ICNZ Insurance Council of New Zealand

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Levy Consultation Team
New Zealand Fire Service Commission

Emailed to: levyconsultation@fire.org.nz

To Whom It May Concern,

RE: ICNZ submission on Funding Fire and Emergency Services for all New Zealanders

1. Thank you for the opportunity to submit on the levy rate to apply from 1 July 2017 to 30 June 2018.

2. This submission is provided on behalf of the Insurance Council of New Zealand ('ICNZ'). ICNZ represents 28 general insurers who do business in New Zealand, and insure over half a trillion dollars' worth of New Zealand's property and liabilities.

3. We note our member insurers are the collection agent for Fire Service revenue in both the current and future Fire and Emergency New Zealand ('FENZ') funding regimes. We also note that section 17F of the Fire Service Act 1975 requires the Chief Executive of the Fire Service to consult with the insurance industry on the estimated expenditure of the Fire Service at least once in each year.

Feedback on the levy rate

4. ICNZ opposes any tax on insurance to fund FENZ. Taxing insurance to fund a public service like FENZ is fundamentally misconceived, unfair and out-of-step with international best practice. It is also costlier to collect than through other means, including general taxation.

5. However, ICNZ acknowledges Government has decided to impose this tax and has set an extremely tight timeframe for insurers to implement levy rate changes. The proposed timeframes are so tight, in fact, that insurers need to know the rate applicable for insurance

contracts entered into from 1 July 2017 by 1 January 2017 at the very latest. The reason is threefold:

a. First, the process for renewing commercial intermediated business (which forms the largest chunk of Fire Service revenues) begins three months before the contracts are entered into. So, for contracts commencing 1 July 2017, insurers systems need to be ready by 1 April 2017. For completeness, the process for renewing non-intermediated (mainly residential) business – the source of the remainder of FENZ' levy revenues – will begin at least six weeks before the renewal date, or mid-May 2017 at the latest.
b. Second, insurers estimate that it will take their project and systems staff at least three months to make a simple rate change to their systems. Working back from 1 April 2017, this means insurers would need to know what the final rate is by 1 January 2017 at the very latest.
c. Third, a significant proportion of intermediated business is invoiced by the intermediaries (brokers in most cases), not the insurer. Insurers need sufficient time to engage with intermediaries to update the intermediaries' systems and processes to ensure the levy is correctly charged to insureds. Failure to provide intermediaries with sufficient time to manage this process exposes Insurers to significant statutory liabilities that they are unable to mitigate. Where intermediaries fail to collect the new levy correctly, insurers have a statutory liability to pay the new levy despite significant practical difficulties in recovering the additional levy amount from the intermediaries or underlying insured.

6. We understand that Cabinet will not determine the applicable levy rate until late February 2017 at the earliest, and that it will be March or even April 2017 before that rate is passed into law. This leaves three or four months at the most to carry out a process that takes at least six months.

7. There are two consequences of the timeframe proposed:
    a. Some insurers will not be able to comply with the law from its implementation date of 1 July 2017.
    b. At this stage of the process, insurers seek certainty about what the levy rate will be. Insurers can begin working on their projects and system changes immediately based on the proposed rates of levy if they have that certainty. However, if the actual rates of levy end up changing from what is proposed, insurers must start from scratch.

8. To this extent, and for these reasons only, ICNZ supports the proposed rates of levy at page 7 of the consultation paper. Perversely, therefore, we are faced, solely because of the practical need to be legally compliant, to support the very large increase in levy rate proposed.

9. We still have deep concerns about the consequences of this increase and the rationale for them. We address these concerns in the remainder of this submission to act as a statement of record and to clearly signal; the need for greater scrutiny and accountability of the FENZ expenditure in future.

Feedback on the proposed activities

10. The consultation document states that there has been no increase in the levy rate for eight years. This gives the misleading impression that the New Zealand Fire Service's revenue from the tax has remained static. Nothing could be further from the truth. Revenue from the levy has increased by $93.17 million since the last levy adjustment in 2008. This revenue growth far exceeds inflationary growth over that time resulting in a real increase in funding for the service. It is quite fallacious therefore to imply that the absence of a levy increase provides a reason for an increase of the magnitude now proposed. Such reasoning certainly does not apply to general taxation; if anything, the growth in income take is often used as a rationale to argue for tax cuts.

11. Given the increase in Fire Service revenue, it might be thought that there had been a corresponding growth in the activities undertaken and the service provided. We note the consultation document states there has been a decline in fire-related responses and see no evidence to show there has been a growth in overall growth of activities. What we do see is a significant increase in salaries and other employee benefits of $66.65 million or a 35 percent increase since the last levy increase in 2008. These costs exceed the average state-sector increases in wages and salaries over this period and the workforce is not measurably larger than it was at the time of the last levy rate increase.

12. Notably, the Fire Service has often argued that much of its costs are fixed, so that the marginal cost for carrying out additional activities is minimal. Professional firefighters remain on call for most of their time at work responding to emergencies and other call-outs for a minority of their time. While the new FENZ does require some genuine, additional expenditure, we do not believe sufficient scrutiny has been given to the redundant use of resources that currently exist for most of the time nor whether the deployment of resources nationwide owe more to historical needs than actual demand requirements today and in the future. Greater scrutiny of this in future may suggest scope for levy rates decreases.

13. We understand that professional firefighters' salaries and benefits are linked to those of the Police. As an emergency response service, we acknowledge there may be some parallels between the two, but fundamental differences do exist. Police are sworn and have no right to withdraw their labour. Professional firefighters are no different to any other civilian employee with all the bargaining rights and ability to withdraw labour.

Additional comments

14. Current legislation requires the Fire Service to consult with ICNZ on levy changes. The consultation now being undertaken is for a levy increase that will be applied to current levy payers to fund the new FENZ in its first year. It is worth noting that this means that absent the changes to be introduced by the FENZ Bill when enacted, when a broader base for levy collection will apply from 1 July 2018, current levy payers will bear a disproportionate burden of the up-front costs. We see no reasons why the Government should not fund the

entire $303 million transitional costs rather than unfairly require that to be borne by those who insure themselves.

15. The application of the significant increase in levy will be applied in an uncapped way to commercial property insurance. We are concerned that such a large increase will result in commercial property owners under-insuring their properties to contain the levy increase. Tax increases which create incentives for property owners to under-insure or not insure is poor policy and raises the risk of country-wide exposure.

16. The recent Kaikoura earthquakes will compound this problem. We have submitted previously that insurance is inappropriate to levy because of the natural ebb and flow of the cost of insurance and the amount of insurance purchased in the insurance market. After a major natural disaster, insurance costs will likely increase. Those increased costs may make insurance less affordable, and lead to greater levels of underinsurance, a situation that will only be aggravated by a 40 percent Fire Service levy increase. Government decisions should certainly not incentivise this kind of behaviour by adding levies that increase the cost of insurance for property owners. It would be the worst possible outcome for individuals and businesses looking to get back on track and maintain their resilience against future natural disaster events.

17. We are concerned that the new FENZ arrangements will drive costs up and lead to further levy rate increases. This is of concern from the changes to rural fire services which will be administered from Wellington in future. The current situation is that assets deployed for rural firefighting are utilised for other purposes when not used for fire service responses. This provides economic efficiency. Future arrangements will remove the responsibilities for fire protection from local areas to Wellington. This raises the likely prospect that the more centralised control for responses will see FENZ acquire assets that will only be used possibly for just a few days a year. Alternatively, FENZ may engage in more expensive lease or retainer arrangements.

18. We submit that a conflict exists for the Department of Internal Affairs in having oversight of FENZ expenditure on the one hand and on the other providing advice and support for the Minister responsible for the Fire Service. We believe consideration should be given to more independent scrutiny of FENZ expenditure by The Treasury.

19. We express surprise that the capital expenditure, such as for new fire stations in Christchurch, are being funded by the Fire Service and subsequently by FENZ from current revenue. Capital expenditure for long-term assets is commonly funded by a mixture of debt and equity – a more optimal and economically efficient approach. We believe FENZ should in future be required to undertake capital expenditure on a least cost basis, that it should put a business case up for such expenditure that is independently assessed (by The Treasury). The provision of a business case might require closer reflection on whether the deployment of assets is based on accurate future needs rather than historical need.

20. Finally, we note that in 2015 the Fire Service reported almost $68 million in reserves on its balance sheet. $42 million of these reserves were disestablished in the year ending 30 June 2016, though we are unsure what has happened to that money. The Fire Service Act levy provisions are meant to ensure the Fire Service is funded to meet its needs on as needed and on time basis to avoid excessive levies. Thus any excess levy should be treated as an advance payment of levy under section 47(2) of the Act. The "reserves" should more accurately be described as "advances from levy payers". We believe the monies accounted for as reserves should be reviewed to determine whether they are appropriate, or whether some or all of those reserves could be applied to reduce or smooth transitional costs associated with moving from levy arrangement under the Fire Service Act to those operable under the new FENZ Act.

21. Thank you once again for the opportunity to submit. If you have any questions, please contact us on (04) 472 5230.

Yours sincerely,

Tim Grafton

Tim Grafton
Chief Executive