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Committee Secretariat  
Government Administration Select Committee  
Parliament Buildings  
Wellington

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Dear Committee Members,

**Submission on the Fire and Emergency New Zealand Bill**

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1. Thank you for the opportunity to submit on the Fire and Emergency New Zealand Bill ('the Bill'). We provide this submission for the Insurance Council of New Zealand ('ICNZ'). ICNZ represents the interests of its 28 members, who are general (as opposed to life and health) insurers, and who collectively insure over \$600 billion worth of New Zealand property and liabilities. Our members and their insurance products are a central part of the levy provisions in Part 3 of the Bill, and as such will collect and pay the bulk of FENZ' revenue. We understand that some of our members will be submitting to you directly.
2. Our submission primarily deals with Part 3. There are four core arguments to our submission:
  - a. The levy provisions must be simple, clear, and certain. Insurers are being made FENZ' collection agent in this Bill. Insurers will be penalised for incorrect calculation or late payment even when getting it wrong is unintentional, innocent, or the fault of the broker.
  - b. Additional complexities and compliance costs ultimately impact homeowners, vehicle owners, and commercial property owners, and potentially stifle innovation and competition that benefit all these parties. This must be avoided or minimised in the levy provision wherever possible.

- c. FENZ lacks independence and is conflicted in administering the levy collection regime. It collects and spends the money it receives from that regime. The levy shortfall provisions, penalties and offences regime, and dispute resolution scheme must be altered to address this conflict.
  - d. Insurance brokers' involvement in arranging insurance contracts and taking payment of insured policyholder money must be recognised. Brokers act on behalf of the insured, arrange insurance contract structures to suit the interests of the insured, invoice and take payment of insurance premium from the insured, provide insurers with the information on which the levy is calculated, and retain the insured's money for up to 90 days after the insurance contract is entered into before paying the money to the insurer. Brokered business makes up the majority of FENZ' revenues, but brokers are not recognised in the levy provisions, despite being a critical party in the efficient collection of levies and the effective and lawful administration of the regime.
3. Given the importance of the Bill to our members, we would appreciate the opportunity to appear before the Committee to clarify and reinforce our submission, and to answer any questions the Committee may have.

#### **The levy provisions in the Bill have been undermined by a poor consultation process**

4. We must first underscore the overwhelming unfairness of levying a private sector product to fund a public good. New South Wales recently announced it was abolishing its equivalent emergency services levy,<sup>1</sup> leaving New Zealand and Tasmania as outliers in their emergency services funding.<sup>2</sup>
5. Government refused to consult with the public on better funding options. We were astounded by this decision. Ruling out funding options before seeking public submissions on those options is not only undemocratic; it leads to poor policy and legislative outcomes, particularly when the two best ways of funding the Fire Service are not considered. These two better approaches – general taxation and a levy on property rates – have been adopted overseas for sound reasons. To cast them aside from a fundamental review of the Fire Service was a dereliction of duty. In our view politics should not interfere with public administration and consultation on public policy in this way. Government's decision to avoid transparent public consultation on the FENZ levy completely undermines this Bill.
6. In our view, the levy provisions should be rejected in favour of funding through general taxation to give FENZ a fairer, more stable, more transparent, more efficient, and more equitable source of funding.

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<sup>1</sup> <https://www.emergency.nsw.gov.au/media-releases/2015/nsw-moves-to-a-fairer-system-for-funding-fire-and-emergency-services.html>

<sup>2</sup> <http://www.allanmanning.com/new-zealand-and-tasmania-still-out-of-step-when-it-comes-to-fire-service-levy/>

## **The levy will increase costs for insured homeowners and other property owners**

7. The Bill establishes insurers as a collection agent for FENZ funding. Using insurers to collect funding for a public service like FENZ' duplicates our general taxation regime, which adds compliance costs. Compliance costs affect insurance affordability. This punishes people who make the good financial decision to insure their property. And, unfortunately, this will disproportionately impact people on low incomes, who are simply looking to protect their property by insuring it. This disproportionate impact is inequitable; a levy on insurance fails to account for a person's ability to pay for FENZ' services, which is a critical component of the equity of a good taxation regime.

## **General taxation is by far the best funding option for FENZ**

8. Treasury sets out good tax design principles which were used to assess FENZ funding options during the policy review preceding the Bill. The principles are replicated in clause 69 of the Bill, which establishes the purposes of the levy provisions. The principles underlying a good tax are:
  - a. Equity<sup>3</sup>
  - b. Sufficiency<sup>4</sup>
  - c. Predictability and clarity<sup>5</sup>
  - d. Adaptability<sup>6</sup>
  - e. Non-distortionary<sup>7</sup>
  - f. Cost effective.<sup>8</sup>
9. General taxation is the best option for funding the Fire Service because it is:
  - a. The fairest, and avoids free-riding because all those who benefit from this public good pay for it.
  - b. The most economically efficient.
  - c. The most legitimate (the simplest, most certain and most clear).
  - d. The most cost effective.
  - e. The simplest.
  - f. The best way to minimise non-compliance by levy payers.
  - g. The most strongly supported option for funding the Fire Service amongst stakeholders from submissions to the 2012 Independent Fire Review Panel (the 'Swain report').

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<sup>3</sup> Equity means levy payers should pay an amount relative to the amount they use FENZ' services.

<sup>4</sup> Sufficiency means FENZ has enough funding to carry out its functions.

<sup>5</sup> Predictability and clarity mean levy should not be subject to sudden change; should be calculated readily and easily, and payers should be aware of the change and how and when it applies.

<sup>6</sup> Adaptability means the funding base should change in line with changes to FENZ' services.

<sup>7</sup> Non-distortionary means the effect of the funding method on a levy payer's decision making is kept to a minimum.

<sup>8</sup> Cost-effective means the costs of administering and collecting the funding are kept to a minimum, and the enforcement of payments is straight-forward.

10. Only 24 percent of the public believe that the current funding of the Fire Service is fair, and most (59 percent) believe it needs to change. And only 9 percent of the public think that the service should be funded from a levy on insurance premiums.<sup>9</sup>
11. Department of Internal Affairs ('DIA') officials preparing advice to the Minister themselves acknowledged many advantages of general taxation as a funding option, and no disadvantages.<sup>10</sup> Officials advised Government that general taxation was the best funding option because it:
  - a. Ensures all taxpayers contribute.
  - b. Removes confusing legislation that has given rise to parties trying to minimise the levy they pay to the Fire Service.
  - c. Would be highly cost effective as Government would be able to use existing tax collection systems.
  - d. Would be relatively stable and predictable compared to an insurance levy on premiums.
  - e. Would potentially increase the Fire Service Commission's accountability and efficiency as it would be subject to scrutiny by The Treasury.

#### **Levying insurance is by far the worst funding option for FENZ**

12. About 12 separate reports prepared since 1993 note that a levy on insurance is the worst possible option for funding the Fire Service.<sup>11</sup> Further, DIA officials advised government that the insurance-based levy:
  - a. Does not reflect the scope of modern Fire Services provided.
  - b. Does not reflect the risk presented by different properties and assets that the Fire Service protects.
  - c. Is unfair for people who take out insurance for their residential property as they pay a disproportionate share of levy.
  - d. Has a 'free-rider' problem for large companies and state sector agencies that under-insure or do not insure and still get the benefit of the Fire Service as it is a public good.
  - e. Has ambiguous legislation, making the levy difficult to calculate and forecast.
13. In our view, levying insurance to fund FENZ is:
  - a. **Nonsensical.** The rationale for levying insurance to fund the Fire Services is now well-buried in the annals of history. Fire services were originally privately funded by insurers to protect insured property. Insured property owners would display the plaque of their insurer to ensure a fire service response. Now, not only do fire services respond to fires at properties that don't insure, much of FENZ' response work is to a broader range of emergencies that have nothing to do with the

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<sup>9</sup> From a UMR Research poll conducted for ICNZ, of a representative sample of 750 people aged 18 years and over, conducted in May 2015, with a margin of error of  $\pm$ 3.5 percent.

<sup>10</sup> Department of Internal Affairs, "Fire Services Review: Discussion Document", at page 63.

<sup>11</sup> NZIER, "Better ways of funding the fire services in New Zealand", April 2013.

protection of insured property. FENZ' main objectives will be the protection of people and the environment,<sup>12</sup> which are at direct odds with property insurance.<sup>13</sup> For example, FENZ would damage a car to rescue the person inside it. We absolutely support FENZ' broader emergency response role and the protection of life, health and the environment in particular, but the role of property insurance is at odds with FENZ' role, and it must not, therefore, be the role of insurance to fund FENZ.

- b. **Inequitable**, because property owners who do not insure, or who under-insure, get the benefit of the Fire Service without having to pay for it or do not contribute a fair and equitable share.
- c. **Costly**. Government is asking insurers to effectively become a tax collection agent, thereby duplicating the effort and resources of the Inland Revenue. This is extremely inefficient. Added compliance and collection costs increase insurers' business costs, which in turn impact insurance affordability and the cost of insurance for homeowners and other property owners.
- d. **Complex and distortionary**. In endeavouring to comply with the FENZ Bill, insurers incur additional compliance costs, both up front and ongoing. Insurers may also have to redesign their products because of the complexity of the way the levy applies to the multifarious enhancements and benefits offered in insurance contracts across the insurance industry for the benefit of homeowners and other property owners.<sup>14</sup> Government levies should not distort private products and innovation to this extent.

### **Changes to the insurance market will make insurance harder to levy over time**

14. Emerging technologies and innovative insurance products are already disrupting the insurance industry, and will continue to do so in a way that affects the stability of insurance as a funding base for the fire service. These disruptions will be disastrous for FENZ, as its revenues will become volatile and unpredictable.
15. Four examples bear out this issue:
  - a. Driverless cars are disrupting the motor vehicle industry. Driverless technology will reduce the risk of motor vehicle accidents and thefts. The Minister of Transport has spoken publicly in 2015 about developing New Zealand as a leading hub of uptake of driverless technology. A reduction in insurable risk will reduce consumer uptake of insurance because it will change consumers' perceptions of risk. Volvo announced in 2015 that it would cover the costs of accidents caused by its self-driving vehicles. This will add to the reduction in consumer perception of the need for motor insurance, and could spark other motor vehicle manufacturers to follow suit, exacerbating the problem. If people do not need motor vehicle insurance they will not buy it, making motor vehicle insurance an unstable source of levy income.

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<sup>12</sup> Clause 10(b)(i), (ii), (iv) of the Bill.

<sup>13</sup> We note that other forms of insurance product exist to protect people and the environment, but these types of insurance are not being levied to fund FENZ.

<sup>14</sup> Discussed at paragraph 57 below.

- b. Insured people and entities take out insurance directly with offshore insurers, making it difficult for FENZ to police and collect levy.
  - c. Holistic personal risks products will cover not just property but also liabilities, health and life of the insured. These products are not strictly 'property insurance' and a levy on property insurance would therefore apply uncertainly.
  - d. Apps that allow people and entities to insure in real time and to switch their cover on and off are problematic for levy provisions that rely on property being insured for a year (in most cases). A levy calculated as a proportion of a sum insured or as an amount of a declared 'fair and reasonable' value of a piece of property is grossly unfair for a policyholder who insures for a lesser amount of time: the amount of their premium that is made up of FENZ levies would be disproportionate, and unfair, as the levy amount would be the same amount as a person who insures for a full year. Alternatively, it would introduce excessive complexity and compliance cost to calculate an exception to the rule set out in the levy provisions by introducing some other kind of levy on such an insurance product. Ultimately the amount of levy taken from these products would be microscopic and would absolutely not justify the cost involved in insurers creating and administering new systems to handle the collection of levy from these products.
16. This last example above illustrates a trade-off for insurers. The trade-off is between product innovation and enhancement, and development of new benefits for consumers of insurance on the one hand, and the cost of complying with regulation on the other hand. In our view, government regulation should not force insurers into this trade-off, as it stifles competition and innovation. Further, unless more certainty is provided in the levy attachment provisions discussed later in this submission, insurers will be forced to make this trade-off in relation to benefits and product innovations currently offered.

#### **The Bill must prioritise clarity, simplicity, and administrative efficiency**

17. Through the development of the policy behind the Bill, ICNZ supported a levy that met the accepted public finance principles (noted in paragraph 8 above) as best as possible. However, Government has chosen the least equitable and the least fair funding option possible. The levy provisions in the Bill are therefore going to be inherently unfair and inequitable. Bearing this in mind, our view is that the levy provisions must now prioritise some of those accepted public finance principles over others. Levy provisions that maximise clarity, simplicity, and administrative efficiency for insurers are crucial to making the best of a poor funding regime.

#### **The Bill does not reflect the commercial reality of levy collection**

18. Under the current Bill, insurers are forced into a role of collection agent, and are penalised harshly for their mistakes. In our view this is totally inappropriate, and does not reflect the commercial realities of what government is asking insurers to do. We make two

observations on this point, which are discussed more fully in the next sections of this submission:

- a. That insurance brokers' role in the levy collection regime should be factored into the levy provisions.
- b. That amendments must be made to the levy shortfall and penalty provisions to acknowledge the conceptual difference between an insurer and a taxpayer.

### **Brokers should be subject to the levy provisions**

19. Insurance brokers are not factored into the levy provisions, despite being central to the accurate calculation and payment of levy to FENZ by way of insurers. Brokers act on behalf of the insured policyholder; design insurance policies that are in the insured policyholder's best interests; and calculate the amount of FENZ levy on the premium payable by the insured policyholder. Some residential and almost all commercial insurance policies are insured through a broker, meaning well over half of FENZ' revenue can be expected to come through this avenue. In 2012/2013, between 53 and 57 percent of FENZ' revenue, at the very least, would have been brokered.<sup>15</sup> Brokers do all the work, and yet the Bill refers to brokers only once, in the requirement to retain records for 7 years.<sup>16</sup>
20. Typically, brokers will receive premium (including the FENZ levy) from policyholders and hold onto that money for up to 90 days, before payment is due to the insurer. Yet insurers are liable to pay the levy to FENZ much earlier, so must bear the loss in cash-flow this creates, as well as face significant penalties for late payment or shortfall through broker miscalculation of the correct levy payable. These additional costs inevitably flow on to be borne by policyholders, thereby effectively funding the broker's use of their client's money for up to 90 days.
21. We submit that the levy provisions must acknowledge the role of brokers in the levy payment process. Specifically, we submit that the following amendments should be considered:
  - a. For brokered insurance contracts, references to "policyholder" in the Bill should also refer to the policyholder's broker.
  - b. Subject brokers to levy shortfall penalties and interest by amending references to the "levy payer" to "any person", specifically permitting FENZ to pursue the party that, in its view, is at fault for shortfall, and thereby acknowledging the role of brokers in designing policy structures that are "levy avoidance arrangements", "unacceptable levy positions", and the like.
  - c. Allow for mitigation in shortfall and penalties payable by insurers where other parties (specifically, the insured's broker) is at fault.

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<sup>15</sup> This range is based on the levy revenue sources analysed by Martin Jenkins in a report prepared for DIA in 2014. Commercial lines include commercial material damage policies (49 percent of revenue), commercial motor (4 percent of revenue) and "other", including marine cargo (3 percent). These figures, along with the fact that a portion of residential house and contents insurance and private motor (44 percent) will be brokered, leads us to the view that most of the FENZ revenues will be conducted through brokers.

<sup>16</sup> Clause 85(2)(b) of the Bill.

- d. Insert an obligation for a broker to be liable to pay levy to the insurer on receipt of the payment from the policyholder.
22. Such provisions acknowledging the role of brokers will ensure all brokers improve their practices to ensure both the policy structures and levy payments are compliance with the law.

### **Insurers and taxpayers have different incentives**

23. The levy shortfall and penalty provisions are modelled on the GST regime and the Tax Administration Act 1994, but there is a significant conceptual difference between a taxation regime and the regime to fund FENZ: insurers gain no benefit from and have no interest in minimising levy payments to FENZ.
24. Insurers are simply a collection agent for FENZ that sits between the calculator of the levy (the broker) and the person liable to pay the levy (the insured policyholder). In contrast, taxpayers have incentives to minimise their tax exposure, and the tax administration regime rightly places obligations on taxpayers to get it right, and penalties on taxpayers for getting it wrong. Nonetheless, the Bill places all of the obligations to accurately calculate, collect and pay levy to FENZ on the insurer, which is then penalised for getting it wrong.
25. We submit this is a critical conceptual difference between the FENZ regime and the general taxation regime, which must be reflected in a lighter burden on insurers in the FENZ Bill. Specifically, the levy provisions should incentivise compliance and collaboration between insurers and FENZ, rather than punish insurers for what, in most cases, will be calculations and contractual arrangements paid and arranged by the broker. This would better reflect insurers' role as a levy collection agent for FENZ. Inland Revenue is not punished in the same way for making mistakes in administering the taxation regime. This means:
- a. imprisonment offences should be removed
  - b. penalties for non-compliance should be less strict
  - c. voluntary disclosure of shortfall by insurers should mitigate any shortfall penalties, and
  - d. FENZ should have to refer matters to dispute resolution before pursuing charging of offences and penalties.

### **FENZ levy collection powers should be subject to more checks and balances as FENZ is conflicted**

26. Unlike Inland Revenue, FENZ spends the money it receives from insurers. It has an incentive to pursue insurers aggressively for funding. FENZ is inherently conflicted in its role as administrator of the levy provisions. This conflict pervades many aspects of the levy regime, which we refer to when discussing specific provisions below. But, most importantly, we argue this conflict means:
- a. The burden of proof in any proceeding relating to assessment of a levy or a shortfall penalty should not be on the insurer.



- b. There should be independence in the development of the FENZ dispute resolution scheme.
- c. FENZ discretions should be assessed to an objective standard, not a subjective standard.

### **The levy attachment provisions are uncertain in practice**

- 27. Attaching a levy to a multi-faceted financial product was always going to be a complex exercise, and one that is very difficult to translate from well-intentioned high level principle into prescriptive detail with the certainty required to administer the funding regime effectively. This is one of the reasons why a levy on insurance is one of the most difficult regimes to administer.
- 28. We have queried our members for examples of unintended consequences of the levy attachment provisions in the Bill (clauses 71-74). The following is a list of some of the problems we have identified so far, but is by no means an exhaustive stocktake. Before we do so, we wish to underscore that insurers have no direct interest in the winners and losers of which parts of the insured population must pay to fund FENZ. We simply want to underscore the need for clarity, simplicity, and administrative efficiency so that insurers can comply with the law and pay FENZ the correct amount of levy. Nonetheless, these examples also show the nonsensical application of levy provisions to the idiosyncrasies of property insurance.

### **Some types of insurance that are not property insurance are unintentionally caught**

- 29. First, some types of insurance policy that are not property insurance policies may be unintentionally caught. These include:
  - a. **Commercial liability insurance policies.** These exist to protect the interests of the insured when the insured incurs a legal liability to a third party. On one interpretation, the third party's property is 'insured' by the insured's contract of insurance, potentially subjecting it to clause 74(1). But calculating a levy on liability insurance would make no sense. It is impossible to quantify the damage a liability insured could cause to third party property. Their sum insured is not calculated by reference to any property, but instead to their multifarious potential liabilities to third parties for all kinds of legal wrong. We strongly submit that, for clarity, the Bill should specifically exclude contracts of liability insurance.
  - b. **Bailee's insurance** covers a bailee or property during their temporary possession of another person's property. A drycleaner, for example, would take out bailee's insurance to cover their custody of their customers' clothes. Again, this type of insurance policy is not a property insurance policy, it is a liability insurance policy. Unless the levy attachment provisions are clarified, there is a risk that bailee's insurance could be unintentionally levied as the property the bailee is custody of under bailee's insurance could arguably be "insured" under the bailee's insurance. We strongly submit that, for clarity, the Bill should specifically exclude bailee

insurance. Bailee insurance again illustrates the “double dipping” problem as the property in the bailee’s custody may also be insured and levied under a separate contract of insurance taken out by the owner of the property.

- c. **Travel insurance** for visitors to New Zealand could attract levy under the current Bill as it insures the traveller’s belongings against loss or damage. There is certainly the potential for FENZ’ services to be required in respect of that property. However, there are two issues with levying travel insurance. The first is that travellers to New Zealand will be difficult to identify, and will insure with an insurer which is not carrying on business in New Zealand. Further, as a matter of policy, it would seem unwise to levy travellers to New Zealand to fund FENZ, though this would seem possible under the current drafting of the Bill unless travel insurance policies were exempted, which we submit in favour. A related problem concerns **inbound student travel insurance**, which some New Zealand insurers would provide to travellers to New Zealand for study purposes. Again, these travel insurance policies cover the student’s property, and so meet the levy attachment provisions in clauses 74(1) and 76 of the Bill. We submit that any difference in the treatment of travel insurance policies and inbound student travel insurance policies would be unfair and inequitable as between different types of traveller, and so both types should be exempt from the levy provisions of the Bill.

30. The travel insurance example illustrates a second issue with the levy attachment provisions of the Bill that give rise to uncertainty. How do the levy attachment clauses in the Bill deal with property that moves in and out of New Zealand, such as travel insured property, property insured under marine insurance contracts, and aviation insurance contracts? When the property is in New Zealand, it is “property” as defined under the Bill, and therefore can be levied. When the property leaves New Zealand, it is not “property” as defined under the Bill, and therefore cannot be levied.

### **There are good reasons to exempt particular types of insurance**

31. We strongly submit that there are certain types of insurance contracts that should not be levied under the Bill. Reinsurance and marine insurance contracts are already excluded. Liability insurance, bailee insurance and travel insurance should also be excluded. We will be making this submission to the Department of Internal Affairs as well as part of their consideration of exemption regulations to support the Bill.
32. We note that ICNZ has previously submitted in favour of not exempting any property from levy, for fairness and ease of administration. However, we note there is a distinction to be made between exempting types of property and exempting types of insurance policy.
33. There are very good reasons for exempting certain types of insurance policy:
  - a. Liability insurance does not insure property; it insures legal liability. It is therefore far removed from the purposes of the levy. Levying liability insurance would be

inequitable and distortionary, aside of our argument that we do not believe it is the intention of the Bill to capture liability insurance policies in the first place.

- b. Bailee insurance should be exempt for the same reasons as liability insurance, and for the reasons noted at paragraph 29.b. above.
  - c. Travel insurance should be exempt, again because it is primarily an insurance policy to guard against personal risks, not property.
  - d. Marine insurance should be exempt because of the extremely limited potential for the FENZ to ever respond to a marine incident. Other centrally funded support exists for ships. Maritime New Zealand has a Rescue Coordination Centre that involves Police, Coastguard, Defence, Search and Rescue, and the Civil Aviation Authority. FENZ is not currently involved in maritime emergency response, and nor does there appear to be a need for FENZ to duplicate the efforts of the other organisations already involved in maritime response. Further, we also note the transitory nature of many marine trading vessels. Many often travel overseas, and levying time spent overseas is unfair and inequitable. Further, we note that marine trading vessels are not often owned or insured in New Zealand. Any levy that attaches to marine insurance products applying to New Zealand owners or insurers but not offshore owners or insurers is unfair, and puts those New Zealand companies at a competitive disadvantage for having to pay additional costs to operate their business.
  - e. The same rationale and arguments that exist for exempting marine insurance apply to aviation insurance, particularly airline insurance. Aside of the unfairness and inequity of levying an airline for the time its craft were outside of New Zealand, it would put New Zealand owned and insured airlines at a competitive disadvantage.
34. Further, for both marine and aviation insurance, we note:
- a. Ports and airports invest in their own fire and emergency response services, reducing the risk of or need for a FENZ response.
  - b. There are significant practical difficulties for FENZ and insurers or policyholders calculating and administering levy payments for transitory property like ships and planes that move in and out of New Zealand, both in terms of time spent on the ground in New Zealand and in terms of identifying when an offshore-owned, offshore-insured ship or plane comes in to New Zealand.

#### **Some insureds will be levied twice**

35. FENZ “double-dipping” could be a significant practical problem. This is where two different insurance policies cover the same property for different risks. Under the current levy attachment provisions, both policies would be levied despite being issued for different risks.
36. On balance, double-dipping is a concern from an unfairness and equity perspective, and, as we have noted above, clarity, simplicity and ease of administration are far more important considerations in a regime that is inherently unfair and inequitable. We raise the point to draw the problem to the Committee’s attention, to underscore the unfairness and inequity

of a levy on insurance, and to note this may be an issue for property owners that ultimately pay levy.

37. We submit that the Bill should permit an insured policyholder who is particularly disadvantaged by double-dipping to be able to apply to FENZ for an exemption for their specific property, and for a refund of levy, if FENZ considers it appropriate in all the circumstances.
38. Some examples of property that will be levied twice under the current Bill include:
  - a. Properties undergoing construction, renovation, extension, seismic retrofitting or other works will be insured under both a commercial or residential property insurance policy and a contract works policy.
  - b. Rental cars hired by a businessperson will be insured under a commercial fleet policy taken out by the rental car company and also by the businessperson's commercial policy. These commercial policies often provide better insurance coverage for the businessperson when renting a car than the rental car company's insurance terms.
  - c. Houses and cars used in the sharing economy will be insured for domestic use by the home or car owner, and also under a separate commercial insurance policy for any Air BnB, Bookabach, or rideshare activities.
  - d. Aviation insurance policies insured under hull insurance and hull war insurance. Both contracts cover the same aircraft, but for different risks.

## **Clause-by-clause commentary on the Bill**

### **Clause 69 – purpose**

39. The purposes set out in the Bill broadly align with the public finance principles noted at paragraph 8 above, which we support. However, we note that the remaining levy provisions are at odds with these purposes. Specifically, the levy will not be stable, predictable, universal, or equitable, for all of the reasons outlined at paragraphs 12 to 16 above.
40. We note that there is a trade-off between flexibility and predictability. Changes in the levy provisions will impact insurers by imposing uncertainty and cost.

### **Clause 70 – interpretation**

#### *“Contract of insurance”*

41. We are unsure whether the Bill is intended to levy marine insurance contracts or not.
42. The definition of “contract of insurance” excludes contracts of marine insurance in the Bill. “Contract of marine insurance” is further defined in clause 6 of the Bill, and excludes certain marine cargo and marine trailer craft policies, meaning these types of policies are meant to be levied. However, the Department of Internal Affairs is consulting on regulations to support the Bill, and proposes that the current exemption for “any ship or anything in a

ship..." be removed because "fire service activities may include responses to at-sea emergencies..."

43. The policy behind the Bill appears to be that marine insurance should be levied because FENZ may respond to at sea emergencies, but the Bill by and large exempts marine insurance contracts from levy. We would appreciate some clarity around this conflict. We have previously submitted that marine insurance should be exempt from the levy provisions, and we have reiterated those reasons at paragraph 33.d. above.

*"Household unit"*

44. "Household unit" is defined to exclude hostels, boarding houses, and other specialised accommodation. This definition is at odds with the EQC Act provisions. We support as much alignment as possible between the way that government levies for FENZ and EQC apply to insurance, for certainty, ease of administration, and to reduce compliance costs, all of which impact insurance affordability for the insuring public.

*"Levy avoidance arrangement"*

45. We submit that a levy avoidance arrangement should not exist simply because an insurance arrangement has the unintentional and merely incidental effect of the insured paying less levy than FENZ thinks should be paid. Insured policyholders frequently make informed commercial decisions not to insure for the full value of their property. This is a totally legitimate risk management decision and routine commercial practice. The words "or effect" in sub clause (a) of the definition could lead to situations where legitimate commercial decisions are characterised by FENZ as levy avoidance arrangements.
46. We submit that the words "or effect" in sub clause (a) should be deleted as it casts the net too widely, and in a way that would distort and hinder legitimate commercial insurance arrangements.

*"Motor vehicle"*

47. This definition excludes heavy RUC vehicles, which has the practical effect of making heavy RUC vehicles subject to a levy that is calculated on a proportion of the amount insured, rather than an annual rate of levy per vehicle, as is the case with other motor vehicles.
48. Having two separate ways of calculating levies on motor vehicles is unnecessary and will increase compliance costs. We submit that the levy on all motor vehicles, regardless of whether they are heavy RUC vehicles or not, should be levied with an annual per vehicle rate.
49. Unless this is done, the Bill will introduce complexity. The Bill will still levy heavy RUC vehicles under the rubric of 'any other property insured against loss or damage', meaning

the levy will be calculated as a proportion of the sum insured or the vehicle's declared value, rather than a flat rate. But many heavy RUC vehicles, like heavy trailer units and plant, are insured under third party liability policies, not first party property policies. Those vehicles therefore do not have a property sum insured, nor are they routinely valued.

50. Levying the sum insured or the declared value of these heavy RUC vehicles would therefore do two things:
  - a. Increase complexity for insurers in having to alter their systems to accommodate different levies for different types of heavy RUC vehicle, and
  - b. Directly increase costs for the insured property owner, who would have to obtain a valuation to comply with the levy provisions.

### **Clauses 71 & 72 – meaning of “amount insured” and “declared value”**

*How do the levy provisions apply to specific features of insurance contracts?*

51. For property insurance, the Bill proposes a levy that is calculated on a proportion of the “amount insured”.<sup>17</sup> The “amount insured” is the “express maximum limit” the property is insured for. If there is no express maximum limit, then the levy applies to the “maximum amount” the property is insured for, so declared by a statutory declaration or a valuation certificate.
52. Clauses 71 and 72 do not apply neatly to insurance contracts. We expect the dominant reading of the clauses will be that the “express maximum limit” is the sum insured, and that if there is no sum insured, then the “fair and reasonable” value of the property will be levied. This distinction is illustrated neatly in examples 1 and 2 in clause 71 of the Bill.
53. But insurance products are far more complex than those neat examples. Our concern is that FENZ may interpret clauses 71 and 72 of the Bill to mean that certain product features are not within the “express maximum limit” payable by the insurer under the insurance contract.
54. We previously submitted in favour of the property levy attaching to the sum insured specified in the contract of insurance. We reiterate that submission here. The sum insured is the simplest, most identifiable figure for a levy to attach to with certainty, the simplest for insurers to calculate levy on with certainty, and therefore the simplest to create systems within insurance companies to determine how much levy to pay to FENZ.
55. The sum insured is a clear, identifiable contractual limit on the amount an insurer pays to the insured in the event of loss or damage. Any differences in the wording of an “express maximum limit” and a “sum insured” give rise to uncertainty. We submit that for a piece of legislation that regulates how insurers must do business, that legislation should express concepts in insurance industry language to ensure certainty in the law. If ‘express maximum

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<sup>17</sup> Clause 104 of the Bill.

limit' does not mean 'sum insured', FENZ may determine more complex levy calculations on particular policies. This adds compliance costs for insurers, which impacts insurance affordability and the cost borne by policyholders. This is because for each new assessment of a property insurance policy that FENZ conducts, insurers must change their systems to make exceptions to what would otherwise be a basic rule, applying in a straight-line, straightforward way to all property insurance. We also note FENZ' operating costs increase in having to consider whether the features of property insurance policies identified below are within the 'express maximum limit' of the policy, or outside it.

56. We note that stability of FENZ funding will not be affected in any way by giving insurers this certainty. The rate applicable to the sum insured can be adjusted to ensure FENZ receives the funding it needs across the levy on all property insurance.
57. The features of property insurance contracts that do not fit neatly within clauses 71 and 72 of the Bill are:
  - a. Some policies have both capped sum insured benefits and replacement value benefits. For example, some of our members offer house insurance on a replacement value basis for specified insured perils (like fire), but cap a sum insured for other insured perils (like earthquake). Arguably, this kind of contract, taken as a whole, would not have an "express maximum limit" because it would be theoretically possible for the insured to receive more than the specified sums insured, even though that sum insured would be an excellent proxy for a fair and reasonable value of the property.
  - b. Insurance contracts often contain additional benefits for the insured property owner. These benefits are innovated and enhance competition between insurers, to the policyholder's benefit. The benefits are modelled into the insurer's premium but can sometimes lead to a situation where the insured technically receives more than the sum insured. This could mean FENZ argues the sum insured is not the "express maximum limit" on the policy, and require costly and unnecessary valuations for the property, and levy that valuation accordingly.
  - c. Insurance contracts often contain sub limits for particular categories of property or types of damage. By nature, sub limits are subsidiary limits under the overall policy sum insured, and so should not be factored in to a levy on the 'express maximum limit' of the policy.
  - d. Commercial property insurance is often written on a 'first loss' basis. 'First loss' is where the policyholder only partially insures their property compared to the total value of the property. For example, a policyholder with two properties, each valued at \$1 million, may insure both under the one contract of insurance with a sum insured of \$1 million instead of \$2 million. We submit the Bill must specifically recognise that first loss property insurance is permissible. There is a risk that the levy provisions could penalise first loss arrangements by levying the value of the property rather than the sum insured. If government had wanted to levy property values as a matter of policy, it would have levied property rates and not insurance.

58. If FENZ applies the Bill in a way that these product features are levied over and above the specified sum insured in the insurance policy, then this will result in either:
- a. The public facing the increased cost of compliance and calculation of the levy, or
  - b. Insurers will be inhibited from offering these enhancements, stifling innovation and competition.

Both options clearly distort the insurance market and are totally undesirable.

59. Aside of the meaning of “express maximum limit”, we have identified two other unclear aspects of the levy provisions:
- a. Whether references to “property” insured under an insurance contract in the Bill is meant to be considered collectively or individually and severally. People routinely insure a swathe of property under one insurance contract. This happens in both the residential and commercial property insurance. If it is possible for ‘property’ to mean the individual pieces of property insured under the insurance contract, rather than the collective group of property insured, then FENZ could end up conducting an exhaustive and unnecessary line-by-line analysis of each item of property to determine whether it had an ‘express maximum limit’ in the policy, or whether it had a declared or statutory value. We submit this is totally unnecessary. It will add significant compliance costs, which will be unfairly borne by insured policyholders. We submit the references to ‘property’ in the Bill must be defined collectively as all of the property insured under the contract of insurance.
  - b. Whether a “fair and reasonable” valuation is something different from market value and replacement value, which are two of the typical indemnities insurers provide upon loss or damage to property. We submit this standard is uncertain and should be removed.

60. We seek clarity from the Committee in how the levy attaches to insurance contracts. We submit in favour of clarity and simplicity in applying the levy to insurance contracts.

*The requirement to obtain a statutory declaration or valuation should be removed*

61. The requirement for a policyholder to provide a statutory declaration or obtain a valuation certificate is absurd. It is an exceedingly onerous administratively, and would introduce significant compliance costs for insurers and policyholders, and also for FENZ to monitor to ensure the declared value aligned with a fair and reasonable value for the property. It would incentivise insureds looking to minimise their levy exposure to undervalue their property on a statutory declaration.
62. If government had wanted to levy property values as a matter of policy, it would have levied property rates and not insurance.
63. As an alternative to clause 72(3), we submit that the “declared value” of the property should simply be the value declared by the insurer to FENZ on the levy return required under clause



84. The value declared by insurers should be their internal valuation of the full potential loss association with the property insured.
64. Insurers have significant commercial incentives to accurately value the property they insure under open-ended replacement policies that do not have an “express maximum limit” (i.e., a capped sum insured). Insurers rely on an internal valuation for replacement policies to:
- a. provide accuracy and certainty around the insurer’s exposure to the risk(s) insured
  - b. set the premium payable by the insured policyholder, which will accurately reflect the replacement value attributable to the property, and
  - c. help the insurer to manage its reinsurance arrangements. Reinsurers of insurance cover that is offered on a replacement value rather than a capped sum insured value will, like insurers, want clarity and certainty around their own exposure to the insurer. This will place an extra incentive on insurers to accurately value a property without an express maximum limit in the contract of insurance.
65. This commercial incentive spans an insurer’s business and, in terms of persuasive reasons to get a replacement valuation ‘right’, far outweighs any incentives the FENZ levy provisions could provide.
66. We note the incentive to value risk accurately also comes from other Government regulation. The Insurance (Prudential Supervision) Act 2010 sets out mandatory solvency requirements for licensed insurers that are policed by the Reserve Bank. New Zealand insurers have some of the strictest solvency requirements in the world. Insurers must adhere to these standards, which means they must take extremely conservative positions in assessing their risk. And if insurers did not adhere to these solvency standards, they would not be permitted to carry on business in New Zealand.
67. Other protections exist for FENZ in its ability to audit insurer information, and to make use of the provisions restricting levy avoidance arrangements.
68. We therefore submit that clause 72 should be amended to:
- a. Delete clauses 72(3), 72(5) and 72(6).
  - b. Amend clause 72(4) to require the levy payer to declare, during the levy return, the valuation used by the insurer for calculating the insured’s replacement value premium.

#### **Clauses 75 & 76 – who must pay levy to FENZ**

69. These clauses do not clearly make either the policyholder or the insurer liable to pay levy where the policyholder is in New Zealand and the insurer does not carry on business in New Zealand. This is problematic as it does not capture business where a New Zealand-based policyholder either insures:
- a. with an offshore insurer through a New Zealand intermediary, or
  - b. directly with an offshore insurer.

We note that hundreds of millions of dollars' worth of insurance is placed offshore in this way.

70. ICNZ expects that in coming years there will be an increasing amount of insurance taken out offshore by New Zealanders, with the availability of offshore insurance markets (such as Lloyd's) to domestic brokers, and the increased reliance of consumers insuring through the Internet. This threatens the ongoing stability of funding for FENZ.
71. To clarify our understanding of the provisions:
  - a. Clause 75 states that the "insurer" is liable to pay levy, subject to clause 76.
  - b. "Insurer" is defined in clause 70 to mean a person that "carries on insurance business in New Zealand".
  - c. "Carries on insurance business in New Zealand" is also defined in clause 70 to have the same meaning as it has in section 8 of the Insurance (Prudential Supervision) Act 2010 (IPSA).
  - d. In section 8 of IPSA, a person carries on insurance business in New Zealand if they meet a set of criteria, as specified in section 8(1).
  - e. Section 8(1)(a)(ii) and 8(1)(a)(iii) concern overseas companies and associations under the Companies Act 1993, however section 332 of the Companies Act 1993 specifically states that an overseas company does not "carry on business in New Zealand" merely because in New Zealand it enters into a contract of insurance as an insurer with a New Zealand policyholder.
72. Our understanding of these provisions is that if a New Zealand policyholder insures with an offshore insurer who does not otherwise carry on business in New Zealand, then neither the insurer nor the New Zealand policyholder have to pay levy to FENZ.
73. In our view, this problem is more than theoretical. Lloyd's, for example, underwrites a more than trivial amount of insurance for New Zealand policyholders. Lloyd's is a member of ICNZ and is licensed under IPSA to carry on insurance business in New Zealand on behalf of its underwriter. But despite being licensed, it is our understanding that Lloyd's underwriters do not actually "carry on business in New Zealand" as that term is defined in IPSA and the Companies Act. And simply by not "carrying on business in New Zealand", offshore business avoids liability under the levy provisions.
74. We submit that New Zealand policyholders who insure with insurers that do not carry on business in New Zealand should pay levy to FENZ. This would ensure fairness and equity to other levy payers.
75. We understand that there was no intention to change the policy position from that currently set out in sections 49 and 49A of the current Fire Service Act 1975, meaning New Zealand policyholders insuring with offshore insurers who do not carry on business in New Zealand should be caught by the levy provisions.
76. The anomaly could be remedied with a simple addition in clause 76(1)(c) that states:

“(c) between a policyholder and an insurer that does not carry on business in New Zealand.”

77. We also note a concern around how the levy provisions treat New Zealand insurers of New Zealand policyholders, where the New Zealand insurer underwrites part of a larger property insurance contract that is co-insured with other multinational insurers. This is called a multinational placement and is used for larger property risks. In our view, the policyholder should be liable to pay levy to FENZ for multinational placements involving New Zealand insurer(s) as one of a number of foreign insurers.

### **Clauses 75-77 – when a levy payer must pay levy**

78. Clause 77 brings levy payment dates into line with GST Act payment dates, which ICNZ previously submitted in favour of. However, clauses 75(1) and 76(2) state that liability to pay levy begins “on entering into a contract of insurance...”. The combination of these provisions now mean that the amount of time an insurer has to pay levy to FENZ is shorter than it is under the current *Fire Service Act 1975*.<sup>18</sup>
79. The shortness of this time period is problematic for all intermediated (brokered) business. Intermediated business makes up at least 53 to 57 percent of levy revenue received by FENZ. The problem is that the levy provisions require an insurer to pay levy to FENZ well before the insurer actually receives those payments from the insured. This has a cash-flow impact on general insurers, increasing insurers’ costs of business, which impacts on insurance affordability for the insured policyholder.
80. By way of background, here is some essential information about how intermediate insurance contracts are entered into in the insurance industry:
- a. An insurer goes “on risk” when there is an agreement between broker and insurer to hold the policyholder covered on (standard) terms issued by the insurer.<sup>19</sup>
  - b. From this point, the insurer has a contractual obligation to indemnify the insured policyholder, subject to payment of the premium and satisfaction of any conditions by the insured.<sup>20</sup>
  - c. However, insurers and brokers will then commonly spend time satisfying contractual conditions and negotiating specific terms and extensions – which affects the amount of premium and FENZ levy payable by the policyholder and the nature of the contract of insurance.
  - d. When the specific terms and extensions are negotiated between insurer and broker, and the insurer has calculated a final premium, the broker issues a “closing”.

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<sup>18</sup> Section 50 of the current Act states levy is payable on “the 15th day of the second month following the end of the month in which the contract of fire insurance or other arrangement was made”. This means insurers have a minimum of 43 days and a maximum of 76 days to pay levy to FENZ.

<sup>19</sup> Insurers also refer to this point in time as “binding”, or “renewal” for renewal business.

<sup>20</sup> Conditions may include completing a proposal form and any other supporting information and documentation, to the insurer’s satisfaction.

- e. Insurance brokers have 90 days from the end of the month the broker's closing was issued to pay the insurer.<sup>21</sup> Payment is usually made by way of bordereaux, which is where a broker collates a group of premium payments received from its policyholder clients in the course of a month.
81. The insurer suffers a net loss in paying levy given the commercial practices outlined above and under the current Act and the proposed provisions in the Bill, because the insurer is effectively paying levy to FENZ on credit while it waits for that levy payment to arrive from the insured policyholder's broker.<sup>22</sup> This does nothing more than add artificial and unnecessary compliance costs, which distorts the cost of insurance for the insured policyholder.
82. We stress that the foregoing reflects standard commercial practice in the insurance industry and is therefore based on many other commercial considerations, aside of the insurer's need to pay FENZ the portion of premium owed by the policyholder or their broker that relates to government levies.
83. We say the cost is 'unnecessary' because we see absolutely no rationale for levy to be payable to FENZ before the insurer has actually received the money from the broker. To give FENZ a stable source of funding, levy payments must be calculated and payable with certainty, and be made with relative regularity. Regularity of cash flow comes irrespective of the amount of time between when a levy payer becomes liable to pay levy, and when that money actually becomes payable. FENZ will still have cash flow.<sup>23</sup>
84. The Bill 'start date' for liability to pay levy is currently on "entering into the contract of insurance". We expect the Bill means the point the insurer goes "on risk", rather than the point the insurer receives the closing, or the payment of the premium by the insured. We would appreciate as an absolute minimum some clarity in the Bill on this point.
85. We submit that the gap in time between the 'start date' of when a levy payer incurs liability to pay levy in clauses 75(1) and 76(2), and the 'end date' of when a levy payer must pay that levy to FENZ (clause 77) should be adjusted to reflect insurance industry practice, align with the commercial realities of broker payments to insurers, and minimise losses to insurers who will be 'in the red' for that gap in time, which will have flow on impacts for insurance affordability and the cost of insurance for policyholders.

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<sup>21</sup> 90-day payment terms account for the fact that once the insurer has issued a closing, the broker has to receive the insurer's invoice, issue a separate invoice to the insured policyholder, receive payment from the insured policyholder, and then pay the insurer.

<sup>22</sup> There is a secondary technical problem worth noting. The length of time between when an insurer goes on risk and when the broker issues a closing, may be longer, under the Bill, than the length of time between when an insurer enters into a contract of insurance and the GST-aligned date that levy is payable. This means neither the policy, nor the premium, nor the levy calculation will have been finalised before the levy payment is actually due to FENZ.

<sup>23</sup> If the Committee accepts our submission, there will be a point in transitioning from the levy provisions under the current Act and the levy provisions in the Bill where FENZ may be short on cash flow. However, this gap in time will be small, and temporary, and should not impact considerations about the broader design of the levy provisions. It is also theoretical as FENZ is receiving circa \$300 million in additional funding for its transition costs, and will increase the insurance levy rate to recoup any cash flow issues in the short term in any event.

86. If the Committee accepts our submission on this point, then we propose the following options would provide a better outcome and certainty for the insurance industry and reduce its losses in paying levy to FENZ before it receives levy from brokers:
- a. Define the 'start date' ("entering into a contract of insurance" in clauses 75(1) and 76(2)) to:
    - i. For intermediated (brokered) insurance contracts – align with the broker's closing, and
    - ii. For non-intermediated insurance contracts (i.e. directly insured with the insurer) – the issuance of a GST invoice by the insurer.

We note that insurers have commercial incentives to recover the amount payable on the invoice in a timely way, given most of the invoice relates not to FENZ levies but to premium and other government taxes.
  - b. Amend clause 77 to require payment of levy to FENZ on a specific day of the month, on the third month following the month in which the contract of insurance was entered into.<sup>24</sup> Retaining payments on the 15<sup>th</sup> of the month, as under the current Act, would give certainty for insurers and FENZ, regularity of payments for FENZ, and extending the month payable from two months to three months after the inception of the contract would align closer to the commercial reality of 90 day broker payments terms, significantly reducing the number of policies for which an insurer had to advance levy to FENZ before actually receiving the money from the broker.
87. We note these submissions only amend the timing of levy payments. They do not amend the amount of levy FENZ receives.
88. We note that while non-intermediated (mainly residential or domestic) insurance is not subject to the same payment pressures as intermediated insurance, the levy provisions imposed on insurers should align the start and end dates for both commercial and non-commercial insurance. This would avoid unnecessary system changes and additional compliance costs to formulate two different levy payment rules for different types of insurance.
89. We also note in respect of insurance placed directly with the underwriter, especially residential insurance, that insured policyholders often pay premium by instalment. This means the premium is paid by the insured policyholder to the insurer in instalments (commonly fortnightly or monthly) over the course of the year, rather than in full up front. If the insurer is liable to pay the full amount of the levy to FENZ up front, the insurer suffers a cash-flow loss until this full amount is repaid over the full course of the year by the insured. This is yet another example of additional costs for insurance business that impact affordability of insurance for the policyholder.

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<sup>24</sup> Noting the possible amended definition of "entering into a contract of insurance" in paragraph 90 below.

### **Clause 78 should acknowledge intermediated business**

90. Clause 78 makes a policyholder liable to pay an insurer the levy on entering into a contract of insurance, and makes the levy amount a debt due to the insurer. We submit this clause should be amended to specifically acknowledge intermediated business. For example, “policyholder” could be defined for the purposes of the clause to include the policyholder’s agent. Typically, policyholders will rely on their broker to make all arrangements, so liability to ensure brokers pass on the levy they have received is essential to ensure the integrity of the payment through the insurance chain from policyholder to FENZ. An amendment to recognise the role the intermediary plays between the insurer and policyholder would align more closely with industry practice and commercial realities set out at paragraphs 18 to 20 above.

### **Clause 80 – FENZ may release insurer from liability**

91. We submit that FENZ **must** release an insurer from liability if the levy payable by the policyholder to the insurer is irrecoverable. For completeness, we also submit clause 80 must also exempt insurers from any further penalties attaching to the irrecoverable amount under the levy provisions. We note that it is unlikely that FENZ would pursue a shortfall penalty against an insurer when the policyholder is at fault. However, we seek certainty, and therefore submit clause 80 should exempt insurers from further penalties relating to the irrecoverable amount.

### **Clause 82 – levy payers should be innocent until proven guilty**

92. When FENZ alleges that a levy payer has assessed levy payments incorrectly, or when FENZ seeks to impose a shortfall penalty on the levy payer, clause 82 places the burden of proof on the levy payer to prove their innocence. We submit this reversal of the burden of proof is inappropriate for a levy that funds FENZ.
93. We note that section 25 of the New Zealand Bill of Rights Act 1990 (‘NZBORA’) states that everyone charged with an offence has the minimum right of, among other things, the right to a fair and public hearing by an independent and impartial court, and the right to be presumed innocent until proved guilty according to law. We note that FENZ is not independent or impartial because it spends the revenue it collects when administering the levy provisions. NZBORA applies for the benefit of legal persons as well as natural persons.<sup>25</sup> In our view, clause 82 is inconsistent with section 25 of NZBORA. We submit this inconsistency is not justifiable, and that clause 82 should be removed from the Bill.
94. At very least, the Bill should treat more serious, intention-based offences separately in terms of the burden of proof applicable. It is especially inappropriate for a charged levy payer to have to prove their innocence where the charge is more serious and the potential penalties are higher.

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<sup>25</sup> Section 29, New Zealand Bill of Rights Act 1990.

### **Clause 86 – power to require information**

95. This clause permits FENZ to require levy payers and intermediaries to provide any information relating to administration or enforcement of the levy provisions. The power is too pervasive. It would incentivise fishing expeditions, which will simply add cost for levy payers and intermediaries. We submit this power should be subject to a reasonable limit – an objective test of whether the information is necessary or relevant for FENZ to administer or enforce the levy provisions, in place of the current subjective test. This can be achieved by simply deleting the words “FENZ considers” in clause 86(1) of the Bill.
96. We also submit that disputes about whether a levy payer must provide certain information should be able to be heard in the FENZ dispute resolution scheme and the Courts to prevent arbitrary, unreasonable and unlawful exercise of this power.

### **Clauses 88 & 89 – confidentiality**

97. We strongly support the need for appropriate protections to ensure that FENZ private and commercially sensitive information is held in the strictest confidence and with high standards of security. We support the provisions in the Bill to this effect, however we would add there is a need to incentivise FENZ to take practical steps to set high standards to treat the information it receives securely. We note the high cyber security risk and data breach risk posed by government agencies, including the fire service.<sup>26</sup> We submit that, at the very least, FENZ requires a secure online portal to receive the information provided by levy payers under the Bill.

### **Clauses 90-103 – offences, avoidance arrangements, shortfall penalties and interest**

98. We would like to frame our specific comments on this part of the Bill by first reiterating some general comments we made earlier in our submission:
- a. Insurers are mere collection agents for FENZ under the proposed regime. Insurers are not ultimately liable to pay the levy; insured policyholders are.
  - b. Insurers are not incentivised to avoid levy in the same way taxpayers are incentivised to avoid paying tax.
  - c. The levy provisions should therefore incentivise payment of the correct amount of levy, and not punish the collection agent for failing to get it right.
  - d. In intermediated business, insurers do not design policy structures that could be considered levy avoidance arrangements, insurers do not negotiate directly with the insured policyholder, insurers do not calculate the levy payable on that insurance, and insurers do not act on behalf of the insured policyholder. These roles are those of the broker.

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<sup>26</sup> The Fire Service was recently subject to a ‘whaling’ attack which cost it \$52,000 [http://www.radionz.co.nz/news/national/292881/fire-service-scammed-out-of-\\$52,000](http://www.radionz.co.nz/news/national/292881/fire-service-scammed-out-of-$52,000). ACC has had a string of privacy breaches [http://www.nzherald.co.nz/business/news/article.cfm?c\\_id=3&objectid=10865475](http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10865475), and EQC has a large breach <http://www.stuff.co.nz/the-press/news/christchurch-earthquake-2011/10470248/Earthquake-data-privacy-breach-avoidable>.

99. The Bill's enforcement regime replicates certain aspects of the Tax Administration Act ('TAA'). However, some crucial clauses from the TAA are not replicated in the FENZ Bill:
- a. The Commissioner of Inland Revenue must reduce shortfall penalties that are otherwise payable by a taxpayer if the taxpayer has voluntarily disclosed their shortfall. Waivers of:
    - i. 100 percent of the penalty is applicable in most cases of voluntary disclosure.
    - ii. 75 percent of the penalty is applicable for more serious offences, and
    - iii. 40 percent of the penalty is applicable if voluntary disclosure is made after Inland Revenue has served notice of an audit or investigation on the taxpayer.

We submit similar provision should be inserted into the FENZ Bill to incentivise insurers to proactively disclose any levy shortfall they identify to FENZ.

- b. The Commissioner must also take past good behaviour into account and remit accordingly.
  - c. In respect of the abusive levy position provision in clause 96, we note that Inland Revenue reduces the penalty from 100 percent to 20 percent if a taxpayer has received independent tax advice that the position is not abusive, but is ultimately found to be wrong. This reduction is omitted from the FENZ Bill, and we submit it should be introduced.
  - d. Finally, the Commissioner can reduce a shortfall penalty by 75 percent if the shortfall is temporary – that is, repaid within 4 years – among other criteria.
100. We submit that cherry-picking aspects of the TAA to include strict non-compliance penalties, while ignoring provisions that exonerate good levy payer behaviours, is unsubstantiated and unfair.
101. Even with a mirror image of the TAA regime in force for FENZ levy payers, we submit the penalties are too strict for a regime that funds FENZ. Terms of imprisonment for levy offences are totally inappropriate. The Tax Administration regime protects the Crown revenues, and as such, should have provisions equivalent to the gold standard of public revenue collection. Such a regime is not necessary for FENZ.
102. More fundamentally, if a mirror image of Inland Revenue is intended in terms of the enforcement functions and powers of FENZ, we would submit that the levy provisions are best administered by Inland Revenue, not by FENZ. Funding FENZ to run its own levy collection department separately would duplicate systems, audit teams, data analysis and dispute resolution processes, when these are already established at Inland Revenue to police similar provisions in respect of taxpayers. As mentioned previously, we have concerns about FENZ' enforcement culture, and its conflicted levy collecting and fire and emergency response functions. FENZ collects and spends its own levy. Inland Revenue collects tax but a democratically-elected Government then determines how best it is spent. These concerns would be ameliorated by having Inland Revenue collect the levy.



103. We note the importance of cultural differences in government agencies tasked with taxing insurers. A levy to fund the Earthquake Commission (EQC) is also taxed on certain types of insurance policy, but EQC and FENZ take markedly different approaches to collecting their respective revenues. Both organisations are backed by statutory regimes with formal provisions to require payment from insurers. But while EQC works collaboratively with insurers by forgiving mistakes in calculation and providing prompt payment discounts on the levy due to it, FENZ pursues debts aggressively, even where the insurer has honestly and unintentionally miscalculated the amount owing. In our view this underscores the need for FENZ' levy collection function to be separate.
104. An insurer is penalised even if the insurer did not design, or had no knowledge or intention of the levy arrangement struck between the broker and the insured.

#### *Use of money interest*

105. We submit use of money interest ('UOMI') is not an appropriate level of interest for unpaid levy. We support interest on unpaid levy to disincentive levy payers using FENZ as a means of 'borrowing' capital. We understand this underpins the Inland Revenue rationale for the UOMI rate. However, we note:
- a. Insurers, as financial institutions with high financial strength ratings, have a lower cost of borrowing than other taxpayers, which reduces their incentive to retain capital in the form of FENZ levies as an alternative to borrowing capital from other sources.
  - b. Insurers' incentives differ from taxpayer incentives.<sup>27</sup>
106. We submit that Use of Money Interest should therefore be set at the Official Cash Rate, or potentially the Official Cash Rate + 50 basis points which would serve as an appropriate disincentive from 'borrowing' from FENZ through non-payment of levies.
107. Clause 98 is nonsensical. When shortfall is discovered, it is almost always discovered more than 60 days after the inception of the contract of insurance. For intermediated business, broker payment terms are up to 90 days, so it would be possible to be in breach of clause 98 with hindsight, even though the levy payment had not been received by the insurer or passed on to FENZ by the 60-day mark. We submit that clause 98 simply compounds penalties with penalties, and should be deleted from the Bill.
108. If our submissions on the penalty regime is not accepted by the Committee, we submit that there should be a grace period built into the penalty provisions of the Bill, to give insurers time to work with FENZ to develop certainty around the levy provisions and work towards full compliance. We submit that a two-year grace period would be appropriate.

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<sup>27</sup> See paragraphs 23 and 24 above.

## **Subpart 6 – regulations relating to levy**

### *An ability to exempt by type or class of insurance policy*

109. Clause 104(3)(d) allows the Minister to exempt any property or class of property from the levy. We submit that the Minister should also be permitted to exempt any insurance policy or class of insurance policy from the levy, subject to the same requirement for the Minister to give reasons in clause 104(5).
110. As noted above, we believe on the current levy provisions there are some non-property insurance policies that could be unintentionally caught by the levy provisions. For certainty, we submit that these types of policy should be carved out of the Bill, or the Minister should be granted power to exempt on application.

### *Stricter requirements for the Minister to adhere to process*

111. Clauses 105 and 106 establish the process and consultation requirements the Minister must adhere to when creating regulations under clause 104. We strongly support these provisions as currently drafted. However, in our view the process and consultation provisions are totally undermined by clause 106(5)(a). This clause effectively states that if the Minister fails in his or her consultation obligations, then any consequent Regulations are not invalid. We submit this is totally inappropriate, and undermines the object of the previous clauses. We submit that clause 106(5)(a) should be deleted from the Bill.

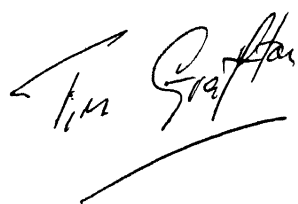
## **Clause 137 should contain an objective test for “reasonable grounds”**

112. Clause 137 allows a FENZ inspector to restrict or prohibit access to fire and emergency sites if the FENZ inspector believes on reasonable grounds that it is necessary to preserve evidence or prevent tampering. We support this clause. Preservation of evidence and prevention of tampering are important to site insurers. Insurers need the best possible evidence of the causes of fire and other emergencies to get the most accurate information to inform their policy response. On this point, we submit that the Bill should require FENZ to provide evidence collected by FENZ from a fire or another emergency on request by an insurer.
113. We submit that the test for the FENZ inspector to consider whether there are “reasonable grounds” to restrict or prohibit access should be objective, not subjective to the particular inspector. This would encourage consistent standards and application of the provision in practice across all FENZ inspectors.
114. Further, and in particular, we submit access to fire and emergency sites should not be unreasonably denied to a qualified fire investigator. Fire investigators hired by insurers to investigate the causes of fire are highly trained and experienced professionals who will often be better qualified than FENZ inspectors to inspect fire sites and determine the cause of a fire.

## Dispute resolution

115. We support the creation of a dispute resolution scheme in Part 4, subpart 5 of the Bill to handle levy disputes in Part 3 of the Bill. Our view is that levy payers should have free access to the scheme to resolve levy payment issues with FENZ. On this point, we submit the dispute resolution scheme should have jurisdiction to consider matters brought to it by either FENZ or a levy payer.
116. We note that while participation in the scheme is voluntary under clause 143, we submit that a dispute scheme developed by FENZ is not sufficiently independent. We note our earlier comments about FENZ' lack of independence in policing its own expenditure. We submit that the scheme should be approved by the Minister in the same way as the dispute resolution schemes under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 after public consultation, including consultation with FENZ and levy payers.
117. We submit that FENZ must refer any disputes between it and a levy payer to the dispute resolution scheme in the first instance, before FENZ takes any further action that may be available to it under the levy shortfall, penalty and interest provisions, or the offences listed in the Bill. Parties to a dispute are far less likely to resolve that dispute in good faith if one party is already entrenched in its view of the dispute. For example, FENZ would be less likely to consider reasonable options to resolve a dispute in a dispute resolution process if it had already determined to pursue a levy payer under one of the levy avoidance arrangement provisions of the Bill. Such an approach is also consistent with a modern approach to regulatory enforcement taken by government regulators like the Commerce Commission and the Financial Markets Authority. These regulators initially take light-handed enforcement steps in the first instance, and escalate the severity of the enforcement response if the other party to the dispute is unresponsive, non-compliant, or a repeat offender. We support this kind of escalating approach to enforcement of the levy provisions in the Bill.
118. Thank you again for the opportunity to submit on the Bill, and for taking the time to consider our submission. If you have any questions, or if you wish to arrange an appearance by ICNZ before the committee, please contact our legal counsel, Nick Mereu, at [nick@icnz.org.nz](mailto:nick@icnz.org.nz) or (04) 495 8008.

Yours sincerely,



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