

Office of the Minister of Transport  
Chair, Cabinet Economic Development Committee

## **REVIEW OF THE NEW ZEALAND TRANSPORT AGENCY'S REGULATORY CAPABILITY AND PERFORMANCE**

### **Proposal**

1. This paper sets out the findings from the Ministry of Transport's (the Ministry's) review that I requested into the capability and performance of the New Zealand Transport Agency's (NZTA's) regulatory function.
2. The paper seeks agreement to a series of changes to strengthen the NZTA's regulatory capability and performance in response to the review findings. The paper also outlines the outcome of the independent review of the monitoring function within the Ministry, commissioned by the Secretary for Transport.

### **Executive summary**

3. The NZTA exercises regulatory functions to promote a safe, efficient, and effective land transport system. These functions include the issuing of driver licences, overseeing the vehicle inspection and certification regime, registration and licensing of transport services, issuing heavy vehicle permits, speed management, rail safety, and a range of other land regulatory functions.
4. In October 2018, the NZTA Board announced that the NZTA had not been performing its regulatory function effectively and, in particular, that it was too focused on education and self-regulation. In response to these concerns, I instructed the Ministry to undertake a review into the capability and performance of the NZTA's regulatory function (the review).
5. The Ministry commissioned MartinJenkins to assist in completing the review. The review involved an extensive assessment of documentation and correspondence provided by NZTA and interested persons, alongside interviews with industry stakeholders, regulated parties, NZTA Board members, senior leaders, and staff (both current and former). Through this process, MartinJenkins interviewed around 70 people and reviewed 250 documents.
6. The review found the following:
  - 6.1. there was no single cause for the regulatory failure at the NZTA, but rather a series of underlying factors that evolved over time, including; an overshadowing of regulatory functions, weak regulatory leadership and expertise, a lack of a clear regulatory strategy and approach, limited regulatory capability, resourcing and funding challenges, the absence of a regulatory culture, structural constraints, lack of accountability, and inadequate audit and risk management.

Collectively, these factors resulted in the NZTA not performing as an effective risk-based regulator based on good regulatory practice and as intended by the legislation

- 6.2. there was a weak focus on NZTA's regulatory role and functions. Regulatory responsibilities were overshadowed by priorities within its other roles and preoccupations, in particular the powerful focus on customer service embedded in the NZTA over many years. Being a responsive and efficient regulator in itself is not an issue. However, a strong focus on customer service and treating regulated parties as customers, alongside the absence of a clear regulatory approach, resulted in poor regulatory performance within the NZTA
- 6.3. there were conflicts of interest amongst the three functions of regulator, infrastructure deliverer, and investor that need careful management, particularly regarding efficiency, cost, and regulatory effectiveness considerations. It is not clear the NZTA identified the potential for these conflicts and put in place systems to manage them
- 6.4. the dispersed nature of the NZTA's regulatory model, with some functions carried out by other agencies, contributed to NZTA not being able to operate as an effective end-to-end regulator for the land transport system. There could also be better leadership and coordination with regulators in the transport system
- 6.5. there were issues with regulatory accountability and decision-making within the NZTA over many years. Since the establishment of the NZTA, there was no single and clear accountability for regulatory decision-making as is present in many other regulatory agencies.
7. Since October 2018, the NZTA has undertaken work to build its capability and systems to deliver its core regulatory functions, including strengthening governance, decision-making, people capability, and operational delivery. The organisation has also restructured and focused more broadly as an organisation on better risk management and strengthening organisational culture. However, even with these improvements, more significant changes are required in order to effectively respond to the issues identified through the review.
8. In response to the review findings, I intend to:
  - 8.1. set expectations that the NZTA Board develop a new regulatory strategy to strengthen the NZTA's regulatory approach and delivery (by March 2020)
  - 8.2. set expectations that the NZTA Board establish a new regulatory operating model that defines the capability, processes, and systems to implement the NZTA's enhanced regulatory strategy and approach (by March 2020). This will be supported by a funding review to enable NZTA to build the capability it needs to deliver as an effective regulator
  - 8.3. establish a Statutory Director of Land Transport that would be responsible for exercising the NZTA's regulatory functions and powers

- 8.4. instruct the Ministry to undertake work to make other changes to the regulatory objectives, functions, and powers of the NZTA that are thought necessary to strengthen and clarify the NZTA's regulatory role and focus
- 8.5. seek advice from the Ministry, the New Zealand Police (the Police), and the NZTA by December 2019 on whether there are opportunities to enhance the way commercial vehicle enforcement functions are currently delivered to support an effective end-to-end regulatory approach for the land transport system
- 8.6. seek, in consultation with the Minister for Workplace Relations and Safety, advice from officials on exploring the merits of designating the NZTA as a health and safety regulator under the Health and Safety at Work Act 2015 (HSWA), with an in principle decision to be taken by December 2019.
9. In addition to these recommendations, I have also recently announced the appointment of changes to the NZTA Board, which have included strengthening regulatory capability on the Board. These changes include the appointment of Catherine Taylor, the former Director of Maritime New Zealand. Ms Taylor will bring extensive regulatory expertise and capability to the NZTA Board, which will be critical as the Agency progresses the rebuild of its regulatory function.
10. Together, the recommendations provide a strong basis for building a capable, confident, risk-based regulator to deliver improved compliance and safety outcomes across the land transport system. I am confident that Sir Brian Roche, as the new NZTA Chair, will provide the strong leadership and direction required to strengthen the NZTA's performance. This leadership will be critical in not only rebuilding the land transport regulator, but in ensuring the NZTA's performs its other critical functions effectively.
11. The nature of the issues set out through the review may raise questions as to whether more substantive changes are needed to the structure of the land transport regulator within the NZTA. I believe that structural change would destabilise the NZTA and impact the ability to drive immediate improvements in the capability and performance of the land transport regulator.
12. I am confident that the recommendations I am proposing in response to the review, along with the strengthened leadership on the NZTA Board, will provide a strong base to respond to the review findings, enabling the NZTA to strengthen its regulatory capability and performance. I will, however, with the Ministry, continue to monitor the capability and performance of the NZTA, and the implementation of the review findings, to see whether further change may be needed in the future.
13. The NZTA is currently experiencing significant cost pressures within its regulatory function. These pressures relate to costs associated with the backlog of regulatory non-compliance cases, a projected deficit against the NZTA's regulatory memorandum accounts, and additional short-term cost pressures to support the operation of its core regulatory functions.
14. The NZTA will need additional capability and capacity to deliver on the review findings and build an effective regulator. A funding review of the regulator is underway with consultation planned in early 2020. I propose to establish a new

charging mechanism to allow a portion of costs to operate the NZTA's regulatory function, and the Ministry's associated monitoring activity, to be met through land transport revenue, prior to inclusion in the National Land Transport Fund (NLTF). This proposal will support a more equitable approach to funding the land transport regulator, and potentially support a rebalancing of regulatory costs within the land transport system, aligned to transport sector funding principles.

15. I propose the provision of a repayable capital injection in the form of a tagged contingency of \$15 million to meet direct rectification costs for the backlog of regulatory compliance cases. I also seek agreement to another repayable capital injection of \$30 million to meet the existing cost pressures within the NZTA's regulatory function (above existing funding settings), including its projected regulatory deficit of \$18 million.
16. Drawdown against the capital injections will be subject to advice from officials and will require joint approval by the Minister of Finance and the Minister of Transport. The NZTA will need to make a robust case that the costs need to be incurred in advance of the Agency's regulatory funding review process.
17. In addition to the review of the NZTA's capability and performance, the Secretary for Transport commissioned a review to assess whether the Ministry, through its monitoring role, should have identified the performance issues within the NZTA's regulatory function earlier. This review also considered whether the Ministry's past, and revised, approach to monitoring Crown entity performance was fit-for-purpose.
18. MartinJenkins also undertook the independent review given its previous expertise in this area and the overlaps with the review into the performance of the NZTA. The review of the Ministry's monitoring performance breaks down and analyses the Ministry's monitoring approach into three periods (2007 – 2015, 2015 – 2017, 2017 – 2019).
19. MartinJenkins found that historically the Ministry's monitoring approach was largely desk-based and light touch, but was not dissimilar to other approaches undertaken by monitoring agencies in the public sector. However, the review noted that there was an uplift in the Ministry's monitoring approach between 2015 – 2017. The Ministry was making some headway in taking a more fit-for-purpose approach and did highlight some performance issues with the regulatory function with the NZTA Board and the then Minister of Transport. However, poor relationships between Ministry personnel and the NZTA, and the lack of provision of information when requested and push back by the NZTA impacted significantly on the effectiveness of the monitoring approach.
20. I am comforted that the review found that in the late period 2017 – 2019, the Ministry has continued to further improve its monitoring approach and is working better with transport Crown entities. Changes in leadership have also meant that the NZTA is more willing to share information and work with the Ministry to identify performance improvements. MartinJenkins states that the current monitoring approach being undertaken by the Ministry is consistent with public sector good practice and that they are confident that it should support the exposure of significant regulatory performance issues in the future and enable the Minister to be appropriately briefed.

21. In support of this finding, MartinJenkins highlighted that issues were beginning to be identified with the effectiveness and efficiency of the regulatory function by the Ministry in early 2018, which led to a focus on this in the 2018 Ministerial Letter of Expectations. Since then the new monitoring approach has supported identification of other risks in the NZTA.
22. Notwithstanding the improvements in the Ministry's monitoring performance identified in the MartinJenkins report, it is true the Ministry did not raise with me the seriousness of NZTA's regulatory failure, which was uncovered by the new NZTA Chair in 2018. I hope this will be a salutary experience for the Ministry.
23. I will encourage the Ministry to continue to embed and refine its monitoring capability and approach so it can drive the performance of transport entities. The Secretary for Transport and the State Services Commissioner will also share the broader lessons learnt from this review with monitors across the public sector.

## Background

24. The NZTA exercises regulatory functions to promote a safe, efficient, and effective land transport system. These functions include the issuing of driver licences, overseeing the vehicle inspection and certification regime, registration and licensing of transport services, issuing heavy vehicle permits, speed management, rail safety, and other land transport regulatory functions.
25. In October 2018, the NZTA Board announced that the NZTA had not performed its regulatory function effectively, in particular that it was too focused on education and self-regulation. The NZTA Board appointed law firm Meredith Connell to provide assistance, with a specific focus on managing the backlog of 850 regulatory non-compliance cases.
26. Following the identified issues, the NZTA announced that it would take immediate enforcement action to address non-compliance issues, which was a shift from its previous high-trust, education-focused approach. These actions included the review, suspension, and revocation of transport service providers (e.g. vehicle inspecting organisations, vehicle inspectors, repair and specialist certifiers) and transport operators (e.g. Transport Service Licence holders).
27. In November 2018, the NZTA confirmed that William Ball of Dargaville had been killed in a vehicle certified by an inspecting organisation that the NZTA had significant concerns with over several years, but had failed to take appropriate action. The NZTA Board commissioned Kristy McDonald QC to undertake a review to determine whether the NZTA's performance was a contributing factor in the death of Mr Ball. The McDonald review found that the NZTA had failed to prioritise public safety and noted that the case was an example of wider systemic failures.
28. The McDonald review also found that the NZTA's approach of viewing regulated parties as customers and prioritising information and education at the expense of strong regulatory oversight and effective enforcement led the NZTA away from its statutory objective and was not consistent with public safety. The NZTA has since been taking action to address the recommendations in the McDonald review.

29. Following the case involving the death of Mr Ball, I instructed the Ministry to review the performance of the NZTA's regulatory function. The scope of the review included assessing whether the NZTA was performing its regulatory function as intended by the relevant legislation and in line with good regulatory practice.
30. At the same time, the Secretary for Transport also commissioned an independent review of the Ministry's monitoring function to assess whether the Ministry should have identified the performance issues in the NZTA earlier through its monitoring role. This review also considered whether the Ministry's past, and revised, approach to monitoring Crown entity performance was fit-for-purpose.

### **Review into regulatory capability and performance of the NZTA**

31. The Ministry commissioned consultancy firm MartinJenkins to assist it in the development of findings against the terms of reference I set for the review. MartinJenkins was assisted by a regulatory expert from WorkSafe New Zealand. The reviewers interviewed around 70 people and evaluated around 250 documents to inform their findings and insights.
32. The review found that there were significant deficiencies in the NZTA's regulatory capability and approach that, over time, led to regulatory failure. The review found that there was no single cause for the regulatory failure at the NZTA, but rather a series of underlying factors that evolved over time. These included the following:
  - 32.1. overshadowing of regulatory responsibilities by higher-priority roles and conflicts of interest between NZTA's functions as regulator, infrastructure deliverer, and investor
  - 32.2. structural constraints, with three separate functions (infrastructure, investment, and regulation) bolted together when the NZTA was established, resulting in disparate functions with different ways of working and cultures
  - 32.3. weak regulatory leadership and expertise and a lack of awareness of regulatory issues at senior leadership and board levels
  - 32.4. lack of a clear, end-to-end regulatory strategy and operating model to enable the NZTA to effectively discharge its regulatory roles and functions
  - 32.5. underinvestment in regulatory capability and resourcing
  - 32.6. absence of a regulatory culture, with the taking of regulatory action seen as failure and a pervasive culture of bad news being unacceptable
  - 32.7. no single accountability for regulatory decision-making as in many other regulatory agencies, and a lack of robust, practical guidance for frontline staff to make effective regulatory decisions
  - 32.8. flaws in the internal audit process and a lack of continuous risk management across the regulatory function.

33. The review identified positive signs of progress in recent times, with NZTA starting work to define its regulatory approach and putting in place enhanced capability and systems to support the delivery of its regulatory functions. This includes strengthening governance, decision-making, people capability, and operational delivery. However, even with the progress made so far, significant work is still needed to build the elements of a well-functioning, risk-based regulator, which are currently absent within the NZTA.

### **Analysis of the issues within the NZTA's regulatory function**

34. Below I provide the Ministry's findings from the NZTA review against the key elements of the Terms of Reference. I also set out the recommendations put forward by the Ministry to respond to the review findings, which I have accepted.

*Was the NZTA performing as an effective, risk-based regulator based on good regulatory practice?*

35. There is an extensive body of evidence that sets out the foundations of good governance and modern regulatory practice<sup>1</sup>. To be successful, regulators need to have:
- 35.1. an approach to regulatory practice that is based on a sophisticated understanding of the nature of the risk, the nature of regulated parties, and changes in the regulated environment
  - 35.2. an understanding of how they use their regulatory levers and tools in a balanced, proportionate, and risk-targeted way to achieve compliance
  - 35.3. leaders who foster a culture that values operational flexibility and adaptation to changes in the regulatory environment, continuous learning, and a culture of challenge and "speaking up"
  - 35.4. comprehensive processes and systems to enable robust, consistent, and evidence-based decision-making
  - 35.5. capability across all levels of the organisation and a purposeful, structured, and integrated approach to achieving a professional workforce
  - 35.6. communication and engagement processes that promote the legitimacy of the regulatory regime
  - 35.7. an ability to fulfil their regulatory objectives within constitutional and statutory requirements.
36. The review has found that many of the key features of an effective regulator, including those noted above, are missing within the NZTA. For many years, the NZTA has lacked a comprehensive, end-to-end regulatory strategy for overseeing the delivery of its regulatory roles and functions. The review also found that the

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<sup>1</sup> OECD Best Practice Principles for Regulatory Policy: The Governance of Regulators (2014).  
Productivity Commission Regulatory institutions and practices (2015).

NZTA as an organisation has not had a clear view of the risk, and parties it is regulating, in the land transport system. It has also lacked a clear understanding of its regulatory roles, including how it works across these roles to effectively target risk.

37. The review also found significant deficiencies in how the NZTA delivers its regulatory functions. This resulted from the absence of a clear operating model to translate the NZTA's regulatory functions and responsibilities into practice. This was not just limited to the delivery of its frontline capability. The review noted that the NZTA did not have a full appreciation of the wider capability it required to operate as a well functioning, risk-based regulator (e.g. regulatory intelligence, research and evaluation, operational policy and practice, risk and assurance).

*Was the NZTA performing its regulatory functions as intended by the outcomes and provisions of the relevant legislation?*

38. The review found that there was regulatory failure at the point of entry (and renewal of entry) into the land transport regulatory system. This resulted from the NZTA treating the issuing of licences as a service for payment, rather than regulated parties qualifying for a privilege to operate. There was regulatory failure within the system when operators were allowed to continue with non-compliant behaviours over extended periods of time.
39. The review concluded that the most significant aspect of regulatory failure has been the combined failure of NZTA to provide oversight and leadership over the regulatory system and deliver on its role and functions within this system. The review found that the NZTA has not had an overarching strategy or regulatory practice framework for leading, planning, and operating as an effective regulator across the entire land transport system.
40. More work is required to ensure that recent improvements across the NZTA's regulatory function are fit-for-purpose to fully support its regulatory role across road, rail, and safety management (including speed). This includes ensuring that the NZTA has strong engagement with others in the sector who also have responsibility for regulatory activity, such as the Police, Road Controlling Authorities, Key Service Delivery Partners, and others with delegated responsibility for regulatory work.

*Did the NZTA's investment, delivery, and regulatory roles result in any conflicts and impacts on the performance of its regulatory services function?*

41. The review highlighted that within the NZTA, there has been a strong preoccupation with its other functions and that the focus of the NZTA Board and senior management was on infrastructure and investment responsibilities. The review found that the regulatory function was a small area of activity by comparison and was not a focus in the reasons for establishing the NZTA.
42. There was also a strong focus on embedding a customer service ethos throughout the NZTA. The review found that this powerful focus on customer service, at the expense of good regulatory practice, adversely influenced regulatory decision-making and activity. The role of the regulator was perceived through a customer service lens, which encouraged communication with customers, understanding and responding to their needs, and making transactions as efficient as possible. Taking

enforcement action was seen as a failure by senior management within the NZTA. However, a strong focus on customer service, imbalanced against having a clear regulatory approach as was the case at the NZTA, resulted in poor regulatory outcomes.

43. The review concluded that there are potential for conflicts of interest amongst the three functions of regulator, infrastructure deliverer, and investor that need careful management, particularly regarding efficiency, cost, and regulatory effectiveness considerations. There was no clear evidence that the NZTA understood that there could have been an actual, or perceived, conflict or tension between its different roles, or had processes and systems in place for managing these.

*Did the NZTA work effectively with other regulators to carry out its regulatory functions and responsibilities?*

44. The review highlighted challenges in how the NZTA worked with other agencies, regulators, and stakeholders in the delivery of its regulatory functions and responsibilities. The review highlighted a specific challenge with the dispersed nature of the NZTA's regulatory model, with some functions carried out by other agencies within the regulatory function. This impeded the NZTA's ability to see itself, and operate as, an effective end-to-end regulator for the land transport system.
45. The review found that the NZTA has made progress on its relationship with other transport regulators. However, this has not reached a mature state yet. The NZTA's relationship with other regulators has tended to be one-directional, with the NZTA seeking advice from other transport regulators, rather than having a group that is sharing learnings across regulators.
46. A large part of the enforcement function for the land transport system is undertaken by the Police. As well as its road policing role, the Police also carries out functions closely associated with the NZTA's regulatory roles in relation to transport licensing and vehicle standards in a subgroup of the Police's Road Policing function, the Commercial Vehicle Safety Team (CVST). The CVST has some of the responsibility for delivering monitoring and enforcement functions within the land transport system.
47. The scope of the review did not include an assessment of the Police's performance in supporting regulatory outcomes in the land transport system. The review did however hear from both the NZTA and the Police that the relationship between both agencies had been challenging, but had improved in the last few years. This was particularly given the NZTA's renewed focus on safety and the Police's focus on the relationship. A key factor behind these challenges was a poor alignment of purpose and priorities between both organisations.
48. With some of the enforcement model for commercial vehicle safety being outside the NZTA, the review has found that this makes it more difficult for it to establish a coherent, end-to-end regulatory approach. It also may impact on outcomes across the system, as it makes it harder to see causes of issues all the way through the supply chain and to influence behaviour.
49. Consideration of the interface of the land transport regulator with the health and safety at work regulator is also required. Currently the Civil Aviation Authority and

Maritime New Zealand (MNZ) are designated as the Health and Safety at Work Act (HSWA) regulators within a scope of designation specified in a document issued by the Prime Minister under HSWA.

50. These designations recognise the significant mutually reinforcing overlap between the objectives of HSWA and the transport regulatory system, and that it is much more efficient and effective for regulators to think holistically about safety issues under transport legislation and HSWA. For example, MNZ, when looking at safety issues on a ship, considers maritime safety legislation obligations and HSWA obligations and determines how best to deliver safety outcomes.
51. It also means that the regulated parties do not have to deal with multiple safety regulators. Without designation, there is also a risk that the regulators will defer to the other regulator in the overlap, thereby creating unintended gaps between their activities and focus.
52. In order to achieve good safety outcomes for the transport regulatory system (both land and rail), it is critical for the NZTA to be able to look from the start to the end of the supply chain for transport operators and determine how best to deliver safety outcomes using both HSWA and transport regulation.

*Was the regulatory function set up to drive home appropriate accountability and transparency?*

53. The review concluded that there have been issues with regulatory accountability and decision-making within the NZTA over many years. The review found that since the establishment of the NZTA, there was no clear identifiable single accountability for regulatory decision-making as in many other regulatory agencies (e.g. a Director/Chief Executive).
54. The NZTA Board delegated its regulatory functions and powers and associated decision-making responsibilities to the Chief Executive of the NZTA. However, there was not a clear understanding of the range of regulatory functions and how accountabilities were delivered, and the Chief Executive also had other larger functions which had significant focus and prioritisation. This created challenges around the responsibility for regulatory decision-making within the NZTA. As a result, there was limited focus and accountability for the performance of the regulatory function.
55. Currently, there is no single role within the NZTA that is accountable for leading its regulatory functions and to ensure high-quality regulatory decisions are made. This creates a significant constraint in the NZTA being able to achieve and maintain regulatory focus. It also creates challenges in strengthening the accountability and independence of regulatory decision-making in the land transport system.

### **Response to the review**

56. In response to the findings of the review, I intend to progress the following recommendations set out below. Together, I consider that the proposed recommendations will provide a firm basis for building an effective, high performing, risk-based regulator for the land transport system.

*Recommendation One: Develop a new regulatory strategy and operating model*

57. The findings from the review have made it clear that NZTA needs to develop a comprehensive regulatory strategy that articulates a proportionate and balanced risk-based approach to regulating the land transport system. This strategy needs to set out how the NZTA works across its regulatory roles and functions to target risk across the land transport system. This means setting out both internally and externally what its regulatory roles are, the risk it regulates in the system, how it targets its focus, and the parties that it regulates.
58. The regulatory strategy will:
  - 58.1. be comprehensive, identifying and covering all of the NZTA's regulatory functions
  - 58.2. define how the NZTA will identify risk across the land transport system, including how it will use its regulatory tools and interventions to target risk
  - 58.3. include the development of an enforcement strategy that states how, and when, it will carry out its different regulatory roles in a way that is transparent and public, so the NZTA's regulated community can understand its regulatory approach
  - 58.4. outline how the NZTA will manage any potential for conflict between its roles of investor, infrastructure builder, and regulator
  - 58.5. establish clear accountabilities for regulatory decision-making within the NZTA
  - 58.6. provide for a good regulatory culture where people are encouraged to raise risks and are able to exercise regulatory judgment within clear regulatory practices and approaches
  - 58.7. define how the NZTA will assess the performance of its regulatory function.
59. The strategy is critical in providing industry, regulated parties, and the NZTA's own staff with clarity on the Agency's regulatory roles and functions, including how it goes about exercising its regulatory mandate within the transport system. The Ministry would have a role in providing feedback on the NZTA's regulatory strategy to ensure it is reflective of the broader system context.
60. Sitting alongside the regulatory strategy, the NZTA will develop a new operating model, setting out the core capabilities that it needs to give effect to through the regulatory strategy. This includes considering what effective capabilities would look like around operational policy, practice and design, education and engagement, assurance, regulatory intelligence, research and evaluation, and proportionate enforcement. A specific focus on supporting effective decision-making and building a strong regulatory culture needs to be at the centre of the capability build.
61. I intend to set expectations for the NZTA Board to develop the regulatory strategy and the operating model by March 2020. It is important that this work happens at

pace, but it also needs to be balanced with the NZTA having sufficient time to respond.

*Recommendation Two: Establish a Statutory Director of Land Transport*

62. There has been a lack of clear focus and accountability within the NZTA around the leadership of the regulatory functions, and in particular ensuring that high-quality regulatory decisions are made.
63. I consider that significant change is required to strengthen the leadership and focus of the land transport regulator. The NZTA requires a single accountable decision maker with the credibility and expertise to exercise its regulatory functions and powers.
64. To achieve this step change, I seek agreement to establish a Statutory Director of Land Transport. The purpose of this role would be to provide a greater level of accountability, independence, and focus in how the NZTA exercises its regulatory powers, functions, and decision-making. The Director of Land Transport role would have statutory independence for exercising the powers and functions of the land transport regulator, which currently sit with the NZTA Board.
65. The key benefits of establishing the statutory director role include the following:
  - 65.1. provides a single point of accountability for how the powers and functions of the regulator are exercised
  - 65.2. reduces the potential for the NZTA's regulatory function to become diluted or lost over time by having a statutory officer with accountability for exercising the regulatory function
  - 65.3. provides greater clarity and transparency to industry, regulated parties, and the NZTA's own workforce about where accountability for regulatory decision-making exists
  - 65.4. provides the public with increased confidence that a dedicated, regulatory expert will be appointed to focus on making well considered regulatory decisions that are in the interest of public safety.
66. This is the approach taken in many jurisdictions, including New Zealand, in relation to the design and governance of regulators. Regulatory operational decision-making is often found in a statutory role with an appointee who has good regulatory decision-making experience, as in the case of the Directors of Civil Aviation and of MNZ. This approach is also evidenced in a range of other countries' land transport regulators.
67. Under this proposed change, the NZTA Board would be responsible for setting the strategic direction and focus of the Agency's regulatory function, including funding and setting resourcing for the function. The NZTA Board would also be responsible for setting its regulatory strategy and enforcement approach, which would guide the parameters that the Director of Land Transport operates within.

68. Accountability for regulatory decision-making would sit solely with the Director of Land Transport. The Director of Land Transport would be able to delegate decision-making within the regulatory function, however, would retain overall responsibility for how the NZTA's regulatory powers and functions are exercised, within the context of the regulatory strategy set by the NZTA Board.
69. In practice, it is likely that the NZTA Board would be responsible for the appointment and removal of the Director of Land Transport. It is anticipated that the position sit on the NZTA's leadership team and contribute to NZTA's overall direction and performance.
70. Decision-making for exercising the powers and functions of the regulator should sit with a single accountable person that has deep regulatory grounding. There is a high risk that, without a statutory role, over time the regulatory voice and focus of the land transport regulator could be lost or traded off against other priorities.
71. I recommend that any agreed legislative changes to enact the statutory Director of Land Transport role be progressed through the Regulatory Stewardship (Transport) Amendment Bill, which is due for introduction in the House by the end of 2019.

*Recommendation Three: Refresh the NZTA's regulatory objectives, functions, and powers*

72. The land transport system is complex, with multiple agencies and roles. The regulatory framework for land transport sits primarily in the Land Transport Act 1998, supported by a series of land transport regulations and rules. The Railways Act 2005 sets out parts of the role of the rail regulator. The Land Transport Management Act 2003 (LTMA) defines the overarching scope, objectives, and functions for the NZTA.
73. The current legislative framework does not set out the NZTA's regulatory objectives, functions, and powers in a comprehensive, consolidated, or clear way. Each of these components exists within different parts of the land transport regulatory framework, resulting in a lack of clarity about the NZTA's roles and functions within the land transport system.
74. I consider that changes are needed to better define the NZTA's regulatory objectives, functions, and powers. This is an important step in providing the NZTA with greater direction and focus on its regulatory roles and functions. It will also assist in providing the wider transport system, including regulated parties and other regulators, with more clarity over the NZTA's regulatory roles and functions. At the same time, I also intend to review and, where relevant, make minor amendments to clarify the NZTA's planning, investment, and delivery roles.
75. I propose to direct the Ministry to progress work to review and strengthen the NZTA's regulatory objectives, functions, and powers. This work should also consider whether the NZTA has all of the legislative powers and tools it requires to carry out the role of an effective regulator. These changes could be progressed alongside the statutory director role through the Regulatory Stewardship (Transport) Amendment Bill.

*Recommendation Four: Strengthen regulatory capability on the NZTA Board*

76. The review noted concerns about the mix of regulatory capability and experience amongst the NZTA's Board and Senior Leadership Team. In the context of the NZTA

Board, the review concluded that members were highly capable and respected individuals, and at various times there were members with some awareness of regulatory issues through their experience or training.

- 77. I have recently announced the appointment of changes to the NZTA Board, which have included a specific focus on strengthening regulatory expertise on the Board. As part of these changes, I have appointed the former Director of Maritime New Zealand Catherine Taylor. Ms Taylor will bring extensive regulatory expertise and capability to the NZTA Board, which will be critical as the Agency progresses the rebuild of its regulatory function.
- 78. With this added capability, I expect the NZTA Board, in its governance capacity, to play a more expansive and active role in driving the NZTA to become an effective, risk-based regulator for the land transport system. I will continue to review the membership of the NZTA Board to ensure there is a sufficient depth of regulatory expertise and capability in the future.

*Recommendation Five: Review regulator coordination and cohesiveness*

- 79. Strengthening coordination and engagement needs to be a priority in improving the performance of the land transport regulatory system. The review has made clear that there are opportunities to strengthen compliance and enforcement across the land transport system. I would like to see a greater level of coherence and alignment in how regulatory activity is undertaken across the land transport system.
- 80. To support a more coherent regulatory approach, I propose to direct officials to undertake work to assess whether the current allocation of compliance and enforcement functions is appropriate.
- 81. In order to provide greater clarity between the land transport regulator and the workplace health safety regulator, and to ensure there is coherence and minimisation of overlap, I propose that officials at the Ministry of Transport and the Ministry of Business, Innovation and Employment (MBIE) undertake work to assess the merits of designating the NZTA as the health and safety regulator for the land transport system.
- 82. I propose that officials from the agencies report back to me and the Minister of Workplace Relations to inform an in principle decision on designating the NZTA as a health and safety regulator by December 2019. An in principle decision in this timeframe is critical if the NZTA is to take on HSWA functions, as it needs to build these into its regulatory strategy and operating model to enable seamless implementation. Final decisions on designating the NZTA would be made once the NZTA has demonstrated it has sufficient capability and capacity to take on this role.
- 83. I would also like advice on whether the commercial vehicle enforcement functions are operating in a way that supports an effective end-to-end regulatory approach for the land transport system. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Withheld for confidentiality

84.

[REDACTED]

I recommend that officials report back to me and the Minister of Police on whether there are opportunities to enhance the way commercial vehicle enforcement functions are currently delivered by December 2019. Withheld for confidentiality

85. Significant work is required to build the core capability of the NZTA's regulatory function before it will be in a place to take on additional roles and functions. However, it is important that consideration is given now to the wider set of roles and functions that are needed to inform the development of the NZTA's regulatory approach and capability. Not considering these issues now would impact the NZTA's ability to develop a well-rounded regulatory approach. My intention is that any additional roles or functions would be included, as the NZTA builds its core capability and demonstrates its ability to perform as an effective regulator.

#### **Addressing short-term cost pressures in the NZTA's regulatory function**

86. For the NZTA to be an effective regulator, it will need to build additional capability and capacity. Work is underway to address this issue through a full review of the funding settings for the NZTA's regulatory function, expected to be brought to Cabinet in early 2020 and consulted on with stakeholders. However, while this review is progressing, the NZTA will need to manage increasing cost pressures across its regulatory function.
87. The NZTA estimates that it needs to incur around \$17 million in additional regulatory costs to support the core operation of its regulatory function that cannot be met within existing funding settings in 2019/20, and which need to happen immediately and cannot wait until a funding review. These relate to key safety critical roles. These costs are in addition to a budgeted operating deficit of around \$18 million in 2019/20 against the memorandum accounts for the regulatory functions of the NZTA. The NZTA's operating costs for its regulatory function in 2019/20 were \$165 million against budgeted expenditure of \$183 million, which includes the projected operating deficit.
88. As at the end of July 2019, the NZTA has also paid out just over \$4 million in direct rectification costs, which have been written-off against retained earnings. These costs relate to issues arising from non-compliant Heavy Vehicle Specialist Certifiers and inspecting organisations. The decision to write these costs off to retained earnings was made on the basis that users should not bear the costs of the NZTA's regulatory failure.
89. In addition, the NZTA has incurred a further \$15 million to 30 June 2019 in direct rectification costs charged against its memorandum accounts. These costs comprise estimates of likely future payments of direct rectification costs, costs of reviewing the backlog of regulatory non-compliance cases, and the improved oversight and management of the rectification claims and management of the NZTA's regulatory function.

90. At the beginning of the 2018/19 financial year, the NZTA had an available retained earnings balance of \$10 million. However, due to a series of write-offs (including the direct rectification costs paid out of \$4 million), the available balance as at the end of the 2018/19 financial year has reduced to \$3.1 million. The NZTA anticipates that it potentially may need to pay out \$13.5 million<sup>2</sup> in additional direct rectification costs associated with the backlog of historic regulatory non-compliance cases.

Table one: Estimated direct rectification costs for regulatory non-compliance cases

Cost type	Estimated amount (\$ million)
Provision for paying out existing claims (on top of the existing \$4 million paid out to date)	5.4
Estimated cost for chassis certified by non compliant Heavy Vehicle Specialist Certifiers	6.7
Contingency amount (based on a more conservative estimate on the existing claims)	1.1
Estimated potential rectification costs based on investigations still to be finalised	0.3
<b>Total</b>	<b>13.5</b>

91. The NZTA Board has taken a decision to limit the future payment of direct rectification costs to only those vehicles affected as part of the backlog of regulatory non-compliance cases identified in October 2018. The NZTA has signalled that it will be strengthening the insurance requirements on inspecting organisations and certifiers to mitigate further costs to the Crown if significant regulatory non-compliance is identified in the future.
92. It is unusual for government agencies to be able to incur expenditure planned to be recovered from future increases in funding in advance of completing a funding review process. However, at the same time, it is important that a practical approach is taken to ensure that agencies are able to address significant deficiencies, such as the case in the NZTA's regulatory function, particularly when not addressing these deficiencies perpetuates existing safety issues and undermines confidence in the land transport regulator.
93. A high benchmark must be applied in considering decisions to both incur additional expenditure and to then recover that expenditure through a funding review process. It is important that appropriate consultation is undertaken with stakeholders and the public before changing funding settings. There are also risks of making decisions on funding settings where the NZTA is yet to establish a clear strategy and approach for how it will perform its regulatory functions.

<sup>2</sup> This includes the payment of \$5.4 million of costs included in the \$15 million of rectification costs as at 30 June 2019 that are yet to be paid out.

94. I am of the view that some short-term relief is needed to ensure that the NZTA can manage the immediate cost pressures within its regulatory function. I seek Cabinet agreement to establish two capital injections to address the NZTA's immediate regulatory cost pressures.
95. I propose that the first capital injection be established as a tagged contingency to meet the direct rectification costs associated with the backlog of historic regulatory non-compliance cases. I propose that this capital injection be for up to \$15 million and would be provided on a repayable basis. Use of the capital injection would be limited to the 850 non-compliance cases identified by the NZTA as at October 2019 and any other historical cases that may subsequently come to light from this period.
96. I recognise that this approach may not align with funding principles and best practice, however, I consider that this approach will ultimately benefit the safety of all road users by enabling a more effective land transport regulator.
97. I propose a second tagged contingency capital injection of \$30 million to cover the operating costs of the NZTA's regulatory function. This capital injection would be used to meet the NZTA's projected regulatory deficit for 2019/20 and critical regulatory cost pressures that need to be met in advance of the NZTA's regulatory funding review process being completed. I propose that this capital injection be made on a repayable basis, with costs collected through the NZTA's regulatory funding review.
98. Access to the capital injection will be dependent on the NZTA making a sufficient case that incurring these costs are urgent and necessary to support it to perform its core regulatory function. I expect the NZTA to ensure its regulatory cost pressures are managed within the limits of the capital injection. Further Cabinet agreement would be required if the NZTA required further costs above the current limits of the capital injection.
99. Drawdowns against both tagged contingency capital injections will require joint approval by the Minister of Finance and the Minister of Transport. Both capital injections will be split over 2019/20 and 2020/21 to reflect that the NZTA will need to incur costs over a two year window and that it will take time for any decisions through the NZTA's regulatory funding review to come into effect (likely to be 1 April 2021).
100. A high level of scrutiny must be applied to ensure that the NZTA is not incurring costs that should be considered and consulted on through a proper funding review process. Officials will provide further advice to the Minister of Finance and Minister of Transport about the terms and conditions for repayment of the capital injections associated with the regulatory costs tagged capital contingency.
101. Consultation on the NZTA's regulatory funding review will set out a proposal for the recovery of costs funded through the repayable tagged contingency capital injection for meeting its regulatory operating costs. Taking this approach would mean that up to \$30 million would be recovered through the NZTA regulatory funding review. This would be in addition to any other funding that would be required to strengthen the NZTA's regulatory capability and performance.

## Creating a sustainable funding pathway for the land transport regulator

102. Under well-established transport funding principles, the NZTA's regulatory activities should principally be cost recovered through charges in the nature of levies imposed on identifiable groups of land transport system participants according to the benefits and risks they contribute to the system. In-line with the funding principles, charges can be supplemented by fees charged for specific products and services and some limited Crown funding.
103. Road users are one of the groups of system participants in the land transport regulatory systems who benefit from, and exacerbate risks within, the system. Therefore, road users should be required to fund a portion (but not all) of the cost of the regulatory activities of the NZTA.
104. Road users contribute to land transport revenue under the LTMA in a manner proportionate to their use and impact in the system, through Fuel Excise Duty, Road User Charges and vehicle registration.
105. Currently, there is no clear or established charging mechanism in place to recover the costs of operating the land transport regulator from road users who benefit from having a well resourced and effective regulator. The primary funding sources available are those provided for the provision of regulatory services, such as fees for driver licences and testing, Transport Services Licences, and vehicle registration. These current funding arrangements create a situation where the costs of operating the regulator are not fairly distributed across all parties within in the transport system.
106. I propose that a new charging mechanism be established in legislation to enable a more balanced and equitable approach to the funding of the NZTA's regulatory activity and the Ministry's associated monitoring function. This recognises there are wider 'club good' benefits of having an effective regulator to the land transport system, including a strong monitoring department to drive accountability and performance. To support this approach, I propose that a proportion of the cost of operating the regulator and the Ministry's monitoring function could be met through land transport revenue prior to inclusion in the NLTF.
107. Implementing the proposal would require an amendment to section 9 of the LTMA which sets out provisions for the Crown to incur certain costs from land transport revenue, such as for search and rescue activities, recreational boating safety and maritime safety services, and revenue management and forecasting. The amendment would enable a proportion of land transport revenue to be 'top sliced' to fund:
  - 107.1. the land transport regulator, as is the case for other regulatory and safety functions performed in the transport sector
  - 107.2. some of the costs of operating the Ministry's monitoring function.

108. The benefits of this approach include:
- 108.1. a fairer proportion of costs for operating the land transport regulator can be recovered from a wider group of road users that benefit from having a well resourced and effective regulator. This means the costs of operating the land transport regulator would be more equitably shared by all participants in the land transport system
  - 108.2. the proposal supports a risk-based approach to allocating the cost of operating the regulator. Road users' contribution to the operation of the land transport regulator would be proportionate to the level of travel and therefore risk exposure they have in the land transport system
  - 108.3. a charging mechanism is already in place through land transport revenue. There would be relatively limited administrative changes required to implement a funding source to support the operation of the land transport regulator
  - 108.4. establishing a broader based charging mechanism could present an opportunity to reduce, rebalance, or consolidate individual fees and charges within the land transport system. Individual charges and fees would still be required to ensure those who derive a direct benefit from a service provided by the regulator pay for the benefit of that service
  - 108.5. the proposal also ensures that the Ministry has access to an appropriate level of resource to effectively perform its monitoring role of the transport entities. A well resourced monitoring function is integral in ensuring appropriate accountability and a strong focus on performance improvement across the transport entities.
109. Progressing with the proposal now means that the use of land transport revenue can be considered as part of the NZTA funding review. If the proposed change is delayed, it could affect land transport revenue being considered as a funding source through the NZTA funding review process. A delay could subsequently affect the timeliness in progressing the funding review and therefore prolong the funding challenges in the NZTA's regulatory function.
110. I consider there is a case for progressing legislative change now to establish a mechanism for using land transport revenue to fund a portion of the operating costs for the NZTA's regulatory function and the Ministry's monitoring function. I therefore seek agreement to amend the LTMA to provide for a portion of the NZTA's regulatory activities and the Ministry's monitoring function to be top-sliced from land transport revenue prior to inclusion in the NLTF. I seek agreement to do this by providing that:
- 110.1. the Crown may, without further appropriation, fund the NZTA's land and rail regulatory activities, including the Ministry's monitoring capability, up to an amount agreed by the Minister of Transport and the Minister of Finance
  - 110.2. the amount of NZTA regulatory activities funded is paid from land transport revenue inflows prior to their inclusion in the NLTF.

111. As noted above, funding requirements for the NZTA's regulatory function, including the amount of any top-slice and charges for other groups of participants, is expected to be considered by Cabinet in early 2020.

### **Strengthening the transport regulatory system**

112. I recognise there will be strong interest from the public in the performance issues identified within the NZTA, including whether these issues could be more systemic within the wider transport system and other regulatory systems. There are some special features relating to the NZTA and its regulatory failure, the combination of which are less likely to be present in most other regulators. These include:
- 112.1. the NZTA had two other significant non-regulatory functions that have overshadowed its regulatory function
  - 112.2. there were not clear accountabilities relating to the operation of its regulatory function, which were critical given the extent of its other roles
  - 112.3. for some of its regulatory function, the NZTA only carried out part of the enforcement role, which made it harder for it to see itself as a lead end-to-end regulator and enforcer.
113. The review has highlighted the need for government agencies, including regulators and their monitors, to be vigilant around the delivery of their regulatory functions. The findings from the review will provide important insights for other regulators to assess their capability and approach.
114. The State Services Commission (SSC) will be undertaking work to assess the impact of the broader review findings on the capability and performance of regulators, regulatory agencies, and monitoring departments across the wider public sector.
115. The institutional framework that the NZTA operates within has created some challenges in building capability and retaining focus on its regulatory function. This is primarily as a result of the NZTA having multiple functions, the absence of a clear and accountable regulatory decision-maker, along with part of the enforcement component of its regulatory approach being delivered outside of the Agency.
116. The recommendations I have put forward in response to the review will provide a strong platform to rebuild capability and confidence in the land transport regulator. It will be important that work is undertaken to assess the NZTA's progress in response to the review findings. I will be instructing my officials to monitor and report to me on the progress that the NZTA is making to build capability and performance in its regulatory function.

### **Enhancing the NZTA's organisational performance**

117. The performance of the NZTA has a significant and direct impact on all New Zealanders who rely on having an accessible and efficient transport system to travel. The NZTA also fulfils a key role as the Government's primary agent for delivering its transport strategy and priorities. For these reasons, it is fundamental that the NZTA is performing effectively.

118. The review of the NZTA's regulatory performance has highlighted broader challenges around its organisational leadership, capability, and culture. The success of the NZTA relies on it having effective leadership, supported by a strong culture and the right capability to deliver its core functions well.
119. I believe that further institutional change would destabilise the NZTA at a time when it needs to deliver a capable regulator and implement regulatory priorities of the Government. This is also important to avoid any impacts on the performance of the NZTA's other functions. However, I will, with the Ministry, continue to monitor the capability and performance of the NZTA, and the implementation of the review findings, to see whether further change may be needed in the future.
120. The nature of the issues set out through the review may raise questions as to whether more substantive changes are needed to the structure of the land transport regulator within the NZTA. I believe that structural change would destabilise the NZTA and impact the ability to drive immediate improvements in the capability and performance of the land transport regulator.
121. I am of the view that the focus needs to be on strengthening regulatory focus, leadership, and culture within the NZTA, which are key issues identified in the review. I am confident that with the recommendations I am proposing in response to the review, along with the strengthened leadership on the NZTA Board, will help drive a step change in the capability and performance of the land transport regulator. I will, however, with the Ministry, continue to monitor the capability and performance of the NZTA, and the implementation of the review findings, to see whether further change may be needed in the future.
122. I am also confident that with Sir Brian Roche as the new Chair of the NZTA, it will have strong leadership and a clear direction. I will be asking the NZTA Board to prioritise work to strengthen the leadership, culture, and organisational performance of the NZTA, alongside responding to the findings from the review of the NZTA's regulatory performance. I will be directing my officials to closely monitor the NZTA Board's progress in this area.

### **Review of the Ministry's monitoring performance**

123. In addition to the review of the NZTA, the Secretary for Transport commissioned an independent review to assess whether the Ministry, through its monitoring role, should have identified the significant performance issues within the NZTA earlier and provided advice to Ministers sooner. In doing so, it was necessary to consider the Ministry's performance of its monitoring function against its own expectations and best practice monitoring expectations in the public sector. The review was also required to deliver any recommendations for change.
124. MartinJenkins was contracted to carry out the independent review, given its experience in this area and the overlaps with the review into the performance of the NZTA. MartinJenkins looked at best practice Crown entity monitoring across the public sector from 2007 to 2019 and assessed the Ministry against this. It conducted a range of interviews with people from transport Crown entities, and former and current Ministry staff, and analysed a range of reports and briefings. MartinJenkins

breaks the Ministry's performance into three periods (2007 – 2015, 2015 – 2017, and 2017 – 2019).

#### *Findings from 2007 to 2015*

125. The early monitoring period is characterised as one of a light touch approach to performance monitoring of the NZTA. This largely involved a desktop exercise, reviewing the NZTA accountability reporting and often summarising the NZTA's views on its own performance. In this regard, the Ministry's approach to monitoring was not too dissimilar to that exercised elsewhere in the public sector.
126. In supporting the NZTA Board appointment process, the Ministry would not have been aware of the need for in-depth regulatory experience at a governance level. As a result, there was a lack of this in-depth regulatory experience on the NZTA Board.<sup>3</sup>
127. The Ministry's approach to monitoring of the NZTA's performance over this time period was not fit-for-purpose and did not identify significant performance issues within the regulatory function.

#### *Findings from 2015 to 2017*

128. There was a Performance Improvement Framework (PIF) review in 2013, and a follow up in 2014, which found that the Ministry's monitoring focus was transactional and too low level and the relationships with the NZTA needed to be improved. It also noted the challenge for the Ministry of being a small organisation with limited resources.
129. In response, the Ministry set up a new transport agency Crown Entity Monitoring Framework (the CEAF). Key findings in relation to this period were that the CEAF:
  - 129.1. reflected the kinds of approaches that were emerging from central agencies as good practice
  - 129.2. was accompanied by the build of a stronger, more experienced monitoring team with commercial, investment, and financial management backgrounds, including Crown company monitoring experience
  - 129.3. was a step up from earlier, less strategic, less focused approaches and aimed to add value to the NZTA through insights gained. It was still largely based on assessing NZTA reporting, but applied a more critical lens
  - 129.4. led to more testing conclusions being drawn on the NZTA's performance. The first monitoring assessment (2016) that was provided to the Minister of Transport and the NZTA Board raised a number of performance issues including with the regulatory function. These included a number of inconsistencies in the way performance information was reported to the NZTA Board, critical regulatory systems and processes that were nearing the end of their working life, and a need to ensure greater regulatory integrity over functions, such as driver licensing. The Ministry rated the NZTA as needing improvement

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<sup>3</sup> See Review of the New Zealand Transport Agency's regulatory capability and performance, MartinJenkins, 2019.

- 129.5. the approach and findings from the CEAF reports challenged the NZTA in ways it had not been before and produced a reaction at senior leadership levels, with relationships becoming more fraught. The NZTA challenged any assessments vigorously. This is consistent with the MartinJenkins review of NZTA's regulatory capability and performance which found that bad news was unacceptable to the NZTA's leadership team at that time
- 129.6. by 2017, monitoring reporting did raise issues with the regulatory function to the NZTA Board and the Minister but these were weaker and less challenging to the NZTA, given the desire to manage relationship issues between the agencies
- 129.7. over this time, the Ministry had an assessment framework for monitoring which was becoming more fit-for-purpose, but poor relationships between Ministry personnel and the NZTA impacted significantly on the effectiveness of the monitoring approach – both for the Ministry gaining critical insights on the NZTA's performance and the NZTA taking notice of messaging in reporting. Information was either not provided by the NZTA to the Ministry (despite requests) or provided in a deluge to make the monitoring extremely difficult. In this regard, the opportunity to expose performance issues in the regulatory function and to provide stronger advice to the Minister was lost at this time.

#### *Findings from 2017 to 2019*

130. The current Secretary for Transport, Peter Mersi, was appointed to the Ministry in July 2016. The review of the Ministry's monitoring performance found that from early 2017, he instigated changes to the organisation and improvements in the Ministry's operating approach. This involved moving the Ministry's monitoring approach to be more constructive, proactive, and collaborative, working closely with the boards and senior leadership of the transport Crown entities. This approach was aimed at providing greater insights on entity capability and performance, including supporting entities to better identify and manage risk. This approach was supported by the PIF as being a step in the right direction in 2017.
131. The key findings of the monitoring review for period from 2017 to 2019 were:
  - 131.1. there has been a step-change in the approach to Crown entity monitoring within the Ministry commencing from early/mid 2017 with the reorganisation of the Ministry and the focus on building and maintaining constructive, collaborative, and respectful relationships with the transport Crown entities. Regarding the NZTA, this developed from early 2018, and at the present time there are effective relationships, good information sharing, and more appreciation of the value that effective monitoring can bring to assisting the entity board and leadership manage critical risks
  - 131.2. the CEAF monitoring framework was refreshed through 2018 and tested with the NZTA. By and large, the refresh maintained the focus of the earlier framework, but significantly improved the approach to the assessments to enable more insightful analysis, as well as a strategic focus on critical risk and trend analysis

- 131.3. the new monitoring approach reflects the key elements of monitoring best practice
- 131.4. the new approach has involved adding to the capability of the monitoring team by hiring people that understand and have had experience in regulatory agencies. For specific lines of enquiry, expert skills are also brought in to assist the monitoring team with their work (for example, construction and procurement expertise)
- 131.5. regarding the appointment of board members, the Ministry's monitoring team added capability to the team for supporting the appointment process and advice on NZTA Board appointments. The capability matrix has been revised to reflect the range of governance and regulatory skills that are required in each of the transport Crown entities, including a focus for in-depth regulatory experience on the board of the NZTA and the other transport agencies
- 131.6. there is increased collaboration across Ministry functional groups and, in particular, better linkages between regulatory policy and stewardship and monitoring functions which have provided additional opportunities for highlighting risks and ways of communicating these to the entity board.
132. MartinJenkins notes that they are confident that the cumulative effect of these changes should support the exposure of significant regulatory performance issues in the future and enable the Minister to be appropriately briefed.
133. MartinJenkins also adds two notes of caution. It makes the point that it is not the role of the monitor to assume the responsibility of the board or to undertake an audit approach to its monitoring work. However, the monitoring process needs to enable the sharing of sufficient evidence to demonstrate there is oversight and management of key risks and priority areas within agencies. In this regard, the review notes that the monitor needs to guard against the risk of delving into too much detail and gaining the perception and reputation for out of place 'micro-management' of the entity.
134. The review also suggests that the current approach of providing monitoring reports to the NZTA management for 'fact checking' prior to reports going to the entity board, and then on to the Minister, presents an inherent risk for entity influence over the messaging and tone of the reporting. This risk could be mitigated to some extent by providing reports to the Board at the same time as to the Chief Executive. In this way, the Board has the opportunity to engage with the messaging and make its own assessment of the insights. The Board has the role to challenge the entity leadership for managing risks and organisational performance.
135. I am disappointed that, regardless of the fact that the Ministry's monitoring approach from 2007 – 2015 was similar to other public sector monitoring agencies, it was not fit-for-purpose and did not ask the hard questions, or provide sufficient focus of the performance of the regulatory function. While I appreciate the Ministry cannot take on the role of the NZTA Board, and is not the NZTA's auditor, the monitoring function does provide a final line of questioning and it did not perform this in a way that supported a focus on the performance of the regulatory function.

136. I note that the uplift in the Ministry's monitoring approach in 2015 – 2017 was making some headway in taking a more fit-for-purpose approach, and did highlight some performance issues with the regulatory function with the NZTA Board and Minister of Transport. However, poor relationships between Ministry personnel and the NZTA, and the lack of provision of information and pushback by the NZTA impacted significantly on the effectiveness of the monitoring approach. This impacted the ability of the Ministry to understand and expose the significance of performance issues in the NZTA's regulatory function and to provide stronger advice to the Minister.
137. I am comforted that since then, the Ministry has continued to improve its monitoring approach and is working better with the transport Crown entities. Changes in leadership have also meant that the NZTA is more willing to share information and work with the Ministry to identify performance improvements. MartinJenkins notes that the monitoring approach being undertaken is consistent with public sector good practice and would be more likely to have found regulatory issues. In support of this finding, MartinJenkins highlights that issues were beginning to be identified with the effectiveness and efficiency of the regulatory function in early 2018, and since then the new monitoring approach has supported identification of other risks in the NZTA.
138. Notwithstanding the improvements in the Ministry's monitoring performance identified in the MartinJenkins report, it is true the Ministry did not raise with me the seriousness of NZTA's regulatory failure, which was uncovered by the new NZTA Chair in 2018. I hope this will be a salutary experience for the Ministry.
139. I believe that there are some key lessons learnt from this review which are applicable more broadly to the public sector monitoring approaches, i.e. that effective monitoring needs to:
- 139.1. be based on good relationships and good information sharing between the Ministry and agency (Board and senior leadership) being monitored, and there needs to be respect and appreciation of the value that effective monitoring can bring
  - 139.2. have a strategic focus on critical risk and trend analysis and be rigorous
  - 139.3. have effective monitors with commercial and governance skills, but also people who understand regulators. Monitors also need to understand the organisation they are monitoring, including its functions, and when to bring in specialist support to help monitoring in some areas
  - 139.4. provide a good capability mix on boards, including regulatory expertise where the board has regulatory functions
  - 139.5. engage closely with other functions working with the agency being monitored (e.g. policy and stewardship functions) to share information and identify risks
  - 139.6. be careful not to take on the role of boards by delving too much in the detail
  - 139.7. consider how monitoring information is provided to the agency's senior leadership, board, and Ministers, to ensure that there is not the perceived or

actual watering-down of information or messaging.

140. The review of the monitoring function has also been provided to the State Services Commissioner. The Commissioner and the Secretary for Transport will work to ensure the lessons learnt from this review are disseminated more broadly to other public sector monitoring agencies.

### **Consultation**

141. The SSC, the Treasury, the NZTA, the Police, and MBIE have been consulted. The Department of the Prime Minister and Cabinet has been informed of this paper.

### **Financial Implications**

142. I have set out a proposed approach for addressing the cost pressures facing the NZTA's regulatory function in the short-term. The proposed response to address these cost pressures, set out in paragraphs 94, 95, 97 and 106, will provide the NZTA with the resources needed to continue to operate its regulatory function while a full funding review process is completed. This approach is supported by the Treasury.
143. I will bring a paper back to Cabinet setting out the longer-term requirements for funding the NZTA's regulatory function, expected in early 2020. This paper will set out proposals to ensure that the NZTA has sufficient resourcing to build an effective and high-performing regulator for the land transport system.
144. The recommendations will take account of the capability build required to respond to the findings of the Ministry's review into the capability and performance of the NZTA's regulatory function.
145. Through the funding review process, specific consideration will be given to the mix of funding sources (e.g. fees, charges, and land transport revenue) that are needed to support the effective operation of the NZTA's regulatory function.

### **Legislative Implications**

146. The proposal to establish the Director of Land Transport role; revise the NZTA's objectives, functions, and powers; and establish a new funding source for the land transport regulator and the Ministry's monitoring function from land transport revenue will require legislative change. I am proposing to progress these proposals through the Regulatory Stewardship (Transport) Amendment Bill, which seeks to modernise and strengthen the land transport regulatory framework, and is expected to be before the House by the end of 2019.

### **Regulatory Impact Analysis**

147. Regulatory impact analysis has been undertaken for the recommendations in this paper that require legislative changes. A Regulatory Impact Statement (RIS) is attached. The Ministry's Regulatory Impact Analysis (RIA) panel has assessed the RIS and considers that it partially meets the relevant quality assurance criteria. The RIS was assessed as partially meets as the Ministry was unable to undertake full

consultation on the proposed recommendations due to the confidentiality of the review process.

### **Human Rights**

148. This paper has no human rights implications.

### **Gender Implications**

149. This paper has no gender implications.

### **Disability Perspective**

150. This paper has no disability implications.

### **Publicity**

151. I propose to hold a press conference during the week of 30 September 2019. At the press conference, I will provide an overview of the findings from the review, including the recommendations in response to the findings. The Chair of the NZTA will also be present to discuss how the Agency will take the findings forward. I also expect that the Secretary for Transport will outline the findings of the review into the Ministry's monitoring performance.

### **Proactive release**

152. I intend to proactively release this paper within 30 days of the Cabinet decision, consistent with the provisions of the Official Information Act 1982.

### **Recommendations**

I recommend that the Committee:

1. **note** that in October 2018, the New Zealand Transport Agency (NZTA) Board announced that the NZTA had not been performing its regulatory function effectively, and in particular that it was too focused on education and self-regulation

#### *Review into the NZTA's regulatory capability and performance*

2. **note** that, in response to concerns raised by the NZTA Board, I commissioned a review into the regulatory capability and performance of the NZTA, with the review finding significant deficiencies in the NZTA's regulatory capability that, over a number of years, resulted in regulatory failure
3. **note** that the underlying causes of regulatory failure at the NZTA included an overshadowing of regulatory functions, weak regulatory leadership and expertise, a lack of a clear regulatory strategy and approach, limited regulatory capability, resourcing and funding challenges, the absence of a regulatory culture, structural constraints, lack of accountability, and inadequate audit and risk management

*Response to review findings*

4. **note** that I intend to set expectations for the NZTA Board to develop a new strategy to strengthen the NZTA's regulatory delivery (by March 2020) and establish a new regulatory operating model that defines the capability, processes, and systems to implement the NZTA's regulatory strategy (by March 2020)
5. **agree** to the establishment of a statutory Director of Land Transport to lead the regulatory function and regulatory decision-making in the NZTA and that this be included in the Regulatory Stewardship (Transport) Amendment Bill
6. **agree** that the Director of Land Transport will be accountable for the delivery of the independent regulatory functions and powers currently held by the NZTA Board under the Land Transport Management Act 2003
7. **authorise** me to refresh the independent regulatory functions and powers in the Land Transport Management Act 2003 to ensure they are fit-for-purpose and consistent with the overall policy intent of this paper without further reference to Cabinet
8. **authorise** me to refresh the NZTA's regulatory objectives and remaining functions and powers in the Land Transport Management Act 2003 to provide greater focus on the NZTA's regulatory role and to ensure that its existing land transport planning, investment, and delivery functions are adequately described and that this be included in the Regulatory Stewardship (Transport) Amendment Bill
9. **note** that the Ministry of Transport (the Ministry), the NZTA, and the New Zealand Police will undertake work to identify whether there are opportunities to enhance the way commercial vehicle enforcement functions are delivered by December 2019
10. **note** that officials will report back to the Minister of Transport and the Minister of Workplace Relations on the merits of designating the NZTA as a health and safety regulator under the Health and Safety at Work Act 2015, with an in principle decision to be taken by December 2019
11. **note** that I have recently announced new appointments to the NZTA Board, which have included strengthening regulatory expertise and capability on the NZTA Board

*Short-term regulatory cost treatment*

12. **note** that the NZTA plans to incur a projected deficit of around \$18 million of regulatory costs in 2019/20, with the Agency estimating that it will need to incur additional costs of up to \$17 million to support the operation of critical activities its regulatory function
13. **note** that the NZTA is continuing to incur costs to rectify and recertify vehicles affected by the backlog of regulatory non-compliance cases, and as a result of growing cost pressures its ability to fund these costs from its retained earnings is limited

14. **agree** to provide the NZTA with repayable capital injections to cover urgent costs associated with its core regulatory functions in advance of the forthcoming funding review
15. **agree** to provide the NZTA with repayable capital injections to cover additional direct rectification costs that it may incur as a result of its regulatory failures
16. **agree** to establish tagged capital contingencies of up to the amounts as follows in Vote Transport, to provide for the decisions in recommendations 14 and 15 above:

Vote Transport Minister for Transport	\$m – increase/(decrease)				
	2019/20	2020/21	2021/22	2022/23	2023/24 & out years
Regulatory Costs – Tagged Capital Contingency	25.000	5.000	-	-	-
Recertification Costs – Tagged Capital Contingency	12.500	2.500	-	-	-

17. **authorise** the Minister of Transport and the Minister of Finance acting jointly to draw down the tagged capital contingencies in recommendation 16 above (establishing any new appropriations as necessary), subject to the NZTA confirming details on the rationale for the additional amount of regulatory costs and rectification costs it will incur
18. **agree** that the “Regulatory Costs” and “Recertification Costs” tagged capital contingencies in recommendation 16 above will expire on 1 June 2021
19. **note** that the expenditure associated with the “Regulatory Costs” and “Recertification Costs” tagged capital contingencies in recommendation 16 will have no impact on Budget allowances as the capital injections are intended to be subject to market interest rates and will be repaid within ten years of each drawdown
20. **note** that officials will provide further advice to the Minister of Finance and Minister of Transport about the terms and conditions for repayment of the capital injections associated with the “Regulatory Costs” and “Recertification Costs” tagged capital contingencies

*Creating a sustainable funding pathway*

21. **note** that the NZTA has commenced a broader review of its regulatory funding and a paper will be brought to Cabinet outlining the outcome of the review, including any proposals to the current funding arrangements, in early 2020

22. **note** that under well-established transport funding principles, NZTA's regulatory activities should principally be cost-recovered through charges in the nature of levies imposed on identifiable groups of land transport system participants according to the benefits and risks they contribute to the system, supplemented by fees charged for specific products and services and some limited Crown funding
23. **note** that road users are one of the groups of system participants in the land transport regulatory systems who benefit from, and exacerbate risks within, the land transport regulatory system and should be required to fund a portion (but not all) of the cost of the regulatory activities of the NZTA
24. **note** that currently there is no clear or established charging mechanism in place to recover the costs of operating the land transport regulator from road users who benefit from having a well-resourced and effective regulator
25. **agree** to amend the Land Transport Management Act 2003 to provide for a more balanced and equitable approach to funding the NZTA's regulatory function by providing that:
- 25.1. the Crown may, without further appropriation, fund the NZTA regulatory activities and the Ministry's associated monitoring activity up to an amount agreed by the Minister of Transport and the Minister of Finance from land transport revenue; and
- 25.2. the amount of NZTA regulatory activities funded is paid from land transport revenue inflows prior to inclusion in the National Land Transport Fund
26. **note** that that the funding model for NZTA regulatory activities and the Ministry's monitoring function, including the amount of any top-slice and charges for other groups of participants, will be consulted on and considered by Cabinet

#### *Review of the Ministry of Transport's monitoring performance*

27. **note** that in addition to the review of the NZTA's capability and performance, the Secretary for Transport commissioned a review to assess whether the Ministry, through its monitoring role, should have identified the performance issues within the NZTA's regulatory function earlier
28. **note** that the review has found that while the Ministry's historic approach to monitoring was light touch, it has made significant improvements in how it undertakes its monitoring function which is now considered more constructive, proactive, collaborative, and representative of best practice

#### *Legislative implications*

29. **note** that the recommendations in response to the NZTA review that have legislative implications will be given effect to in the Regulatory Stewardship (Transport) Amendment Bill, which is due for introduction in the House by the end of 2019
30. **invite** the Minister of Transport to issue drafting instructions to the Parliamentary Counsel Office to give effect to the decisions in recommendations 5, 6, 7, 8 and 26

31. **authorise** the Minister of Transport to make final decisions, consistent with the overall policy intent, on details that arise during the drafting of the Regulatory Stewardship (Transport) Amendment Bill without reference to Cabinet

*Communications and engagement*

32. **note** that I intend to publically release the review into the NZTA's regulatory capability and performance, along with the review into the Ministry's monitoring performance, following Cabinet consideration of this paper.

Authorised for lodgement

Hon Phil Twyford  
Minister of Transport

proactively released