted that the internal processes of the RBNZ's prudential supervision department, which is responsible for prudential supervision, can be 'random'. The

264. See Appendix 3.

respondent referred to long delays between steps in a process involving regulated entities, followed by the imposition of requirements for more-or-less immediate action from them.

b. **Lack of relevant financial markets expertise among staff**: This was a common theme. One respondent noted that until the 2000s, there was "regular interchange of staff between the banks and RBNZ," meaning RBNZ regulatory staff had first-hand finance industry expertise. But this has changed with the banks moving their head offices to Auckland and the RBNZ based in Wellington. As one respondent said, "They will always struggle to get good people [with financial markets expertise] in Wellington, especially with the banks now in Auckland… this makes interchange impossible." Another said, "RBNZ [staff are] completely divorced from the reality of how things are done." More colourfully, another said, "[RBNZ] is all a little archaic… Entrenched people don't get challenged." Another said, "On the insurance side, the level of capability is less than with the banks. There is a potential risk to policyholder protection. RBNZ ends up just focussing on the minutiae."

c. **Lack of commerciality**: This concern is allied to both the expertise issue noted above, and the materiality issue noted below. As one respondent said about the RBNZ's 'deafness' to the need for a materiality threshold before a matter becomes a breach of a bank's conditions of registration, "RBNZ says, 'If it's not material just disclose it'. But that's a regulator way of thinking. They don't understand the commercial, reputational implications."

d. **Unwillingness to consult or engage**: As one respondent said, "I would call them out for not truly consulting." Another said, "The RBNZ upholds independence to the point that it precludes constructive dialogue." Several respondents drew a contrast with the FMA, noting that the RBNZ was happy to issue hundreds of pages of "prescriptive, black letter requirements," but "without much or any guidance" for the banks on their application. One respondent did note, however, that the RBNZ "isn't resourced to spend time doing this [issuing guidance]."

e. **Lack of internal accountability:** Several respondents perceived a lack of oversight from the most immediate past Governor, Alan Bollard, in either engaging with the banks over concerns about prudential regulation or trying to resolve them. One respondent noted, "Staff are often running around doing things without serious scrutiny from above." Another said there is a group "with no accountability within the RBNZ… They favour form over substance and seem to enjoy exercising power." Another commented it was "unclear how much information flowed up to the RBNZ Board," but that if the Governor were accountable to the board for prudential regulation, then the board "could be useful in pulling up entrenched behaviour." Another noted that the RBNZ's governance structure meant it did not benefit from outside perspectives: "[t]he value of diverse thinking is to challenge, so you don't get capture by one person's view."

Two main criticisms were made in relation to substance:

a. **Materiality thresholds**: Several respondents highlighted the lack of a 'materiality threshold' before RBNZ approval is needed either for:
   - changes to banks' internal risk models in the Conditions for Registration of banks; or
   - changes to functions outsourced to related parties.

   One respondent noted that without a materiality threshold, the new requirement for a compendium of outsourced functions – and for approval of *any* change to outsourcing arrangements with a related

entity – could lead the Australian-owned banks to cease outsourcing functions to related entities, thereby increasing costs and harming customers.

Several respondents noted that the lack of a materiality threshold could be attributed to a lack of trust in the banks by the RBNZ staff responsible for prudential regulatory decisions. As one respondent put it, this led the RBNZ to "insist on approving absolutely everything."

Although this view was not shared by all banks, one respondent noted that even APRA – long regarded as a more heavy-handed, intrusive regulator than the RBNZ – was "now more reasonable to deal with than the RBNZ."

b. **Black letter approach**: Along with the lack of a materiality threshold in the RBNZ's regulatory regime, several respondents commented on the RBNZ's "black letter" approach to interpreting its rules: "If RBNZ had two or three public policy experts who could bring a 'purposive approach' to interpretation, that would be hugely positive." Another said, "[The RBNZ] has an overly legalistic approach which ignores the purpose of the legislation," and that "what they're doing undermines [public] confidence over things that are of no risk." Several survey recipients noted that this was in stark contrast to APRA's approach to public disclosure in Australia.

Another respondent put the concern differently, saying the problem was less about the RBNZ's 'black letter' approach to its rules, and the opaqueness of the rules, and more about the lack of guidelines from the RBNZ explaining them, an issue the respondent put down to a lack of resources.

Observations and recommendations

While our survey sample size for the RBNZ was comparatively small, both the survey results and our interviews with survey recipients, raise serious concerns about the RBNZ's exercise of its regulatory powers. That is not to suggest the RBNZ's regulation of the financial system has left the financial system vulnerable to risks. Rather, the problems relate to the *standards of behaviour* of the RBNZ in exercising its regulatory powers, and also in relation to the *efficiency* of the regulatory regime the RBNZ has created.

The concerns suggest the RBNZ's regulatory function suffers from poor internal accountabilities and inadequate external monitoring. Together, these point to shortcomings in the RBNZ's governance, internal and external. This failure may be exacerbated – and perhaps even facilitated – by the unavailability of merits review of the RBNZ's exercise of discretionary decision-making power.

It is probably also influenced by the RBNZ's need for independence in setting monetary policy. As the New Zealand Bankers' Association noted in its submission to the Productivity Commission:

> [T]his culture of independence also influences the way 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…[265]

These shortcomings should come as no surprise.

265. New Zealand Banker's Association, "Submission to the Productivity Commission on the Regulatory Institutions & Practices Issues Paper" (2013), 8.

The governance framework for the RBNZ's regulatory function lacks many safeguards. First, the single-member decision-maker model lacks the safeguards that exist with multi-member bodies. These include not just the benefit of a second (or third) pair of eyes, but also the opportunity to bring outside perspectives, including current banking and finance expertise, to bear on the exercise of discretionary power. It was just this sort of expertise Prada and Walter considered essential for an effective regulator of financial markets conduct like the Securities Commission.[266] This observation is equally applicable to the prudential regulator of those same financial markets. Indeed, the RBNZ itself recently acknowledged this, at least in theory. In its December 2017 Bulletin, the RBNZ noted that "multi-member decision making bodies (cf single decision-maker models) provide potentially greater consistency and continuity over time and a greater weight against ministerial influence."[267]

Second, though the RBNZ has a board, the Governor's regulatory policymaking and decision-making powers do not derive from it. As a result, the board has only limited means of holding the Governor accountable for either the development of regulatory policy or its implementation.

And third, the RBNZ is not subject to the same level of independent departmental or parliamentary review as are other regulators.[268] Hence, with the exception of bank disclosure requirements, its prudential policies for banks are not subject to scrutiny even by the Regulations Review Committee.

The RBNZ itself has recently acknowledged that, "[i]n the financial policy sphere the construction of robust accountability arrangements is not straightforward" and that "this warrants ongoing development and innovation."[269] We agree. The principles of regulatory governance and the experience with reforming the FMA both suggest the performance of New Zealand's prudential regulator would be improved by:

- Amending the Act by conferring the Governor's prudential regulatory powers on the board, and permitting the board to delegate those powers to the Governor (and for him or her to delegate them to staff).
- Broadening the skill set of the RBNZ board to increase the level of banking and insurance industry expertise. Given the systemic reservations of the Productivity Commission in relation to regulatory appointment processes, safeguards should also be introduced to ensure the selection process is informed by high-quality analysis of the skills needed.
- Creating an effective mechanism to monitor how well the board and Governor discharge their prudential regulatory powers (see the Conclusion).

We also recommend the RBNZ consider moving its prudential regulatory staff to Auckland to bring it closer to the financial institutions it regulates. The FMA's experience with its Auckland office suggests this would facilitate greater consultation and engagement between the regulator and the regulated. It would also facilitate the interchange of personnel between the financial market participants and the RBNZ. Both would help improve the trust and confidence of each in the other.

Our recommendations differ from those in the Rennie report in that we do *not* recommend the

266. Michel Prada and Neil Walter, "Report on the Effectiveness of New Zealand's Securities Commission," op. cit. 25–26.
267. RBNZ *Bulletin*, op. cit. 11, quoting the Bank for International Settlements 2009 report from its Central Bank Governance Group, "Issues in the governance of central banks."
268. Ibid, 65–66.
269. Ibid, 30.

formation of separate committees, with external participants, operating at a level *below the board* to deal with prudential regulatory decision-making. We think that such a structure:

- would add an unnecessary layer of complexity;
- is inconsistent with the approach taken by other more successful regulatory agencies with board governance models, including the FMA;
- is not justified by any evidence or analysis; and
- would make the RBNZ board role less attractive to future applicants.

For completeness, we note that the references in the Rennie report to the RBNZ board's role being an unusual one are correct, but not for the reasons stated.[270] What is unusual about the RBNZ board is the decision-making powers of the RBNZ's 'CEO' – the Governor – do not derive from the board, as they do, for example, for the CEO of the FMA (or for CEOs in the corporate world). As we have outlined earlier in this section,[271] this means the Governor is not accountable to the RBNZ board the way other CEOs are accountable to their boards.

The Rennie report suggests there is a "tension" between the RBNZ board's "advice role" and its role assessing the RBNZ's performance.[272] If there is such a tension, it is not an unusual one. It is an inherent feature of the board governance model, where the board both *tests and approves* the strategies developed by management – and no doubt helps shape them – and *evaluates management's performance*.

Rather than 'clarifying' the RBNZ board role, the proposals in the Rennie report would further eviscerate the board. And it would perpetuate the gap between the role of the RBNZ board and the principles of best practice for board governance for regulatory agencies discussed in Chapter 1.

We do not comment on the appropriateness of the committee model proposed in the Rennie report for RBNZ's monetary policy responsibilities. As noted earlier, the governance of the RBNZ's monetary policy responsibilities is beyond the scope of this report. That is because in exercising its powers relating to monetary policy, the RBNZ is not acting as a regulatory agency. Consequently, different accountability and independence issues arise. It would therefore be quite feasible to introduce the reforms we recommend to the RBNZ's prudential regulatory powers and either:

- leave unchanged the current arrangements for monetary policy – under which monetary policy-setting responsibilities are delegated directly to the Governor under the Act; or
- introduce a committee-based model for setting monetary policy as recommended in the Rennie report.

In its December 2017 Briefing to the Incoming Minister of Finance (BIM),[273] the RBNZ commented on the implications of involving external participants in the RBNZ's deliberations on prudential policy, suggesting that only full-time members should be considered:[274]

> Committees may also include external members to access outside perspectives, when other avenues are costly or not feasible. Financial policy decision-making generally involves extensive

---

270. Iain Rennie, "Decision making and Governance at the Reserve Bank of New Zealand," 16.
271. Ibid, 67.
272. Ibid. 16.
273. Reserve Bank of New Zealand, "Appendix 6: The Reserve Bank's decision-making process," in *Briefing for the Incoming Minister on the Reserve Bank of New Zealand* (2017), 54.
274. Ibid.

public and key stakeholder consultation, while monetary policy decision-making involves less formal but frequent sectoral engagement. Policy making in monetary and financial policy often involves complex considerations based on multiple indicators, analytic models and competing economic theories. Full-time members with experience and expertise are likely to be better suited to this task than part-time external participants.

Anticipating that external participants might be added to the RBNZ's governing committee, the BIM also argued that the Governor should retain final decision-making powers:[275] Provided the Governing Committee remains relatively small, we believe it should continue to make decisions by consensus, with the Governor having the final decision if no consensus can be achieved.

Furthermore, the BIM suggested any external committee appointments should be made *by the Governor*, or by the RBNZ board *on the recommendation of the Governor*.[276]

Four points need to be made in response. The first relates to complexity. Prudential policy undoubtedly involves "complex considerations," including both "analytic models" and "competing economic theories." But so too do the regulatory regimes of many other agencies, including the FMA and the Electricity Authority. And the RBNZ's BIM does not try to show that prudential supervisory issues are inherently more complex than these other regimes. The concern about complexity points merely to the need for any external participants of the RBNZ's regulatory governance arrangements to have an appropriate skill set. It does not preclude their involvement.

Second, the suggestion that any external participants should be full-time is also misguided. A full-time external participant is unlikely to be 'external' for long. Nor, in any case, is there a need for a suitably qualified external participant to commit to full-time involvement in the RBNZ's prudential regulatory function. Participation in, say, developing prudential regulatory strategy, and in periodic evaluations of the RBNZ's performance as a prudential regulator, does not require this.

Third, when the purpose of external participation is to challenge – or, at the very least, contest – the RBNZ's views, permitting the Governor to control the process for appointing external participants would compromise this objective. After all, it would be only natural for a Governor to seek external participants who share the RBNZ's views given the objective of external participation is to avoid 'group think'.

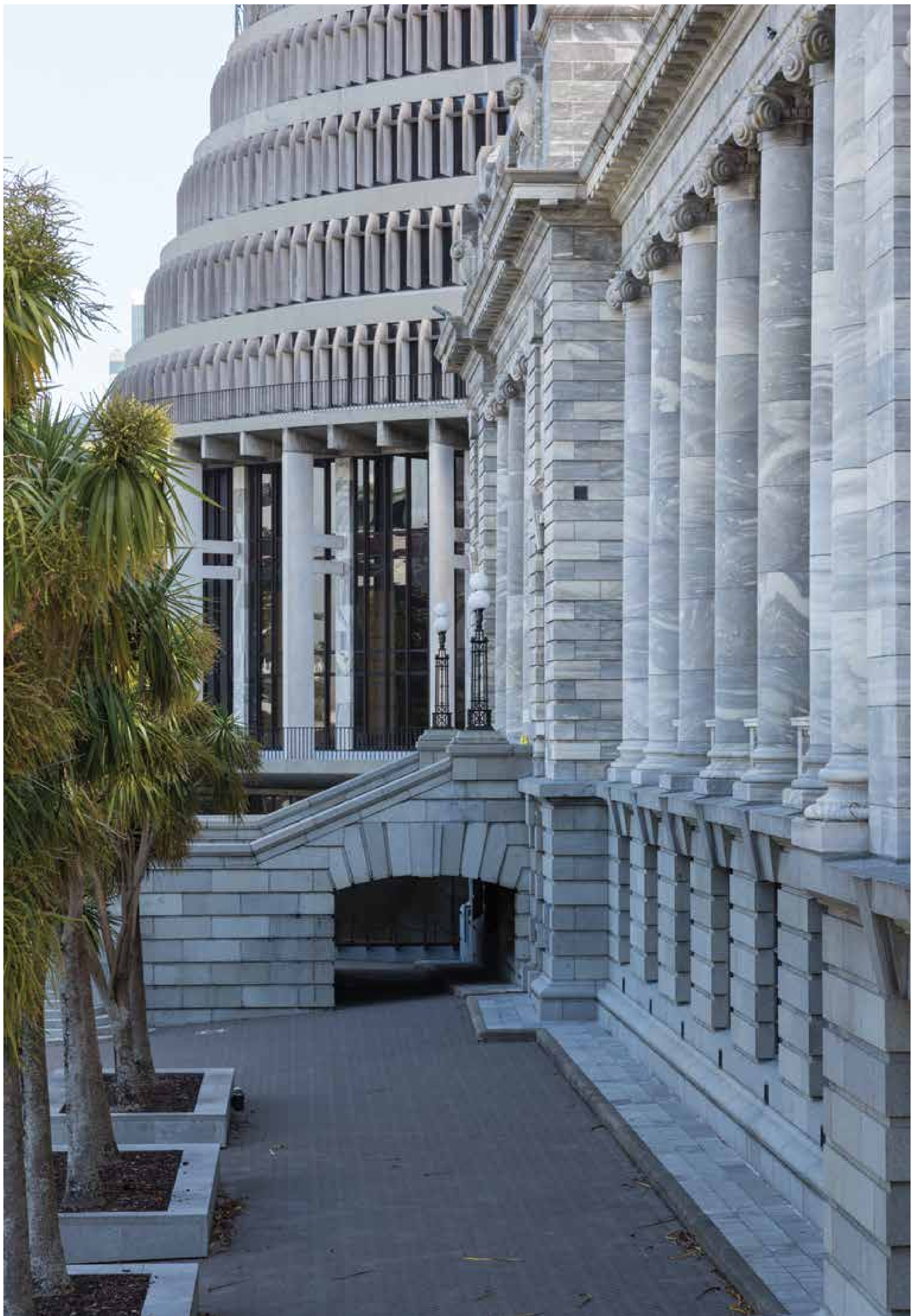
Fourth, and most importantly, external participation in a committee, with the Governor having the final decision, is not required to address concerns about the RBNZ's governance. The shortcomings in the RBNZ's governance stem from a combination of:

- the poor internal accountabilities inherent in its single-member decision-making model; and
- the lack of effective external monitoring of the RBNZ's regulatory performance.

Adding external participants to one of the RBNZ's committees will not introduce the checks and balances that are the hallmarks of a robust governance framework for the exercise of regulatory power. To achieve this, a change from the single-member decision-making model is required.

---

275. Ibid.
276. Ibid. 55.



CHAPTER 6

Conclusions and recommendations

Respect is a hallmark of a well-performing regulator. Yet our survey reveals that many of New Zealand's commercial regulators – including critically important regulators like the RBNZ and the Commerce Commission – command neither the respect nor the confidence of many of the businesses they are tasked with regulating.

This is a matter of concern. As we saw in Chapter 1, if businesses lack confidence in their regulators, this can increase uncertainty and stifle innovation. The consequence is reduced productivity and increased costs for consumers.

If poor regulatory performance means the confidence of consumers in the performance of their regulators is misplaced, this can also have disastrous consequences such as the losses from finance company failures during the GFC.

New Zealand's regulatory landscape is complex. We have many regulators and they come in a variety of forms. Yet there is little evidence of any principles that guide whether regulators are housed within government departments or as statutory Crown entities, or the form of their internal and external governance arrangements.

However, our research suggests that governance arrangements, both internal and external, are key to the performance of regulatory agencies and in the confidence market participants have in them.

Three factors in particular appear significant.

1. Internal governance

The checks and balances created by a regulatory agency's internal governance arrangements play a key role in regulatory performance.

For regulators constituted as statutory Crown entities, three governance models are common:

- board governance model;
- multi-member commission model; and
- single-member decision-maker model.

Our survey results and case studies of three of New Zealand's most important regulators – the FMA, the Commerce Commission and the RBNZ – identify reasons for believing the board governance model creates better checks and balances on regulatory decision-making than the other two models.

The insights we were able to derive from the ratings of the FMA, compared with its predecessor, the Securities Commission, were particularly helpful. With its board governance model, the FMA emerged in 2011 from the ashes of the Securities Commission, and has since become one of New Zealand's most respected regulators.

Our research that two factors, in particular, contribute to the FMA's high ratings:

a. First, the internal checks and balances that come from separating governance and executive decision-making roles and, more specifically, from separating the chair and CEO roles that were formerly embodied in the Chairperson of the Securities Commission; and
b. Second, the quality of its leadership. The FMA's board governance role appears to have appealed to a wider range of candidates with current financial markets expertise than did membership of the former Securities Commission. This has contributed to the FMA enjoying a highly respected board.

These two factors work in tandem to help ensure the FMA's regulatory strategies are effective, and the executive are accountable for their performance.

Our detailed reviews of both the Commerce Commission and the RBNZ suggested both would benefit from improved internal governance. We recommend the following reforms:

- Commerce Commission: moving from the commission model of internal governance that the Commerce Commission shares with the former Securities Commission to a hybrid board governance model; and
- RBNZ: reforming its poorly respected single-member decision-maker model by making the RBNZ Governor accountable to the RBNZ board for the exercise of prudential regulatory decision-making power.

In each case, steps should be taken to broaden the skill sets and expertise of the respective boards.

These specific conclusions in relation to the Commerce Commission and the RBNZ suggest potential benefits from improved regulatory performance may be gained by similar reforms to other regulatory agencies, whose regulatory functions dictate that they operate independently from political control, but which currently lack a board governance structure.

Indeed, we recommend adopting the more principled approach discussed in Chapter 1 of this report to determine the institutional form of all regulatory agencies.[277] This will require carefully weighing the arguments for political control against the benefits of independent and impartial regulatory decision-making. This approach should result in regulatory agencies operating independently of political control in (at least) the following situations:[278]

- where the costs and benefits are long-term, and likely to be undervalued due to a focus on electoral cycles; or
- where significant private interests have to be weighed against a dispersed public interest;
- where a substantial degree of technical expertise or expert judgment of complex analysis is required.

// Our detailed reviews of both the Commerce Commission and the RBNZ suggested both would benefit from improved internal governance

In some cases, as with the OIO, this might require a change in institutional form from government department to statutory Crown entity – or to the new hybrid form of departmental agency.[279]

2. External monitoring

External monitoring in the corporate world is performed by shareholders. For regulatory agencies, it is done by departments, ministers and Parliament.[280] And they have developed extensive external accountability mechanisms to support them.

Yet the Productivity Commission found that external monitoring of regulatory agencies has serious shortcomings, such as focusing too much on procedural compliance and too little on strategic performance.[281]

277. See page 16.
278. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 220. For the reasons noted in footnote 51, we are not convinced by the Productivity Commission's suggestion that regulatory agencies should also be established as independent entities where the causal relationship between the policy instrument and the desired outcome is complex or uncertain.
279. State Services Commission, "Machinery of Government Supplementary Guidance Note: Departmental Agency Model" (2017).
280. See page 17.
281. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 353.

This should not be surprising. Many of our regulatory regimes are complex, and specialist expertise is required to evaluate them. Government departments cannot hope to replicate the expertise of the specialist regulatory agencies tasked with their enforcement. This means departments have only a limited means to monitor the effectiveness of the relevant regulator's strategic approach and substantive decision-making.

The Productivity Commission's findings were supported by our survey. Despite respondents comprehensively rating the FMA ahead of the Securities Commission across the range of KPIs, the FMA's worst comparative result related to external accountability. This was hardly surprising as none of the reforms to the governance of our financial markets regulator was aimed at strengthening external governance mechanisms.

To address concerns about the quality of external governance, the Productivity Commission recommended the government establish a peer review process through which panels of senior regulatory leaders would review the practices and performance of other regulatory agencies.[282] The government did not accept this recommendation. We doubt its effectiveness in any event. To evaluate the substantive performance of, say, the Commerce Commission, specialist expertise in competition policy and economics is required. This is a scarce skill-set in the civil service.

As we saw in Chapter 1, to address this issue, Germany has created a specialist agency to monitor its competition regulator's performance.[283] And there have been calls in other jurisdictions for a 'super regulator' to monitor financial regulators in the wake of the GFC.[284]

In an economy the size of New Zealand's, it would be hard to justify forming a specialist agency to monitor a single regulator's performance – even one as important as the Commerce Commission. However, New Zealand does have an agency with deep economic expertise: the Productivity Commission itself. And it has the power to co-opt inquiry directors where a specific skill set is required.[285] With an appropriate increase in its budget, the Productivity Commission could be tasked with undertaking, say, three-yearly reviews of the strategies and substantive performance of the RBNZ, the FMA and the Commerce Commission, and report to Parliament on its findings. This would create an effective external mechanism to monitor and hold to account our three most important commercial regulatory agencies. We recommend the government task the Productivity Commission with this role.

3. Appointment Processes

The third and final factor is the capability of the leadership of our regulatory agencies. Internal governance and external monitoring mechanisms are not sufficient. The skill sets and expertise of those appointed to governance roles are also critical.

Yet both the Productivity Commission's report and our survey reveal misgivings about the quality of appointment processes and the expertise of regulatory agency leadership.[286] It appears that too often, appointment processes are not informed by high-quality analysis.

282. Ibid. 366.
283. See page 19.
284. Gerard Caprio, et al. *Guardians of Finance*, op. cit. 230.
285. Productivity Commission, "Our team," Website.
286. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 257.

As we saw in Chapter 1,[287] Canada and the United Kingdom have addressed similar problems by establishing independent agencies that must first recommend a candidate before a minister makes a board appointment to a regulatory agency. This process is similar to the process adopted to appoint the RBNZ Governor, where the Minister of Finance may only appoint a candidate recommended by the RBNZ board.

The Productivity Commission did not favour the UK or Canadian approach, fearing that introducing an independent appointment agency would weaken ministerial accountability for entity performance.[288] Instead, it recommended creating a "centre of expertise" within either the State Services Commission or Treasury to support departments manage appointments and reappointments to regulatory Crown entities.[289] The government did not support this recommendation.

We do not share the Productivity Commission's concern that adopting the Canadian or UK approach would dilute ministerial accountability. As ministers retain ultimate responsibility for appointments in the United Kingdom, they remain accountable. In any event, concerns about diluting accountability are likely more theoretical than real. We doubt any potential dilution of ministerial accountability would lead to practical differences in the extent to which a regulator is accountable to Parliament. In any case, there are likely to be greater gains from strengthening procedures at the top of the cliff, rather than enduring the losses caused by weak accountability mechanisms at its bottom.

Because of the importance of regulatory capability, we recommend the government establish a Commission for Appointments to Regulatory Agencies modelled on the United Kingdom's Commissioner for Public Appointments to ensure all appointments to regulatory agencies are subject to independent scrutiny and a standardised process. At the *very least*, the government should implement the Productivity Commission's recommendation for a "centre of expertise" to support departments managing appointments and reappointments to regulatory Crown entities.[290]

These recommendations call for substantial changes to the governance of some of our most important regulators. They also involve important machinery of government reforms. However, as we have seen in this report, regulatory governance matters. In the modern regulatory state, we must have effective mechanisms to guard the guards.

---

287. See page 20.
288. Productivity Commission, "Regulatory Institutions and Practices," op. cit. 263.
289. Ibid. 265.
290. Ibid.

Recommendations

Internal governance

1. The 'board governance model', which is the most common governance structure among New Zealand's statutory Crown entities, creates better internal checks and balances on regulatory decision-making than the alternative 'commission model' of the Commerce Commission or the 'single-member decision-maker model' of the RBNZ. It should be adopted by all regulatory agencies which, applying a principled approach, should operate independently of political control.

2. In the case of the Commerce Commission, this should be achieved by:
   a. reshaping the Commissioner role so it is largely a governance (or board member) role with substantial decision-making power delegated by the board to the Commission's CEO; and
   b. broadening the skill set of the Commissioners to include more members with industry expertise.

3. In the case of the RBNZ, this should be achieved by:
   a. legislative reforms that make the RBNZ Governor accountable to the RBNZ board for the exercise of prudential regulatory policymaking and decision-making power; and
   b. broadening the skill set of the RBNZ board to include more banking and insurance expertise.

We also recommend the RBNZ move its prudential regulatory team to Auckland to bring them closer to the financial institutions they regulate.

Institutional form

4. The principled approach to the institutional form of regulatory agencies discussed in Chapter 1 should be applied to the institutional form of all regulatory agencies in New Zealand. While many regulators have the benefit of regulatory independence, others for whom independence may be more appropriate, form part of government departments and are subject to significant political control. The OIO is one such example.

External monitoring

5. The Productivity Commission should report separately to Parliament once every three years on the regulatory strategies and performance of the FMA, the Commerce Commission and the RBNZ. Its budget should be increased so it can perform this important external monitoring function.

Appointment processes

6. An independent agency should be created to ensure all appointments to regulatory agencies are subject to independent scrutiny and a standardised process.

Bibliography

Australian Productivity Commission. "Regulator Audit Framework" (2014).

Bailey, Steven and Judy Kavanagh. "Regulatory Systems, Institutions and Practices," *Policy Quarterly Journal* 10:4 (2014).

Bainbridge, Stephen. "Why a Board? Group Decisionmaking in Corporate Governance," *Vanderbilt Law Review* 55 (2002).

Bird, Joanna. "Regulating the Regulators: Accountability of Australian Regulators," *Melbourne University Law Review* 35:3 (2011).

Black, Julia. "Calling Regulators to Account: Challenges, Capacities and Prospects," LSE Legal Studies Working Paper No. 15/2012 (London: London School of Economics, 2012).

Brunton, Colmar. "Research Findings from a National Survey of New Zealand Businesses" (Wellington: Productivity Commission, 2013).

Brunton, Colmar. "Stakeholder survey – Final report: Financial Markets Authority" (2012).

Cabinet Office. "Governance Code on Public Appointments" (Wellington: New Zealand Government, 2016).

Chorus. "Submission on the Productivity Commission's Draft Report on Regulatory Institutions and Practices," DR 91 (2014).

Coen David, and Mark Thatcher. "The New Governance of Markets and Non-Majoritarian Regulators," *Governance: An International Journal of Policy, Administration, and Institutions* 18:3 (2005).

Commerce Act 1986, s 105(1).

Commerce Commission. "Commission members," Website.

Commerce Commission. "Our Vision and Strategy 2017–2022" (2017).

Commerce Committee. "Inquiry into Finance Company Failures" (Wellington: New Zealand Parliament, 2011).

Crown Entities Act 2004.

Currie, David, Alex Chisholm and Tim Jarvis. "Institutional Design and Decision-Making in the Competition and Markets Authority," *CPI Journal* 10 (2014).

Department of Prime Minister and Cabinet. "The appointments process and Cabinet appointment papers," CabGuide (7 July 2017), Website.

Edwards, Meredith, John Halligan, Bryan Horrigan, and Geoffrey Nicoll. "Public Sector Governance in Australia" (Canberra: ANU Press, 2012).

Fiennes, Toby. "New Zealand's evolving approach to prudential supervision," Speech by Head of Prudential Supervision at the Reserve Bank to the New Zealand Bankers' Association in Auckland (2016).

Financial Markets Authority. "Exercise and limits of delegated authority," *Regulatory Delegations Policy* (2015), 6.

Financial Markets Authority Bill 2010.

Financial Markets Authority. "FMA releases stakeholder feedback report," Media release (5 December 2013).

Financial Markets Authority. "How we regulate," Website.

Financial Markets Authority. "Statement of Intent 2017–2020" (2017).

Freiberg, Arie. *The Tools of Regulation* (Sydney: Federation Press, 2010).

Gerard Caprio, James Barth, and Ross Levine. *Guardians of Finance: Making Regulators Work for Us* (Cambridge: MIT Press, 2012).

Gill, Derek. "New Zealand," in OECD, *Distributed Public Governance: Agencies, Authorities and Other Government Bodies* (Paris: OECD Publishing, 2002).

Hermann, Christoph, Markus Krajewski and Jorg Philipp Terhechte, eds. *European Yearbook of International Economic Law* (New York: Springer, 2013).

Horn, Murray. *The Political Economy of Public Administration: Institutional Choice in the Public Sector* (London: Cambridge University Press, 1995).

Hunt, Chris. "Outcomes of the 2016 New Zealand Financial Sector Assessment Programme" (2017).

Institute of Directors. "The Four Pillars of Governance Best Practice" (Wellington: Institute of Directors, 2017).

International Monetary Fund. "New Zealand Financial System Stability Assessment" (2017).

Kovacic, William and David A. Hyman. "Competition Agency Design: What's on the Menu?" *The George Washington Law School* 2012:135 (2012).

Laking, Rob. "Distributed Public Governance: Principles for Control and Accountability of Agencies, Authorities and other Government Bodies," in OECD, *Distributed Public Governance: Agencies, Authorities and Other Government Bodies* (Paris: OECD Publishing, 2002).

Land Information New Zealand. "Legislation, Ministers & Delegated Powers," Website.

Levine, Ross. "The Governance of Financial Regulation: Reform Lessons from the Recent Crisis," BIS Working Papers 329 (2010).

Mednis, Kristin. "Integrity Plus 2013 New Zealand National Integrity System Assessment: Crown Entitles," Supplementary Paper (2013).

Monopolkommission. "Commissioners," Website.

Monopolkommission. "Mission," Website.

New Zealand Banker's Association. "Submission to the Productivity Commission on the Regulatory Institutions & Practices Issues Paper" (2013).

New Zealand Government. "Standing Orders of the House of Representatives," Standing Order 383(1) (2017).

OECD. "OECD Reviews of Regulatory Reform: Germany 2004" (Paris: OECD Publishing, 2004), 98.

OECD. "The Governance of Regulators, OECD Best Practice Principles for Regulatory Policy" (Paris: OECD Publishing, 2014).

Office of the Controller and Auditor-General. "How Government Departments Monitor Crown Entities" (Wellington: OAG, 2009).

Office of the Minister of Commerce. "Creating a Financial Markets Authority and Enhancing Kiwisaver Governance and Reporting" (Wellington: New Zealand Government, 2010).

Ottow, Annetje. *Market and Competition Authorities: Good Agency Principles* (OUP, 2015).

Prada, Michel and Neil Walter. "Report on the Effectiveness of New Zealand's Securities Commission" (Wellington: KPMG, 2009).

Productivity Commission. "Our team," Website.

Productivity Commission. "Regulatory Institutions and Practices" (Wellington: Productivity Commission, 2014).

Public Audit Act 2001.

Public Finance Act 1989.

Rennie, Iain. "Decision-making and Governance at the Reserve Bank of New Zealand," The Treasury, Website.

Reserve Bank Act 1989.

Reserve Bank of New Zealand. "Appendix 6: The Reserve Bank's decision-making process," in *Briefing for the Incoming Minister on the Reserve Bank of New Zealand* (2017).

Reserve Bank of New Zealand. "Letters of Expectations," Website.

Reserve Bank of New Zealand. "Report for the Minister of Finance on the operation of the prudential regime for Nonbank Deposit Takers" (2013).

Reserve Bank of New Zealand. "Statement of Policy-Making Approach" (2017).

Reserve Bank of New Zealand. *Bulletin* 80:11 (December 2017).

Robertson, Grant. "Review of Reserve Bank Act announced as Policy Targets Agreement re-signed" (Wellington: New Zealand Government, 7 November 2017).

Securities Commission. "Disclosure by Finance Companies," Discussion Document (April 2005).

Securities Commission. "Review of Finance Company Disclosure" (August 2006).

Sparrow, Malcolm. *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance* (Washington, DC: Brookings Institution Press, 2000).

Spencer, Kathy. "Accountability and Performance Monitoring of Regulatory Crown Entities" (Wellington: Productivity Commission, 2014).

State Services Commission. "Machinery of Government Supplementary Guidance Note: 'Due Diligence' on Proposed Machinery of Government Changes" (2016).

State Services Commission. "Machinery of Government Supplementary Guidance Note: Departmental Agency Model" (2017).

State Services Commission. "New Zealand's state sector – The organisations," Website.

State Services Commission. "Performance Improvement Framework," Website.

State Services Commission. "Resource for Preparation of Governance Manuals – Guidance for Statutory Crown Entities," Website.

State Services Commission. "Reviewing the Machinery of Government" (2007).

State Services Commission. "Statutory Crown Entities – A Guide for Ministers" (29 April 2015), Website.

Telecommunications Act 2001.

The Treasury. "Managing for Outcomes: Output Plans Guidance for Departments," Website.

The Treasury. "Quarterly Report on Implementation of the Government Response to the Productivity Commission Report on Regulatory Institutions and Practices" (Wellington: New Zealand Government, 2016).

Urhig, John. "Review of the Corporate Governance of Statutory Authorities and Office Holders" (Canberra: Department of Finance, 2013).

Vector. "New Zealand Productivity Commission Inquiry into Regulatory Institutions and Practices: Submission on Draft Report," DR 98 (2013).

Wheeler, Graeme. "Decision making in the Reserve Bank of New Zealand," speech to the University of Auckland Business School (2013).

Wyman, Oliver. "FMA Progress Review: Stakeholder Feedback Report" (2013).

Appendices

Appendix 1: Table of results (%) for all regulators across all KPIS (arranged from highest to lowest based on sum of 'agree' and 'strong agree')

Regulator	Number of times rated	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum Agree and Strongly Agree	Sum Disagree and Strongly Disagree
External Reporting Board	2	52.2	34.8	0.0	0.0	0.0	100.0	0.0
Takeovers Panel	5	41.4	41.4	13.3	3.8	0.0	82.8	3.8
Inland Revenue Department	8	8.9	66.8	18.8	2.8	2.8	75.6	5.6
Accident Compensation Corporation	4	34.8	40.2	15.6	9.4	0.0	75.0	9.4
Privacy Commissioner	5	0.0	63.6	30.2	4.0	0.0	63.6	4.0
Financial Markets Authority	17	12.8	48.0	28.9	9.2	1.1	60.8	10.3
Ministry for Primary Industries	8	10.9	48.7	27.6	12.1	0.7	59.6	12.8
Ministry of Transport	5	25.9	29.9	25.3	18.1	0.7	55.9	18.8
WorkSafe	18	2.2	45.7	29.1	21.7	1.3	48.0	23.0
Energy Efficiency and Conservation Authority	2	2.2	43.5	54.3	0.0	0.0	45.7	0.0
New Zealand Transport Agency	5	2.6	42.2	19.6	29.6	6.1	44.8	35.7
Ministry of Business, Innovation, and Employment	27	3.7	40.8	40.3	14.5	0.7	44.6	15.2
Electricity Authority	9	2.2	39.4	27.9	27.9	2.7	41.5	30.6
Commerce Commission	38	6.0	33.9	34.3	22.4	3.3	39.9	25.8
Broadcasting Standards Authority	3	16.7	22.5	30.4	27.5	2.9	39.1	30.4
Department of Conservation	1	0.0	33.3	50.0	16.7	0.0	33.3	16.7
Office of Film Literature and Classification	1	0.0	33.3	50.0	16.7	0.0	33.3	16.7
Reserve Bank of New Zealand	8	6.5	22.0	35.4	23.8	12.2	28.6	36.0
Civil Aviation Authority	3	1.4	24.6	42.8	31.2	0.0	26.1	31.2
Earthquake Commission	3	0.0	17.4	36.2	40.6	5.8	17.4	46.4
Environmental Protection Authority	1	0.0	4.3	21.7	69.6	4.3	4.3	73.9
Heritage New Zealand	1	0.0	0.0	10.5	73.7	15.8	0.0	89.5
Human Rights Commission	1	0.0	0.0	30.4	30.4	39.1	0.0	69.6
Land Information New Zealand (including the Overseas Investment Office	2	0.0	0.0	23.9	37.0	39.1	0.0	76.1
Average – All Regulators	**N/A**	**9.5**	**34.5**	**28.2**	**21.9**	**5.8**	**44.0**	**27.7**

Appendix 2: Percentages of survey respondents 'agreeing' or 'strongly agreeing' that the regulators meet the 23 KPIs[291]

Regulator	1	2	3	4	5	6	7	8	9
External Reporting Board	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Takeovers Panel	83.3	83.3	83.3	66.7	66.7	100.0	83.3	83.3	100.0
Accident Compensation Corporation	75.0	75.0	75.0	75.0	100.0	75.0	75.0	66.7	75.0
Inland Revenue Department	100.0	87.5	87.5	75.0	75.0	75.0	75.0	50.0	62.5
Office of Film Literature and Classification	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	0.0
Privacy Commissioner	100.0	80.0	75.0	100.0	75.0	50.0	50.0	33.3	0.0
Financial Markets Authority	76.5	94.1	76.5	64.7	70.6	70.6	52.9	60.0	41.2
Ministry for Primary Industries	62.5	87.5	75.0	75.0	71.4	42.9	57.1	33.3	50.0
Ministry of Transport	50.0	50.0	50.0	66.7	66.7	66.7	50.0	33.3	66.7
WorkSafe	94.4	83.3	66.7	64.7	55.6	41.2	27.8	45.5	29.4
Energy Efficiency and Conservation Authority	100.0	100.0	100.0	0.0	50.0	50.0	50.0	0.0	50.0
New Zealand Transport Agency	80.0	80.0	80.0	40.0	20.0	40.0	40.0	50.0	20.0
Ministry of Business, Innovation, and Employment	51.9	40.7	65.4	37.0	51.9	61.5	44.4	42.9	33.3
Electricity Authority	87.5	75.0	50.0	62.5	62.5	50.0	37.5	37.5	37.5
Commerce Commission	76.3	55.3	51.4	52.6	56.8	48.6	36.1	35.5	23.7
Broadcasting Standards Authority	66.7	33.3	33.3	66.7	66.7	33.3	33.3	0.0	33.3
Department of Conservation	100.0	0.0	100.0	0.0	0.0	100.0	0.0		100.0
Reserve Bank of New Zealand	75.0	25.0	37.5	37.5	50.0	25.0	12.5	14.3	0.0
Civil Aviation Authority	66.7	100.0	33.3	66.7	33.3	33.3	0.0	0.0	0.0
Earthquake Commission	100.0	0.0	0.0	0.0	0.0	33.3	33.3	0.0	0.0
Environmental Protection Authority	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
Heritage New Zealand	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Human Rights Commission	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land Information New Zealand (including the Overseas Investment Office	0.0	0.0	0.0	0.0	0.0		0.0		0.0
Average	**68.6**	**56.3**	**55.8**	**47.9**	**48.8**	**52.0**	**39.9**	**35.7**	**38.4**

291. Blank cells indicate a 'don't know/not applicable' response.

10	11	12	13	14	15	16	17	18	19	20	21	22	23	Average
100.0	100.0		100.0	100.0	100.0	100.0		100.0	100.0	100.0	100.0		100.0	**100.0**
100.0	83.3	100.0	100.0	100.0	100.0	100.0	100.0	66.7	66.7	66.7	66.7	66.7	40.0	**82.9**
75.0	75.0	75.0	75.0	75.0	75.0	75.0	75.0	75.0	75.0	75.0	100.0	66.7	66.7	**76.1**
87.5	75.0	75.0	62.5	75.0	75.0	85.7	87.5	75.0	75.0	71.4	75.0	75.0	57.1	**75.6**
100.0	100.0	0.0	100.0	100.0	0.0	0.0	0.0	0.0				100.0		**68.4**
75.0	100.0	33.3	75.0	75.0	75.0	100.0	50.0	100.0	66.7	100.0	33.3	66.7	0.0	**65.8**
82.4	64.7	37.5	43.8	58.8	58.8	56.3	58.8	70.6	56.3	66.7	60.0	42.9	33.3	**60.8**
71.4	71.4	50.0	50.0	75.0	50.0	62.5	62.5	62.5	75.0	25.0	33.3	66.7	60.0	**59.6**
83.3	66.7	80.0	80.0	66.7	50.0	50.0	66.7	66.7	50.0	25.0	50.0	25.0	25.0	**55.9**
66.7	52.9	41.2	33.3	33.3	44.4	41.2	52.9	56.3	46.7	7.7	33.3	53.8	30.8	**48.0**
100.0	100.0	0.0	0.0	50.0	100.0	0.0	50.0	50.0	0.0	0.0	50.0	50.0	0.0	**45.7**
60.0	40.0	40.0	40.0	40.0	60.0	40.0	40.0	40.0	60.0	40.0	20.0	20.0	40.0	**44.8**
77.8	63.0	28.6	38.5	40.0	40.0	54.2	44.0	55.6	56.5	38.1	33.3	16.7	9.5	**44.6**
50.0	25.0	25.0	37.5	12.5	25.0	37.5	37.5	37.5	42.9	12.5	37.5	50.0	25.0	**41.5**
55.3	55.3	20.0	26.3	55.3	16.2	39.5	30.6	41.7	45.5	22.6	23.5	32.4	17.6	**39.9**
66.7	33.3	33.3	33.3	66.7	33.3	66.7	33.3	66.7	50.0	0.0	0.0	50.0	0.0	**39.1**
100.0	0.0	0.0	0.0	100.0	0.0	0.0		0.0		0.0	0.0			**33.3**
25.0	25.0	37.5	25.0	37.5	25.0	37.5	25.0	37.5	37.5	12.5	12.5	28.6	14.3	**28.6**
66.7	0.0	33.3	0.0	33.3	0.0	33.3	0.0	33.3	33.3	0.0	33.3	0.0	0.0	**26.1**
33.3	0.0	0.0	0.0	33.3	33.3	33.3	33.3	0.0	33.3	33.3	0.0	0.0	0.0	**17.4**
0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**4.3**
0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**
0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**
0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0		0.0	0.0	0.0	0.0	**0.0**
61.5	**47.1**	**30.9**	**38.3**	**51.1**	**40.0**	**44.0**	**38.5**	**43.1**	**46.2**	**30.3**	**33.1**	**36.9**	**23.6**	

Appendix 3: Table of rankings from most to least respected regulator

Regulator	Number Times Ranked	Number Times Ranked Worst	Percent of Time Ranked Worst	Number Times Ranked Best	Percent of Time Ranked Best	Mean Score Best to Worst
Takeovers Panel	12	0	0.0%	6	50.0%	2.3
External Reporting Board	4	0	0.0%	2	50.0%	1.6
Inland Revenue Department	30	3	10.0%	5	16.7%	1.1
Financial Markets Authority	29	1	3.4%	9	31.0%	1
Accident Compensation Corporation	30	3	10.0%	5	16.7%	0.6
Ministry for Primary Industries	15	0	0.0%	2	13.3%	0.6
Privacy Commissioner	18	1	5.6%	3	16.7%	0.6
Energy Efficiency and Conservation Authority	11	1	9.1%	1	9.1%	0.5
Commerce Commission – Price Regulation Branch	23	4	17.4%	4	17.4%	0.3
Commerce Commission – Telecommunications Commissioner	9	1	11.1%	2	22.2%	0.3
Department of Conservation	8	0	0.0%	1	12.5%	0.3
Civil Aviation Authority of New Zealand	7	1	14.3%	3	42.9%	0.1
Health and Disability Commissioner	1	0	0.0%	0	0.0%	0
Ministry of Business, Innovation, and Employment	43	5	11.6%	7	16.3%	-0.1
WorkSafe New Zealand	30	6	20.0%	3	10.0%	-0.1
Ministry of Transport	12	1	8.3%	1	8.3%	-0.2
Commerce Commission – Competition and Consumer Branch	33	10	30.3%	2	6.1%	-0.6
Electricity Authority	11	3	27.3%	0	0.0%	-0.8
Environmental Protection Authority	6	2	33.3%	1	16.7%	-1
Earthquake Commission	8	1	12.5%	0	0.0%	-1.1
Land Information New Zealand (including the Overseas Investment Office)	9	3	33.3%	0	0.0%	-1.1
Transport Accident Investigation Commission	4	0	0.0%	0	0.0%	-1.1
Reserve Bank of New Zealand	3	0	0.0%	1	33.3%	-1.4
Office of Film and Literature Classification	3	0	0.0%	0	0.0%	-1.5
Fire and Emergency New Zealand	8	0	0.0%	0	0.0%	-1.6
New Zealand Transport Agency	16	3	18.8%	1	6.3%	-1.7
Broadcasting Standards Authority	5	3	60.0%	0	0.0%	-1.9
Human Rights Commission	7	3	42.9%	0	0.0%	-2.2
Heritage New Zealand Pouhere Taonga	2	2	100.0%	0	0.0%	-5.5

Appendix 4: Ratings (%) of FMA's performance compared with the former Securities Commission

Metric	Number of Responses[292]	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum of Strongly Agree and Agree	Sum of Disagree and Strongly Disagree
The relevant people in your business are more readily able to understand the FMA's objectives than those of its predecessor, the Securities Commission	25	28.0	56.0	12.0	4.0	0.0	84.0	4.0
The FMA's objectives and actions make more sense to you having regard to the regulator's statutory purpose than those of its predecessor	23	30.4	65.2	13.0	0.0	0.0	95.7	0.0
The FMA's actions are more clearly motivated by the goal of efficiently achieving its statutory objectives and not for arbitrary objectives (such as self-protection of the regulator, or other political or personal goals) than its predecessor	26	30.8	57.7	11.5	3.8	0.0	88.5	3.8
The FMA more clearly communicates its objectives and reasons for its actions to businesses in your industry than did its predecessor	23	39.1	52.2	17.4	0.0	0.0	91.3	0.0
Staff within the FMA appear to have a better understanding of the regulator's overall statutory objectives and act consistently with them than was the case with the Securities Commission	21	23.8	61.9	28.6	0.0	0.0	85.7	0.0
The board members of the FMA are more skilled, knowledgeable and better-respected by businesses in your industry than their predecessor Commissioners at the Securities Commission	17	52.9	47.1	29.4	0.0	0.0	100.0	0.0
Staff within the FMA are more skilled, knowledgeable and well-respected by businesses in your industry than was the case with its predecessor	25	24.0	48.0	32.0	0.0	0.0	72.0	0.0
The processes for appointing the leaders of the FMA are more transparent and robust than were those of the Securities Commission	15	46.7	53.3	33.3	6.7	0.0	100.0	6.7

292. This excludes respondents who selected 'don't know/not applicable' for any given KPI.

Metric	Number of Responses[292]	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum of Strongly Agree and Agree	Sum of Disagree and Strongly Disagree
The FMA better understands the commercial realities facing your industry than did the Securities Commission	25	32.0	28.0	40.0	4.0	0.0	60.0	4.0
Your interactions with the FMA are generally more constructive than they were with the Securities Commission	19	36.8	47.4	36.8	0.0	0.0	84.2	0.0
The FMA is more willing to listen to the views of your business and take them into account than was the Securities Commission	21	38.1	38.1	38.1	0.0	0.0	76.2	0.0
The FMA's compliance and monitoring approaches are more streamlined and coordinated than was the case with its predecessor	21	33.3	42.9	33.3	4.8	0.0	76.2	4.8
The FMA's actions and decisions are more consistent and predictable than were those of the Securities Commission	21	38.1	47.6	23.8	4.8	0.0	85.7	4.8
Concerns about the FMA's decision-making are less of a hindrance or deterrence from taking action to improve the profitability of your business than they were under the former Securities Commission	17	29.4	47.1	47.1	5.9	0.0	76.5	5.9
The FMA more clearly articulates the justification and reasons for its actions than did its predecessor	23	26.1	52.2	30.4	0.0	0.0	78.3	0.0
Businesses across your industry are treated more fairly and consistently by the FMA than they were by the Securities Commission	20	25.0	55.0	40.0	0.0	0.0	80.0	0.0
Action taken by the FMA is more proportionate to the regulatory risks being managed than was the case with the Securities Commission	24	29.2	41.7	37.5	0.0	0.0	70.8	0.0
The FMA more effectively consults and engages with you and businesses in your industry to ensure that good regulatory processes are being followed than the former Securities Commission did	23	39.1	47.8	17.4	4.3	0.0	87.0	4.3

Metric	Number of Responses[292]	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum of Strongly Agree and Agree	Sum of Disagree and Strongly Disagree
The FMA more effectively consults and engages with other important stakeholders to ensure that good regulatory processes are being followed than the former Securities Commission did	23	30.4	52.2	21.7	4.3	0.0	82.6	4.3
The FMA is better at learning from its mistakes than was the former Securities Commission	21	28.6	38.1	42.9	4.8	0.0	66.7	4.8
There are more effective accountability mechanisms within the FMA to enable participants in your industry to voice concerns about mistakes than was the case with the former Securities Commission	19	21.1	57.9	42.1	0.0	0.0	78.9	0.0
The FMA is more readily held to account for the quality of their work (including any mistakes) by its responsible government department, minister or some other external accountability mechanism than was the Securities Commission	18	16.7	50.0	55.6	5.6	0.0	66.7	5.6
The board governance model of the FMA has contributed to an increase in your respect for and confidence in the FMA compared with the predecessor Securities Commission	23	34.8	43.5	30.4	0.0	0.0	78.3	0.0
Averages across all KPIs	**N/A**	**31.9**	**49.2**	**31.1**	**2.3**	**0.0**	**81.1**	**2.3**

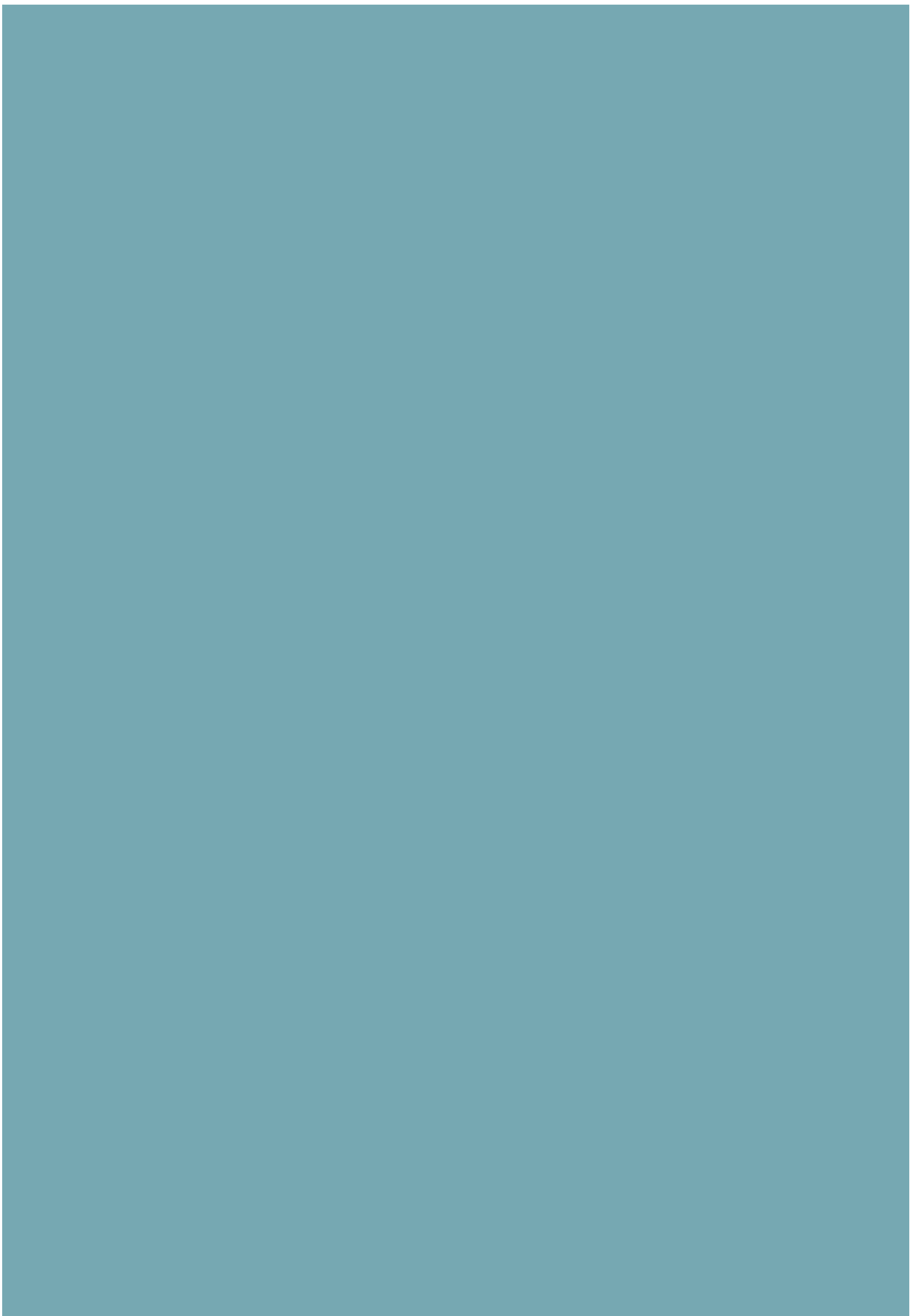
Appendix 5: Ratings (%) of FMA's performance by KPI

Question	Number of Responses	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum of Strongly Agree and Agree	Sum of Disagree and Strongly Disagree
The relevant people in your business are readily able to understand the FMA's objectives	17	17.6	58.8	17.6	5.9	0.0	76.5	5.9
The FMA's objectives and actions make sense to you having regard to its statutory purpose	17	11.8	82.4	5.9	0.0	0.0	94.1	0.0
The FMA's actions are motivated by the goal of efficiently achieving its statutory objectives and not for ancillary or arbitrary objectives (such as self-protection of the regulator, its leaders or other staff, or for other goals)	17	17.6	58.8	23.5	0.0	0.0	76.5	0.0
The FMA communicates its objectives and reasons for its actions clearly to businesses in your industry	17	23.5	41.2	17.6	17.6	0.0	64.7	17.6
Staff within the FMA appear to understand the FMA's overall statutory objectives and act consistently with them	17	17.6	52.9	23.5	5.9	0.0	70.6	5.9
The leaders of the FMA are skilled, knowledgeable and well-respected by businesses in your industry	17	35.3	35.3	29.4	0.0	0.0	70.6	0.0
Staff within the FMA are skilled, knowledgeable and well-respected by businesses in your industry	17	11.8	41.2	23.5	23.5	0.0	52.9	23.5
The processes for appointing the leaders of the FMA are transparent and robust	15	6.7	53.3	26.7	13.3	0.0	60.0	13.3
The FMA understands the commercial realities facing your industry	17	5.9	35.3	47.1	11.8	0.0	41.2	11.8
Your interactions with the FMA are generally constructive	17	29.4	52.9	11.8	5.9	0.0	82.4	5.9
The FMA is willing to listen to the views of your business and take them into account	17	23.5	41.2	23.5	11.8	0.0	64.7	11.8
The FMA's compliance and monitoring approaches are streamlined and coordinated	16	6.3	31.3	50.0	12.5	0.0	37.5	12.5
The FMA's actions are consistent and predictable	16	12.5	31.3	50.0	6.3	0.0	43.8	6.3

Question	Number of Responses	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Sum of Strongly Agree and Agree	Sum of Disagree and Strongly Disagree
The FMA clearly articulates the justification and reasons for its actions	17	5.9	52.9	41.2	0.0	0.0	58.8	0.0
You are not hindered or deterred from taking action to improve the profitability of your business by any lack of predictability in the FMA's decision-making	17	11.8	47.1	35.3	0.0	5.9	58.8	5.9
Businesses across your industry are treated fairly and consistently by the FMA	16	12.5	43.8	43.8	0.0	0.0	56.3	0.0
Action taken by the FMA is proportionate to the regulatory risk being managed	17	5.9	52.9	29.4	11.8	0.0	58.8	11.8
The FMA effectively consults and engages with you and businesses in your industry to ensure that good regulatory processes are being followed	17	17.6	52.9	17.6	5.9	5.9	70.6	11.8
The FMA effectively consults and engages with other important stakeholders to ensure that good regulatory processes are being followed	16	6.3	50.0	31.3	6.3	6.3	56.3	12.5
The FMA reviews and learns from its mistakes	15	0.0	66.7	20.0	13.3	0.0	66.7	13.3
There are effective accountability mechanisms within the FMA to enable participants in your industry to voice concerns about mistakes	15	0.0	60.0	20.0	13.3	6.7	60.0	20.0
There are effective appeal and judicial review rights to challenge the decisions of the FMA in the courts	14	7.1	35.7	42.9	14.3	0.0	42.9	14.3
The FMA is readily held to account for the quality of their work (including any mistakes) by its responsible government department, minister or some other effective external accountability mechanism	15	6.7	26.7	33.3	33.3	0.0	33.3	33.3
Average across all metrics	N/A	12.8	48	28.9	9.2	1.1	60.8	10.3

Appendix 6: Comparative results (% of 'strongly agree' and 'agree') for the FMA, Commerce Commission and the RBNZ for each of the 23 KPIs

KPI	FMA	Commerce Commission	RBNZ
The relevant people in your business are readily able to understand the regulator's objectives	76.5	76.3	75.0
The regulator's objectives and actions make sense to you having regard to the regulator's statutory purpose	94.1	55.3	25.0
The regulator's actions are motivated by the goal of efficiently achieving its statutory objectives and not for ancillary or arbitrary objectives (such as self-protection of the regulator, its leaders or other staff, or for other political or personal goals)	76.5	51.4	37.5
The regulator communicates its objectives and reasons for its actions clearly to businesses in your industry	64.7	52.6	37.5
Staff within the regulator appear to understand the regulator's overall statutory objectives and act consistently with them	70.6	56.8	50.0
The leaders of the regulator are skilled, knowledgeable and well-respected by businesses in your industry	70.6	48.6	25.0
Staff within the regulator are skilled, knowledgeable and well-respected by businesses in your industry	52.9	36.1	12.5
The processes for appointing the leaders of the regulator are transparent and robust	60.0	35.5	14.3
The regulator understands the commercial realities facing your industry	41.2	23.7	0.0
Your interactions with the regulator are generally constructive	82.4	55.3	25.0
The regulator is willing to listen to the views of your business and take them into account	64.7	55.3	25.0
The regulator's compliance and monitoring approaches are streamlined and coordinated	37.5	20.0	37.5
The regulator's actions are consistent and predictable	43.8	26.3	25.0
The regulator clearly articulates the justification and reasons for its actions	58.8	55.3	37.5
You are not hindered or deterred from taking action to improve the profitability of your business by any lack of predictability in the regulator's decision-making	58.8	16.2	25.0
Businesses across your industry are treated fairly and consistently by the regulator	56.3	39.5	37.5
Action taken by the regulator is proportionate to the regulatory risk being managed	58.8	30.6	25.0
The regulator effectively consults and engages with you and businesses in your industry to ensure that good regulatory processes are being followed	70.6	41.7	37.5
The regulator effectively consults and engages with other important stakeholders to ensure that good regulatory processes are being followed	56.3	45.5	37.5
The regulator learns from its mistake	66.7	22.6	12.5
There are effective accountability mechanisms within the regulator to enable participants in your industry to voice concerns about mistakes	60.0	23.5	12.5
There are effective appeal and judicial review rights to challenge the decisions of the regulator in the courts	42.9	32.4	28.6
The regulator is readily held to account for the quality of their work (including any mistakes) by its responsible government department, minister or some other effective external accountability mechanism	33.3	17.6	14.3
Average	**60.8**	**39.9**	**28.6**



"Who will guard the guards?" has been a troubling question since Plato's *Republic*. More than two millennia later, it is regulatory agencies, rather than armies, who wield many of the powers of the state. And though these agencies focus on protecting consumers rather than defending citizens against external enemies, the question remains as relevant today as it was in ancient Greece.

The arsenals of our modern-day regulators are fully loaded. But having power is one thing. Exercising it wisely, fairly and predictably is another. And that brings us to the question: Who guards us against regulatory failure?

It is an important question. Yet we give much less thought to how to *govern* our regulatory agencies than we give to how we should *arm* them.

This report aims to address this shortcoming. It examines what good regulatory governance looks like and why it matters. It then goes on to analyse the results of a detailed survey of the performance of New Zealand's commercial regulatory agencies against a range of key performance indicators.

It finds concerning deficiencies in the performance and behaviours of some of New Zealand's most important regulatory agencies, including the Commerce Commission and the Reserve Bank of New Zealand. By contrast, it finds high levels of respect for New Zealand's financial markets regulator, the Financial Markets Authority.

The report concludes by drawing lessons from these contrasting findings, and then recommends reforms to New Zealand's regulatory governance structures in light of them.

$25.00

ISBN
978-0-9951009-4-7 (print)
978-0-9951009-5-4 (online)

The New Zealand Initiative
PO Box 10147
Wellington 6143