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Fire Funding Review
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ICNZ submission on Fire and Emergency New Zealand Funding Review

Thank you for the opportunity to submit on the consultation document on the Fire and Emergency New Zealand (FENZ) Funding Review, which was released by the Department of Internal Affairs on 25 October 2019.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

Please contact Andrew Saunders (andrew@icnz.org.nz or 04 914 2224) if you have any questions on our submission or require further information.

This submission is in two parts:

- Part 1 - Overarching comments
- Part 2 - Responses to the specific questions in the consultation document

Summary

- ICNZ supports a strong fire service that is integrated appropriately with other emergency services and properly funded.
- ICNZ has never considered that funding FENZ through a levy on insurance is appropriate and that alternatives exist that are fairer, simpler, more sustainable, more transparent and less costly, so we support the current review being undertaken.
- The current FENZ insurance levy is a historical anachronism that is flawed and should be replaced because it increases the costs of insurance (potentially creating a barrier to uptake), is unfair because the levy is only paid by those with insurance, distorts the insurance market in New Zealand, and is costly to collect.

- The current property/vehicle-based funding of ICNZ does not accurately reflect the nature and breadth of the work that FENZ now does (i.e. the non-property or fire related matters listed in section 12 of the *Fire and Emergency New Zealand Act 2017*) or the significant public good aspects. It is also effectively a user-pays model where those users that do fund it have no practical say in service levels etc.
- There are multiple options for funding FENZ and amongst these ICNZ considers the best option for funding FENZ in future would be full taxpayer funding, and the worst would be to continue the levy on insurance. The next best option is to apply a mixed model that includes a greater contribution from the Crown/general taxation combined with direct levies on property (based on value or size etc.) and motor vehicles of various types etc. In terms of funding from motorists, moving the levy from insurance to vehicle licensing looks like a no brainer as there are clear advantages and no apparent problems.
- Some options can be potentially progressed more quickly than others, for example moving funding from motorists to licensing from insurance. The increases in the Crown's direct contribution could also take place over time to stagger and smooth the impact on taxpayer funding.
- The design of future levy/s has to follow the selection of the collection mechanism/s. Otherwise there is a high risk (as occurred with the proposed 2017 levy) that levy design elements are incompatible with the collection mechanism because the data required is not available within the system that is trying to collect the levy from end customers, or it is not sufficiently verified and robust etc. to be able to be relied upon for levy purposes. This is a particular problem with insurance as insurance policies are (rightly) designed to meet customer needs rather than to facilitate easy collection of the levy and for example policies often apply to property that is, and is not, subject to the levy, complicating the calculation of value.
- As a matter of principle, any non-central government entities that collect the levy should be compensated for the costs they incur in collecting it, whether it be local authorities, insurers or others etc. This should include both system establishment and change costs as well as ongoing administration. Not compensating for this is fundamentally inequitable and unfair and could skew the analysis of costs of different collection method/s.

Part 1 - Overarching comments

The historical link between fire insurance and fire services has long since broken down – the levy based on fire insurance is a relic of a bygone age

The earliest fire brigades in New Zealand were formed by insurance companies in order to reduce their exposure to risk. Over time, however, the insurance industry role was phased out as local government (initially) and then central government (in 1976) took over responsibility for the provision and funding of urban fire services.

A number of factors have contributed to the breakdown of the historical link between fire insurance and fire services, including extending coverage to non-insured property, the change in scope of fire services to include a full range of non-fire emergency services (i.e. medical emergencies and responses to hazardous substances) and the increased focus of fire-fighters on the preservation of life rather than preservation of property.

What was originally called the Fire Services Levy, in its broadly current form as the FENZ levy, was introduced as a 'temporary fix' in 1993. Work ICNZ had done in 2013/14 identified twelve reports produced since 1993 and almost all recommended moving away from an insurance-based levy to at least partial use of alternative methods, including greater use of Crown/taxpayer funding.

The historical link is also evidenced in the structure of the consultation document itself. The analysis is centred around an insurance-based view of the levy (i.e. the basis is buildings and vehicles) even though much of FENZ's work does not relate to motor vehicles or buildings. Based on the statistics on page 11 of the consultation document, structure fires, vegetation fires and motor vehicle incidents in the 2018/19 year amounted to just under twenty-five percent of FENZ's total incidents attended. Given the scope of the review and the diversity of FENZ's work it is important that there is an openness to considering fundamentally different ways of funding FENZ.

There are fundamental problems with using an insurance-based levy

There are fundamental problems with current insurance-based levy including its lack of universality, the reducing connection between FENZ's activities and property insurance, the fact that insurance policies are not necessarily attached to individual or even specific property, that insured value does not necessarily correlate to risk, the costs and complexity of collecting it and distortionary effects on insurance. These issues are fully outlined against the principles for the review, and the two additional principles that we recommend should also be included, in our response to Question 1 in the consultation document in Part 2 of this submission below.

It is also problematic that the historical legacy of fire service funding has led to a situation where a public agency providing emergency services is almost entirely funded by insurers and their customers, however, neither the customers or insurers have any real say in how that service is provided. There are also risks attached to monopoly government service provision where levy payers have little or no say in how services are provided or, perhaps more importantly, in how much they are required to pay – irrespective of services consumed. There are also potential inherent conflicts of interest in the current system where FENZ oversees the collection of a levy that it itself uses.

Looking to the future there are issues that further illustrate the limitations of an insurance-based system. For instance, climate change has the potential to increase incidences of wildfire and as has been shown recently these can be very damaging and costly. Notably the proportion of forests insured is considered to be lower than for buildings (there are significant amounts of self-insured or uninsured forestry) and furthermore wildfire risks are often on private or Crown land where no funding levy is collected – noting also that insurers do not insure land itself.

Looking at a wider context, in the financial services sector in Australia and New Zealand there is currently a major regulatory focus on examining the behaviours and conduct of financial service companies. Multiple regulatory change processes are underway to address issues identified and to provide an explicit regulatory focus on customers and greater regulatory oversight of insurers and banks etc. Building systems and processes to deliver good customer outcomes in the manner expected by regulators and the market will involve significant change within companies over coming years and is likely to involve significant costs. It would be somewhat perverse to at the same time continue to require that insurers serve as an extension of the government in the calculation and collection of what is effectively a tax on people and businesses that choose to insure.

FENZ services have significant public good aspects

The services provided by FENZ have a mixture of public, private and club good elements. Public goods (which by definition include non-rivalry in consumption and non-excludability) are generally best funded out of general taxation. With private goods (where the benefits and costs are largely of a private nature, with few externalities or spillovers) and club goods (excludable but non-rival) it is logical the costs should be funded by those parties and/or user charges.

Many desired outcomes and outputs of fire and rescue services involve the protection of the wider public interest of the New Zealand economy, its citizens and the environment. The benefit is to all New Zealanders, not just selective (private) groups or particular sectors of the economy. Fire and rescue activities are therefore, at least partially, a public good.

One of the features of modern fire services is the emphasis on saving life and limb. Undertaking this function has the elements of a public good in the technical sense that exclusion from the service is not only difficult, but also undesirable. The original fire brigades (developed by the insurance companies in England) would attend a fire but would only fight that fire if the plaque on the front of the house confirmed that the house was covered. Their concern was to protect property rather than people. In contrast the service is now rightly provided so that all have access and with no regard to the levy collected on insurance (i.e. FENZ attends uninsured properties), confirming the public good nature of the service.

FENZ's activities also have a significant private and club good component, which requires giving consideration to basing an appropriate proportion of the funding on the risk or cost of services provided by FENZ, with provision also for at least some user-charges where appropriate. These factors however need to be weighed against the benefits of direct Crown/central government funding, for example universality and efficiency of collection.

Funding of FENZ out of step with approaches in Australia and in many other overseas jurisdictions

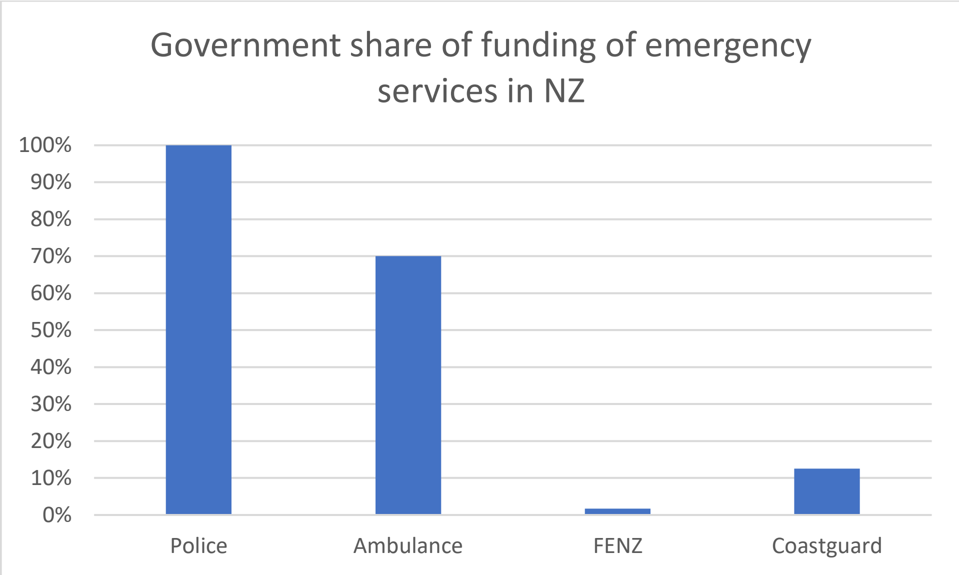
As identified in the consultation document, the funding of FENZ relying almost entirely on a levy on certain insurance policies (currently policies of fire insurance) is out of step with approaches in Australia and many other overseas jurisdictions (including the United Kingdom and certain states of the USA such as Washington and Florida). Australian states have successively and largely successfully moved from insurance-based levies to property-based levies to fund their fire and emergency services over recent decades, which have generally been viewed as a more effective and equitable funding method. Only New South Wales remains using an insurance-based levy and it has also made efforts to move to a property-based levy.

A number of Australian states have been able to use property information to include direct allowances for risk, based on the likelihood of service and the service provided in the event of use. South Australian, Western Australia, Queensland and Victoria all differentiate to varying degrees between property type and the location of a property when charging fire-service levies. While this may be appropriate in principle this is not something that can be achieved with an insurance-based levy for various reasons including that:

- an insurance policy does not necessarily attach to a specific property (e.g. an insurance policy might be held by a customer (i.e. a business or trust etc.) for a portfolio of properties in different locations around a city or New Zealand); and
- information that is required by underwriters is not necessarily what would be required to apply differential charges.

Funding of FENZ is out of step with other emergency services in New Zealand

FENZ is currently almost entirely funded by a levy on insurance, which is ultimately paid by those property owners and motorists who insure themselves. Central government currently contributes $10 million per annum to FENZ, which equates to approximately 1.7% of FENZ's funding. In contrast, as shown in the following chart it meets 100% of the costs of Police, 70-75% for ambulance services (largely through district health boards), and 12.5% of the budget for the Coastguard.



This comparison shows that government's contribution to the FENZ is significantly lower than for other emergency services, despite the significant public good aspects of its work. It also reveals a lack of alignment of funding of similar services (e.g. ambulances and FENZ both respond to medical emergencies) for which there is no clear rationale. Overall this comparison suggests that central government funding should be increased to bring it more into line with other emergency services and to remove distortions between them in terms of funding.

FENZ provides a universal emergency service and it would be logical to fund it entirely, or significantly, through general taxation

In a modern fire and emergency service with a mixture of volunteers and professional firefighters the primary focus is on the rescue of people rather than the preservation of property. Excluding people from being able to access fire services because they (or the building owner) had failed to pay a levy would put firefighters in an intolerable position. As exclusion is not possible, there is a strong public policy rationale for recovering the costs of such a good (whether or not it is considered purely a public good) from the community as a whole through general taxation.

Putting to one side the fact that 'funding Fire and Emergency predominantly through general taxation' is noted, without any particular rationale, as being outside the scope of the funding review there is a strong case for funding it entirely from general taxation. Previous work undertaken for ICNZ in 2013/14 by NZIER found that 'The best way of funding fire services in New Zealand, based upon our previous analysis using public policy revenue principles, is from general taxation. Now that there is an expectation of surpluses in Government revenues in the near future, we recommend that this option be considered again.'

There are a range of good policy reasons for funding FENZ through taxation. These include recognising the public good aspects of the work FENZ undertakes, equitability associated with the broad base of collection, the efficiency of taxation as a collection mechanism and increased scrutiny of the expenditure because it would have to go through the annual Budget process and be evaluated alongside other public expenditure. It would also recognise the extent of land and property owned by government and its insurance arrangements likely lead to less FENZ levy being paid relative to other property owners. There are disadvantages including the need to call on taxpayer funds, and the inability to build in incentives to take preventive measures (such as sprinkler systems) that reduce the cost and risk of fires, although this is not done currently and would likely not be workable under an insurance based levy.

Recognising the stated scope of the review excludes funding FENZ predominantly through general taxation (i.e. more than 50%), there are very strong reasons for central government to significantly increase its current ($10 million/1.7%) funding contribution to FENZ. We discuss further the rationale for government significantly increasing its current contribution in response to Questions 11 and 12 below in Part 2 of this submission.

Funding from households, businesses and motorists should be recovered through levies on property rather than insurance

To the extent that FENZ is funded by private entities (i.e. not central government) then we consider this should be through a levy on property directly, rather than indirectly through insurance. The primary reasons for this are that it would maximise universality as all property owners would contribute (freeriding avoided), enable funding to be potentially tailored to the nature of the property itself and its relevant risks, and it would avoid distorting the provision of insurance in New Zealand.

Other funding streams such as user charges for call outs (including false alarms) should also be considered for reintroduction. As well as an additional funding stream (likely to be modest) such charges can incentivise people and businesses to reduce the incidence of false alarms etc. that have an impact on FENZ. There are reasons why a punitive regime in relation to false alarms should be avoided (i.e. don't want to discourage people from calling for FENZ) but it is important that incentives to minimise false alarm call outs are maintained, noting for example the impact of false alarms on volunteers in particular. User charges can better encourage individuals and businesses to undertake effective and efficient risk minimisation strategies based on known risks.

Adjusting funding to levels of services and risk could improve equity and incentives to reduce risks, but needs to be implementable

Finally, we recognise there are inherent tensions between making the funding of FENZ more sophisticated and risk based and keeping the funding system administratively manageable and cost effective. Extra complexity that is introduced needs to be able to be addressed by information that is already held by, or can be straightforwardly gathered and maintained by, the entity/s undertaking the collection of the levy. It is not necessarily a question of how complex the levy design is per se but whether that complexity can be matched by the collection mechanism. As is shown with the current insurance-based levy, even a relatively simple levy design (e.g. one main rate for property) can be very problematic to implement due to the mismatch between the basis of the levy design and the collection mechanism (insurance) and uncertainties in some cases around what property is covered.

Differentiating charges for different property types has the potential to improve the equitability of the funding regime by better aligning the charges to users with the costs they impose on the system. Those property types that are likely to access the service, or which require it to increase its capabilities, should be contributing more. Some form of risk-mitigation incentive should also be included if practicable. The ACC system provides a good example of cost-recovery where the payers' need for the service is uncertain. All earners and motor vehicle owner/operators are charged on the basis of the likelihood of their using the ACC's services and by the expected cost imposed on ACC in the event of use.

Best-practice features of the funding regimes for fire services used in other countries that could be considered for implementation in New Zealand if practicable include:

- charging based on the size of the building (particularly for commercial property), rather than the value of the property, because the cost of responding to an incident is linked more closely to the size than the value of the building;
- charging based on the cost of the expected level of response, as some types of property may be more likely to have an incident and complex facilities such as petrochemical or fertiliser plants are likely to impose a higher cost on the fire service in the event of an incident; and
- incentivising risk mitigation, such as offering rebates where for example sprinkler systems are installed (noting they are required for certain buildings already).

Implementing a funding regime incorporating the above elements would be more equitable, encourage better use of FENZ's resources and would encourage people to take precautionary measures to prevent fires and save lives. A balance nonetheless ultimately needs to be struck between the accuracy of the price signals provided to users and ensuring the complexity of the funding regime does not make it unworkable or overly costly to collect.

More information on how FENZ's funding relates to its scope of coverage and activities is required to enable a detailed consideration of funding models, including at a high level

Beyond the question of which parties should be providing the funding for FENZ, more information on how FENZ's funding relates to its scope of coverage and activities is required to enable a detailed consideration of appropriate funding sources and models. This level of detail is fundamental to any regime, particularly one that is being funded by its users, and will be required at a later stage when the specific allocation is being considered within and between groups, and rates are being set for specific collection method/s. Such information is also relevant to some extent to the high-level decisions being considered in the consultation document (i.e. ensuring that the high-level design includes all relevant beneficiaries). We note that various work of this kind was done, including by Martin Jenkins, during the reviews that led to the establishment of FENZ in 2017.

What is required is for FENZ to:

- engage levy payers and other stakeholders on the appropriate service levels for FENZ;
- clearly identify the types of services FENZ provides, estimating the cost of each main service line, classify each as a private good, club good or public good, and matching the costs incurred in providing that service with the charges to the beneficiaries of the service (recognising some activities require greater or specialist capabilities); and
- apply a funding model that charges for FENZ's services to the greatest extent practicable on the basis of the expected risk and level of use, especially for non-residential users.

In the absence of a clearer nexus between use and costs incurred by FENZ there will also likely be ongoing concerns as to equitability and to the relevant role and use of FENZ vis-a-vis other emergency services.

Part 2 - Responses to the specific questions in the consultation document

In this part of the submission we provide responses to the specific questions in the consultation document.

Question 1. Are there other principles the Government should consider?

We consider the existing five principles outlined on page 12 of the consultation document are broadly appropriate but one needs to be revised and they should be supported by two further principles.

The existing 'equitable' principle needs to be reframed to remove 'policyholders', as this is insurance centric, and to introduce more concepts of equity including horizontal equity, vertical equity and ability to pay.

The two other principles that should be included are:

- 'efficiency' or 'economy in collection' to recognise the importance of collection mechanism/s being efficient so that the costs imposed on those who are funding FENZ are minimised and the maximum amount of what is collected can be put towards FENZ's emergency activities rather than administrative costs.
- 'non-distortionary' or 'neutrality' to ensure that the imposition of the levy does not inappropriately distort other markets (e.g. incentivise different uses of buildings) or the provision of other services, as can occur with insurance under the current levy, and there should also be minimal scope for avoidance.

It is critical the inherent trade-offs between the different principles are recognised. We are particularly mindful that a focus on pursuing equity (within an inherently inequitable insurance-based levy) led to the complexity and problems associated with the 2017 levy. There are real trade-offs between equity and efficiency and these need to be considered upfront and assessed as part of a cost-benefit analysis before choosing the appropriate method/s for funding FENZ.

The ultimate design of the levy must also follow the selection of the collection mechanism/s. Otherwise there is a high risk that the levy design elements (scope, cover etc.) are incompatible with the collection mechanism because the data required is not available within the system that is trying to collect the levy from end customers, or it is not sufficiently verified or robust to be able to be relied upon for levy purposes. This occurred with the proposed 2017 levy where the levy design required insurers to apply or not apply the levy on the basis of information insurers did not have or would not normally collect, further complicating the application of it. The only logical exception to this principle would be where FENZ fully compensates the collection agency/s for the costs of expanding and modifying their systems as necessary. It is also important to note that for some collection methods (e.g. the current approach) significant numbers of entities would be involved (i.e. many different individual systems to be modified).

Question 2. Which of the principles is/are the most important to you, and why?

They are all important, however, in determining the appropriate funding model at a high level we consider universality, equity (as modified) and stability of the existing principles as well as our proposed additional principles 'efficiency' and 'non-distortionary' are the most important. We agree that predictability and flexibility can be focussed on at a later stage when the chosen funding approach/mechanism/s are being further developed.

Question 3. Do you agree with the summary of benefits to businesses and households?

We generally agree with the benefits outlined and note these accrue to all businesses and households as well as to other entities that own property (central and local government, community and religious organisations etc.) and others such as tourists, who benefit from some of FENZ's services, not just to those that are insured with relevant types of policies.

As discussed above in Part 1 of this submission we consider the benefits to various groups (such as households and businesses) need to be considered more discretely. For example, responding to issues with hazardous substances is a material part of FENZ's work but relates primarily to business and vehicle related issues rather than to households.

In responding to these questions in relation to businesses it is important to recognise that currently the property levy is applied to heavy motor vehicles and so these could be arguably discussed under the headings of businesses or motorists (i.e. in relation to Questions 7-10). However, given we recommend funding from heavy vehicles is gathered through vehicle licensing we have discussed these issues in the section on motorists.

Question 4. Which option do you prefer and why?

Of the three options outlined, we consider that a <u>property</u> based or <u>property and use</u> based option would both be superior options to the status quo (insurance-based levy). We agree with the analysis in the table that an insurance-based approach is the worst option.

We generally agree with the brief analysis outlined in the table on page 13 of the consultation document in regard to <u>insurance/status quo</u>. Further to this we outline the following points:

- *Universal* – The insurance-based levy is not universal with regard to businesses and households (or other relevant entities that own property). Those who do not insure do not contribute to FENZ, despite receiving the same benefits of FENZ's services (freeriding). Land is not insurable per se and so some types of land that pose a fire risk and are attended (e.g. scrubland) are not insured and therefore don't contribute to FENZ at all. Large owners of property and/or large organisations also have greater scope to alter their insurance exposure or to self-insure and therefore pay less FENZ levy (e.g. commercial forestry is often self-insured). The result of this is that those who do pay the levy pay more than would otherwise need to be the case.
- *Stable* – The status-quo provides a somewhat stable source of funding. However, FENZ's revenue will fluctuate with changes in insured values, which are not at all correlated to FENZ's costs. There is also a risk of abrupt changes in insurance penetration or levels (e.g. following a natural disaster or international shock or over time due to climate change). Given this we consider it is less stable into the future than the property-based options and this should be reflected in the table on page 13.
- *Equitable* – The status quo is inequitable as all people and entities benefit from FENZ's services but only those with certain types of insurance pay for it. There is for example the potential for similar buildings/vehicles/forests etc. to pay very different amounts of levy due to choices around insurance and levels of self-insurance etc. The current funding regime makes little attempt to identify and charge beneficiaries based on the cost or risks they impose on FENZ. The extent to which the current regime results in significant cross-subsidisations between different user groups is however hard to gauge in the absence of more detailed information being provided by FENZ, as discussed in Part 1 of this submission. The current insurance levy

also both incentivises, and cannot fully prevent, self or under-insurance and the restructuring of insurance policies as parties seek to minimise their levy. This is easier for larger and more diversified entities to achieve and to the extent this occurs it creates inequities with other levy payers. It is important to recognise the above issues are largely inherent to an insurance-based levy and not things that could be addressed through refinements of it.

- *Efficient* – The current insurance levy is relatively straightforward to collect on standalone residential property (due largely to the levy cap) but is highly costly to collect for insurers (and brokers) on commercial and other property. These collection costs add to the costs of insurance in New Zealand and potentially even discourage the provision of it. It imposes costs on insurers because insurers have to undertake the collection of the levy for free (i.e. without compensation), have to pay levies on policies to FENZ often before insurers receive the premium for the subject policy[1], are liable for penalties and interest on any underpayment (even if purely accidental) and need to dedicate staff time, including from senior staff, to responding to FENZ inquires and audits etc. Furthermore, because the basis of the insurance levy often differs from the basis of the insurance policies on which it is levied, there is material extra work in the calculation of the levy and its administration. Some of these costs have been exacerbated in recent years by FENZ changing its view on some key issues and not updating its guidance material promptly. While interpretation issues can be subtle, the consequences are not trivial as insurers are subject to penalties for any underpayments that result from any difference of interpretation. Changes to levy rates also impose material systems costs (IT systems, collateral etc) on insurers and brokers and adjustments to levy design (e.g. the planned and subsequently dropped 2017 changes) can impose large project and transition costs. It was estimated the adoption of the proposed 2017 levy (now deferred) would have imposed compliance costs on the various affected insurers into the tens of millions of dollars for IT and other system changes and new collateral etc.
- *Non-distortionary* – A levy on insurance makes it more expensive and risks reducing uptake of insurance, which has the potential to reduce the resilience of households, businesses and potentially whole communities to various risks (natural disaster risks, fire etc). The current levy also distorts the provision of insurance by encouraging some levy payers to restructure their insurance arrangements to reduce the levy they pay in ways they might otherwise not do. This is largely a factor in the commercial property area where there are various legitimate ways of structuring insurance and where the levy is uncapped, meaning that the individual levy bills can be large (e.g. for a single commercial building with a sum insured of $50 million the FENZ levy payable would be $53,000 per annum).

Comment on the analysis of <u>property</u>-based levy in the table on page 13:

- *Universal* – Agree that a property-based levy would be universal and could achieve almost 100% coverage for buildings utilising LINZ records. There is however no obvious way to collect the levy on building contents but building use could be factored in, see below.

[1] For commercial property the levy is generally calculated and collected by brokers, with a long delay before it is paid to insurers (due to the provisions of the Insurance Intermediaries Act 1994). This mismatch in collection versus remittance creates two problems. First, insurers are exposed to fines and penalties for late payment – an additional business cost. Second, calculation errors occur. Subsequent recovery from the underlying insured is technically possible under the legislation but is practically difficult. To the extent not recovered, any shortfall on FENZ collection is effectively a business cost and something to be factored in the setting of premiums.

- *Stable* – Agree that property numbers are slowly increasing, and will not decrease rapidly. Given this we suggest that for a property levy two ticks would be more appropriate for stability as it is materially more stable than insurance on property, which is susceptible to a range of possible effects.
- *Equitable* – We consider that a property-based levy has the potential to be a quite equitable approach and would be materially more equitable than an insurance-based approach. Different approaches can be taken to different types of property (residential and commercial) and amongst different types of property. Factoring in use also (discussed further below) could enable a more sophisticated and potentially equitable funding regime, so long as care was taken to ensure workability. It could ultimately be tailored to the extent that information on property is readily available.
- *Efficient* – The efficiency of a property-based levy to collect would depend on the method of collection and the collecting agency and the extent to which these were aligned or workable (e.g. aligned with existing or available data sets). Existing local government rating systems are a possible option.
- *Non-distortionary* – By levying property directly the secondary impacts on the provision of insurance would be avoided. The existence and extent of any other distortions from a property-based levy (i.e. on property use) would depend largely on the specific design of the levy.

Our comments on the analysis of property and use in the table on page 13:

- *Universal* – We agree with the analysis in the table that a property and use based approach has the potential to be more universal than a property or insurance-based levy.
- *Stable* – A property and use approach should like a property-based approach be highly stable on a national level.
- *Equitable* – We agree with the analysis in the table that property and use has the potential to be more equitable than a property or insurance-based levy. Carefully designed levy adjustments for use could reflect risks or other factors that would make the levy more sophisticated and equitable. As noted elsewhere, care would need to be taken to ensure workability and efficiency of collection was maintained.
- *Efficient* – The efficiency of a property and use levy to collect would depend on the method of collection and the collecting agency. It has the potential to be more complex and therefore more administratively complex and costly to collect than a property-based levy – although as noted above it is not complexity itself that is the issue but the workability of application.
- *Non-distortionary* – By levying property and use directly, rather than using insurance as a proxy, the secondary impacts on the provision of insurance would be avoided. The existence and extent of any distortions from a property and use based levy would ultimately depend largely on the specific design of the levy.

The other option that should also be considered is taxpayer funding, which we provide further comment on below in response to Question 6.

Question 5. What are the likely issues or challenges with implementing these options?

As outlined above in Part 1 of this submission and in our response to Question 4 we consider there are a number of existing and future issues with an insurance-based funding model. Given the problems with both the current insurance levy and the proposed insurance levy proposed in the 2017 FENZ legislation, which is currently on hold, the design of an insurance-based levy would need to be thoroughly reconsidered should the Government choose to retain this general approach.

A property-based levy model has been shown to work effectively in Australia and elsewhere. Such a levy could be collected by local authorities or a dedicated agency. It is possible this could be separated in relation to different classes of property (i.e. residential or commercial). While issues have arisen in rolling out a property-based levy in New South Wales in recent years, the fact sophisticated property-based levies have been successfully deployed in other Australian states show this is a workable approach in relation to both households and businesses where carefully designed and implemented.

As noted in the consultation document some Australian states (e.g. Queensland and South Australia) and other jurisdictions have implemented sophisticated levies encompassing location and use based factors. We note however that if a levy moves beyond being based on existing and accepted metrics (e.g. RV or size) it may require acquiring or generating new information and this increases the complexity of implementation. The proposed levy model in the 2017 FENZ Act created this problem and a dedicated collection agency or local authorities would have the same issue if the use-based aspect required (reliable) data beyond what they already possess or can straightforwardly access.

We also reiterate that to implement a property and use based model it is particularly necessary for FENZ to define the source of its costs and how this relates to use of property – in order to be able to equitably determine how use should be reflected in the levy charged. It would also seem illogical to design an elaborate and granular collection method in the absence of a reciprocally nuanced approach to setting service levels.

With a property related regime that also involved adjustments for risk reduction, if local authorities were the collection agency this role could have synergies to oversight of building related fire protection (e.g. passive fire and other protection initiatives).

Question 6. Is there another option or options the Government should consider?

As discussed in Part 1 of this submission, another option for funding FENZ includes replacing the levy with taxpayer funding, either entirely or partially (e.g. up to 50%). This would:

- better align its funding with that of other emergency services;
- recognise the service is provided so that all have access and with no regard to levy collected (i.e. fire service attends uninsured properties), confirming the public or merit good rather than private good nature of the service;
- effectively remove all collection costs;
- enable increased scrutiny of the expenditure alongside other public spending as it would have to go through the annual Budget process; and
- reduce the incentive to shift responsibilities to FENZ (not-government funded) from other entities that are funded to a much greater degree by central government.

Question 7. Do you agree with the summary of benefits to motorists?

We agree with the benefits listed on page 14 of the consultation document and that FENZ's activities in relation to motorists, as outlined in its legislation, are explicitly focussed on protecting life rather than property.

Question 8. Which option do you prefer and why?

We consider collecting the FENZ levy through vehicle licensing is clearly the best option for sourcing funding from motorists. We agree with the analysis in the table on page 14 that this is the best of the three options considered. Using vehicle licencing has many advantages and few if any disadvantages and looks like a no-brainer. We agree that land transport revenue is focussed on other areas, although current FENZ funding levels would represent a very small proportion of this and it would be an efficient collection method (as it already exists).

Our comments on analysis of insurance (status-quo) in the table on page 14 of the consultation document:

- *Universal* – We agree a lower percentage of vehicles are insured compared with licensed, and currently only those with fire insurance (not third party only) pay the levy. Survey data suggests levels of car insurance are around 93% (already 5% lower than vehicle registration levels) but excluding non-fire third party policies this would drop further.
- *Stable* – We agree vehicle insurance levels are likely to be relatively stable over the near term but over the longer-term changes in the market and technology (e.g. further expansions of ride sharing and/or deployment of autonomous vehicles etc.) could alter the size of the national fleet and the insurance of it, potentially fundamentally over time.
- *Equitable* – We agree that an insurance-based levy is reasonably equitable when applied on a fixed level (noting the current levy is fixed at $8.45 for light vehicles and most owners have insurance). A fixed or capped levy rate does not however reflect the extent to which a vehicle is used (i.e. a person with one vehicle travelling 100,000 km per year pays less than someone with two vehicles travelling a combined 20,000 km per year). Furthermore, insurance is purchased to restore and in relation to building fires this relates to some extent to FENZ's activities, however, in the case of vehicle incidents FENZ does not attend to reduce loss, solely to save lives and so there is less linkage between the funded activities and the underlying financial product being levied. For heavy vehicles, which pay the levy based on value like other property, there are equitability issues as there is no clear link between value and the use of FENZ's services. Arguably for heavy vehicles, the most highly levied vehicles (e.g. new high value trucks) pose less risk due to their advanced safety technologies compared with older lower value trucks.
- *Efficient* – It is comparatively straightforward for insurers to collect the insurance levy on individually insured vehicles, however, for vehicle fleets insured under fleet insurance policies or other policies that can cover off road vehicles (e.g. farm vehicles) it is more problematic. This is because such policies are not necessarily based on specific vehicles, or even on a specific number because fleet sizes can vary over a year. Insurers are therefore subject to additional administrative costs, are often required to source information for levy purposes that is not pertinent to the insurance policy itself and also bear the costs and dedicated time associated with information requests from and audits by FENZ.

- *Non-distortionary* – The current motor levy does not create any particular identified distortions in the provision of insurance.

Our comments on licensing in the table on page 14:

- *Universal* – We agree that vehicle licensing captures almost all vehicles on the road and this is a materially greater percentage than are covered by relevant insurance policies. It would also neatly not include vehicles that are not used on the road but which can fall within the definitions under the current legislation (e.g. off road agricultural vehicles such as mobile irrigators).
- *Stable* – We agree that given vehicle numbers are slowly increasing, vehicle licensing should provide as stable a base as possible, and more stable than a levy on insurance.
- *Equitable* – Using licensing as a collection method would be more equitable than the status quo, assuming a similar fixed levy was applied, as all vehicle owners would contribute. Including those that are uninsured would also lead to a reduction to the levy rate as it would be spread across a greater number of vehicles (i.e. not just those that are insured). It could be possible if desired to introduce various levy adjustments for different types of vehicles, as opposed to a single levy, by utilising the various information already contained in the licensing system and recognising that differential licensing rates are applied to different categories of light and heavy vehicles currently.
- *Efficient* – Collection costs should be virtually zero as vehicle licensing is already collected annually and already includes a separate ACC component. It would simply be a matter of the New Zealand Transport Agency (NZTA) modifying its single system to include an additional line to collect a FENZ levy on vehicles alongside licensing fees and the ACC levy.
- *Non-distortionary* – Applying a levy to licensing should not create any distortions.

With regard to the potential use of land transport revenue as a funding stream for FENZ, we agree that land transport revenue is focussed on other areas (primarily road building/maintenance and public transport) although it does fund road policing. The level of funding recovered from motorists under the current insurance-based levy would represent a very small proportion of the land transport fund. In terms of positives with using this method, it would generally reflect the extent to which a vehicle is driven (as they are largely fuel/mileage based) and would be an efficient collection method (as collection methods of fuel excise and RUC already exist). By way of relativity the land transport fund collected approximately $3.6 billion in 2016/17 and so the current FENZ levy collection from motorists of approximately $22 million per annum would represent a very small proportion of the total fund (0.6%).

Question 9. What are the likely issues or challenges with implementing these options?

Continuing to implement a vehicle-based levy on insurance would involve ongoing costs of collection and complications, particularly associated with its application to vehicle fleet policies. Such issues and reductions in the base are likely to grow over time should the uptake of new technologies such as autonomous vehicles increase significantly (particularly if these change the levels or nature of insurance).

Implementing a vehicle licensing option should be straightforward because the collection method already exists, is operated by a single government entity, and is directly linked to what is intended to be collected (i.e. individual vehicle information).

Using land transport revenue would be straightforward in terms of implementation as the collection mechanism already exists. The issue with this would relate entirely to whether there are sufficient monies in the land transport fund to enable some of this to be allocated to FENZ and the opportunity costs of this in terms of land transport.

Question 10. Is there another option or options the Government should consider?

We have not identified any other options the Government should consider in regard to funding from motorists specifically and reiterate the vehicle licensing option is a very strong option.

Question 11. What do you like or dislike about these options?

As outlined elsewhere in this submission we consider there is a strong rationale for increased Crown funding of FENZ and that FENZ charging for some services should also be reconsidered. While FENZ clearly provides services that benefit local communities we don't see there is a compelling case for local authorities to provide a direct contribution.

In regard to the Crown's direct contribution and recognising the stated scope of the review excludes funding FENZ <u>predominantly</u> through general taxation (i.e. more than 50%) there are very strong reasons for central government to significantly increase its current ($10 million/1.7%) funding contribution to FENZ. These include:

- recognising the public benefit and non-property related aspects of FENZ's activities;
- alignment with funding of other emergency services and enable scrutiny of spending as part of the annual Budget process;
- the efficiency of collection of general taxation compared with levies;
- government does not appear to be paying its fair share for the benefits it receives from FENZ's services as its assets are often under insured or self-insured;[2]

Given the high-level nature of this consultation we do not propose what an appropriate level of direct Crown contribution should be. This is something that would need to be carefully considered in subsequent phases of this review alongside the allocation to other groups and based on information from FENZ as to the costs associated with its various activities and capabilities.

Funding from local government is common in other jurisdictions and this is often associated with the fire service being operated and/or managed on a local basis. We don't however see there is a compelling case for requiring a contribution from local authorities given the New Zealand context and the inherently national and centrally-run nature of FENZ. If local authorities were involved in funding FENZ directly they would logically expect a greater say in the FENZ resources allocated to their area.

Where people/businesses actions are imposing real costs on FENZ, then user charges are appropriate to both recover some of this and to encourage steps being taken to reduce these risks and impacts.[3] A punitive regime should be avoided so that people are not discouraged from using FENZ services, however, to impose no costs on the basis that levy payers are fully funding FENZ does not provide any incentive to reduce false alarms etc.

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[2] As of 2013, we understand public assets were estimated by the Office of the Auditor-General to be insured to approximately half their carrying value.

[3] Under the former Forest & Rural Fire firefighting cost recovery mechanisms, which were abolished in 2017 with the new FENZ Act, there used to be an extension under a land owners public liability policy for firefighting costs liability (strict liability).

Question 12. What are the likely issues or challenges with implementing these options?

The only implementation issues associated with a direct contribution from the Crown are the extent to which this funding needs to compete with all the other potential uses of Crown funding. Nonetheless, a contribution to FENZ would at most make up a modest proportion of total Crown funding and would enable it to be assessed against other potential uses (including other emergency services).

A local authority contribution would put new pressures on local government funding and likely require increases in rates to provide for this. It would also require the development of a model to allocate funding across areas. Under FENZ's explicitly national model it is not obvious how this would work or whether it might cut across other funding allocations. An in-kind contribution (such as collecting funding) could be considered but would need to be properly recognised.

The issues with FENZ charging for some services would relate to challenges associated with modelling expected revenue given the unpredictability of fire and emergency events. If the funding from charging is only a modest proportion of total funding, which is likely, then this should be a manageable variable. There would also be administration costs associated with managing and collecting user charges.

Question 13. Is there another option or options the Government should consider?

We have not identified any another options that the Government should consider.

Question 14. Which option do you think is the most suitable and why?

Either (1) fund from general taxation or (2) combine property levies on residential and commercial property (potentially with a use element if workable), collection through vehicle licensing and a significantly increased contribution from the Crown.

Question 15. What do you like and/or dislike about the different collection mechanism options?

For the reasons outlined elsewhere in this submission, continuing to use an insurance-based approach for funding FENZ is not the best option and should therefore be stopped and replaced with better alternatives.

We consider vehicle licencing is clearly the best option for securing funding for FENZ directly from motorists and heavy vehicles. We agree the logical collection agent would be NZTA.

A property levy, potentially with a use component if practical, is superior to an insurance-based option for collecting revenue from households and business. This could be collected by local authorities or a dedicated agency.

Funding from Crown revenue would be very efficient as it would leverage existing mechanisms.

The consultation document notes that there would be costs for FENZ and the collection agent/s associated with moving to a new funding model (including set-up costs, ongoing administrative costs and any costs associated with the ownership and upkeep of property data). While this is undoubtedly true it must be recognised that the existing insurance levy has significant ongoing collection costs for insurers, brokers and FENZ itself and that even if it was to be retained these would be material going forward and changes to the existing levy would inevitably be required that would impose more costs. These matters need to be considered through a thorough cost benefit analysis and ICNZ would be happy to engage with DIA on gathering relevant information from insurers to inform this.

Conclusion

Thank you again for the opportunity to submit on the consultation document. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,

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