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Fire Services Review
Department of Internal Affairs
PO Box 805
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Emailed to: fireservicesreview@dia.govt.nz

To Whom It May Concern,

Submission on the Fire Services Review Discussion Document

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1. Thank you for the opportunity to submit on the Fire Service Review Discussion Document. We provide this submission on behalf of our members, though we understand many will also be providing their own submission directly to you.

2. We have structured our letter into the following main submissions:
   - First, we describe who ICNZ represents and what their interests are in the Discussion Document.
   - We then note that omitting alternative funding options from the Discussion Document makes a mockery of open public consultation, and that even though it is not an option in the Discussion Document, general taxation is the best option for funding the Fire Service.
   - We support a strong governance structure for the efficient delivery of Fire Services, which entails a robust levy review process.
   - We support funding option two (the mixed funding model) and discuss various aspects of that funding model. Our overriding submission is for an administratively simple, clear and low cost regime. We appreciate that it means our levy setting preferences are in some circumstances less equitable than others. However, we note that we are making this submission in the context of an unfair system that is being made slightly fairer overall. There will inevitably be trade-offs between levy settings that make the system slightly more equitable and levy settings that make the system cheaper and simpler. For margin calls, we favour the latter.

- Finally, the realities of collection should be reflected in the legislation, so those collecting the levy are fairly compensated for their collection efforts, and insurers should not be penalised for delays in levy payment by brokers.

3. If you have any questions please contact us directly. Our contact details are at the bottom of this letter.

About us

4. ICNZ represents the interests of the fire and general insurance industry in New Zealand. Our 28 members insure over $600 billion worth of New Zealand assets and liabilities.

5. The levy that funds the Fire Service is a tax on our members' insurance products. $339 million of the Fire Service Commission's $350 million expenditure in the 2013/2014 financial year came from the levy on insurance products. We understand from Cabinet papers recently released to the public that this figure is closer to $400 million in the upcoming financial year, and with the Fire Service's Vision 2020 and expansion of the services it delivers, this number will no doubt continue to rise.

6. Our members therefore have a strong and direct interest in ensuring that the Fire Service is funded appropriately.

Omitting alternative funding options from the Discussion Document makes a mockery of open public consultation

7. We are astounded that general taxation and property based options for funding the Fire Service are omitted from the Discussion Document. Excluding funding options before seeking public submissions on those options is undemocratic. It also leads to poor policy outcomes particularly when the optimum ways of funding the Fire Service are not considered. These optimum approaches are ones that have been adopted overseas for sound reasons. To cast them aside when a fundamental review of the Fire Service is occurring is a dereliction of duty.

8. We understand Government intends to return its balance sheet to surplus, and accepting an additional $350 million in Fire Service expenditure would hinder that goal. However, in our view this should not have led Government to foreclose open and transparent public discussion about the best ways to fund the Fire Service. Predetermining policy options in advance of a public review is one thing, but predetermining those options **and extinguishing the discussion** in advance of the review is extremely disappointing.

9. We note that general taxation is the most strongly supported option for funding the Fire Service amongst stakeholders, as it was argued for by most of the submitters to the 2012 Independent Fire Review Panel (the Swain report).

10. We also note that 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.[1]

11. It is even more remarkable that the Department is not consulting publicly on general taxation as the Department's officials have listed the many advantages of general taxation as a funding option.[2] No disadvantages are noted by officials. In our view politics should not interfere with public administration and consultation on public policy in this way.

General taxation is the best option for funding the Fire Service

12. We appreciate the Department's consideration of the NZIER reports commissioned by ICNZ in preparing the Discussion Document. To re-iterate briefly, NZIER found:
    - The link between fire insurance and the Fire Services is increasingly tenuous. The Fire Service now responds to an increasing number of non-fire events[3] and has a greater focus on protection of life than protection of property.
    - A levy on insurance is the worst possible option for funding the Fire Service. About twenty reports produced since 1993 support this finding.

13. General taxation is the best option for funding the Fire Service because it is:
    - the fairest, and avoids free-riding because all those who benefit from this public good pay for it
    - the most economically efficient
    - the most legitimate (the simplest, most certain and most clear)
    - the most cost effective
    - the simplest, and
    - the best way to minimise non-compliance.

14. We reiterate that general taxation is the most strongly supported funding option amongst Fire Service stakeholders from submissions to the Independent Fire Review Panel.

15. We support and underscore the Department's findings that general taxation:
    - Ensures all taxpayers contribute.
    - Removes confusing legislation that has given rise to parties trying to minimise the levy they pay to the Fire Service.
    - Would be highly cost effective as Government would be able to use existing tax collection systems.
    - Would be relatively stable and predictable compared to an insurance levy on premiums.

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[1] 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 ±/-3.5 percent.

[2] Department of Internal Affairs, "Fire Services Review: Discussion Document", at page 63.

[3] Including floods and storms, evacuations, hazardous substance spills, accidents and medical emergencies (particularly motor vehicle accidents), and other rescues.

- Would potentially increase the Fire Service Commission's accountability and efficiency as it would be subject to scrutiny by The Treasury.

16. The Department criticised the NZIER reports in its funding document[4] but we note the criticisms do not relate to NZIER's analysis of general taxation being the best option for funding the Fire Service. We also note the Department agrees that the current insurance-based levy:
    - Does not reflect the scope of modern Fire Services provided.
    - Does not reflect the risk presented by different properties and assets that the Fire Service protects.
    - Is unfair for people who take out insurance for their residential property as they pay a disproportionate share of levy.
    - 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.
    - Has ambiguous legislation, making the levy difficult to calculate and forecast.

17. With expert reports and official advice indicating that general taxation remains the best option for funding the Fire Service, and with wholesale support from stakeholder for a switch to general taxation, we would like to underscore our disappointment that it has been ruled out by Government before the conversation has begun.

18. We strongly recommend that Government revisits this decision.

A strong governance structure is required for efficient delivery of Fire Services

19. Insurers have an interest in ensuring the Fire Service is governed effectively for two main reasons. First, despite its expanded services the Fire Service remains responsible for protecting insured property. Fast and effective responses by the Fire Service are vital to protecting insured property. Second, inefficiencies in Fire Service will make the Fire Service costlier to run. A costlier service means more revenue will be required from the levy on insurance, which in turn will increase the cost of insurance and distort the insurance market.

20. With a wider mandate as the first response emergency service, and cost expansion from (potentially) including the Rural Fire Service under its rubric, there is a much greater need for effective governance oversight of the Fire Service's spend.

21. For these reasons we prefer governance options 2 and 3 to option 1. We see the governance options 1 to 3 as being on a scale from least to most efficient and effective. We expect option 3 will also cost the most to operate initially, and option 1 will cost the least to operate initially, but we expect option 3 will bring efficiency (and cost-saving) gains for the Fire Service over time.

[4] Department of Internal Affairs, "Fire Service Review Background: Funding options and alternatives", at pages 29-32.

22. Regardless of whether general taxation is accepted as an option or not, The Treasury should have a direct role in scrutinising the Fire Service's spend because the Fire Service provides a public good. This need for Treasury scrutiny is greater if there is a Crown appropriation under the proposed mixed model funding option (option number 2).

Strong governance requires a robust levy review process

23. We support an enhanced statutory process to review the levy and other contributions as outlined by the Department.[5] We also support enhancements to consultation and transparency of levy reviews and the Commission's expenditure, to better align with the Treasury's public sector charge guidance.

24. We do not agree that the process should favour adaptability over stability. Stability is important for insurers' business. Year to year changes to the levy would make administration, compliance and product pricing difficult for insurers. We support the Department's suggestion of a three-year period of review.

If general taxation is not under consideration, we support funding option 2

25. The funding option chosen should be fair for all those that contribute, simple to administer for insurers, and consistent between different lines of insurance product.

26. Given our position on general taxation outlined above, we consider funding option 2 to be the lesser of two evils. Allowing for contributions to Fire Service revenue by current 'free riders' and allowing for a share of the Fire Service's costs to be paid by all motor vehicle users rather than just insured motor vehicle users makes for a fairer and more efficient funding system.

27. We submit that the Crown appropriation or direct user charge must, to the greatest extent possible, fully recover the Fire Service's costs in respect of those services. Likewise, we submit that any revenue sourced from vehicle licensing or road user charges must, to the greatest extent possible, fully recover the Fire Service's costs in respect of those services.

28. Consistent with the argument that the Fire Service provides a public good, we would favour a Crown appropriation and this would support Treasury oversight of Fire Service expenditure. It would also signal that transition to a fairer funding system for the Fire Service through general taxation remains possible in the future.

29. We understand a Crown appropriation could create a theoretical 'double dipping' problem, as the Crown already pays to fund the Fire Service through its state sector agencies that buy insurance which the levy is payable on. We strongly disagree that this should be a hurdle to a Crown appropriation to fund the Fire Services. We submit:

[5] Discussion Document, above n 2, at pages 40-42.

- Fundamentally the Fire Service is a public good and so should be funded by the Crown anyway.
- We do not currently know what the scope of the levy provisions will be, and we also have no visibility of the number of state sector agencies who actually insure. In these circumstances, it is difficult to point to a double dipping 'problem'.
- We understand some of the biggest Crown property owners choose to minimise their exposure to the levy and are therefore 'free riding' the Fire Service's public good.
- Crown agencies could be exempt from the levy on insurance and simply contribute to the Fire Service as a public good through an appropriation.
- Not contributing to the Fire Service at all and free riding is a worse situation than any marginal 'double-dipping' concerns.
- Parliament will be well-placed to assess who is free-riding and require a token contribution from those agencies, which would be fairer than the status quo.
- Parliament could make insurance of Crown property mandatory. Without mandatory insurance 'free riding' would continue.
- The current system effectively 'double dips' on the private sector. For instance, airports and forests with their own fire response units pay levy on their insurance policies despite effectively providing their own service.
- Finally, the funding of the Fire Service through a levy on insurance is an inherently unfair regime anyway, so any double-dipping concerns would be a minor unfairness in a grander scheme of unfairness.

If the levy stays on insurance, it should attach to the sum(s) insured

30. We support expansion of the levy base from contracts of fire insurance to the aggregate of any sum(s) insured under any contracts indemnifying the insured against any perils causing material damage to any insured property.[6] We support this attachment for both residential and non-residential property.

31. Some of our members support more limited attachments based on the types of property the levy attaches to (for example, buildings only rather than all property) and the risks covered by insurance that the levy attaches to (for example, fire policies only rather than all risks). There is merit to a building only-attachment at the residential level, given our argument for alignment with the EQC premium levy below and indications from Government that contents cover will be removed from EQC cover following the parallel review of the EQC regime. On commercial policies, however, it would be unfair for building owners to subsidise fire and non-fire callouts related to machinery, plant and other commercial property that are not 'buildings'. It would therefore be less equitable. In terms of perils, while it would be more equitable to attach the levy to policies covering fire only, it is subject to gaming through split policies and other levy minimisation mechanisms. A levy attaching to certain perils would therefore be more distortionary.

6 Subject to certain exceptions, which we note below at paragraphs 45 and 56-59.

32. With the qualifier that a levy on insurance will inevitably create incentives for insureds to avoid or minimise their levy payment, we submit the only way levy could be avoided or minimised under an all perils attachment to all material damage sums insured would be for the insured to underinsure. The disincentives of underinsuring would, in our view, outweigh the incentives of underinsuring simply to minimise levy payments.

33. We also support attachment to the sum(s) insured because:
    - It is the simplest option for insurers to administer. It is the easiest to calculate, which also makes it certain and predictable.
    - Simplicity and clarity makes it easier for the Commission's auditors to monitor and predict.
    - Insurers offering replacement value insurance already have an interest in ensuring the property is adequately and accurately insured, as closely to the 'true' replacement value of the property.

34. We do not support attachment to the premium because premiums are less certain and predictable than sums insured. The revenue stream for the Commission will fluctuate according to the vagaries of the insurance market and in particular whether the insurance market is 'hard' or 'soft'. In a soft market with surplus capital available to reinsure, the cost of insurance goes down for insurers. This means for retail insurance that premiums drop, competition increases and underwriting standards change. If the levy attached to premiums, a soft insurance market would cause difficulties for the Fire Service and put more pressure on other sources of Fire Service revenue (such as a Crown appropriation). Whether an insurance market is soft or hard is part of the insurance cycle and cannot be controlled. We note that there has been a recent softening of the Australian insurance market which has seen a significant drop in Gross Written Premium there (upwards of ten percent). Other vagaries that affect the premium an insurer charges to the insured include how global financial markets are performing (to account for insurers' returns on their investments) and the cost of reinsurance. Finally, domestic competition between insurers can significantly impact premium. The recent influx of new entrants into the New Zealand insurance market, including Berkshire Hathaway, Chubb, Hollard and Youi is a signal of a competitive market and therefore one in which premium adjustments could be more volatile.

35. We disagree with the Department's analysis that a levy on sum insured would not incentivise the minimisation of fire risk, and that a levy on premium would mean fire-prone properties pay more, as disadvantages and advantages of those levy attachments respectively.[7] In our view the levy's ability to send appropriate risk-oriented price signals is negligible at best. We accept that people posing a higher fire risk would pay more levy if the levy attached to premium, but this difference would be marginal, especially for residential property. For commercial properties with a separate fire policy or sublimit, the fire risk may be more directly reflected in the premium and therefore more levy may be payable for riskier properties, but our view remains any price (and levy) difference would be negligible because a

[7] At pages 3 and 14 of the funding options document, above n 4,

commercial policy covering fire risks will be a small part of a larger commercial policy arrangement covering other many other risks.

36. Even if the difference were more than negligible, there is an irony in a levy attachment to premium. A remote rural property would be deemed a higher fire risk by insurers because of the absence of timely fire response services, and would pay higher premiums and a higher levy to the Fire Service as a result of that higher fire risk, but would receive the least effective service.

37. Our Members would appreciate the opportunity to meet with officials to discuss how various fire and non-fire risk factors influence pricing, particularly with regard to the various levy setting options being considered by the Department.

If the levy stays on insurance, it should apply as a fixed rate

38. A fixed rate levy remains appropriate. We support the Department's analysis on the advantages of a fixed rate.[8]

39. We expect the rate would need to differ for residential and commercial property. Whatever rate the levy is set at, the source of levy revenue should match the Fire Service's costs to the greatest degree possible. In other words, the cross-subsidy of Fire Services costs with levy revenue that does not relate to those costs should be minimised as much as possible. By way of example, levy revenue on residential property is grossly disproportionate to Fire Service expenditure on residential property. The (cap and) residential property levy rate should be reduced to ensure that residential property insureds are not paying for activities that are unrelated to protection of residential property.

40. We are opposed to a variable rate for the same reasons outlined in the Discussion Document. Complexity aside, some of our members have advised us that their current IT systems would simply not be able to accommodate a levy charged on a variable rate. The costs associated with investing in totally new systems to accommodate a variable rate would, in our view, far outweigh the benefits. We also support consistency with the way EQC premium will be charged on insurance which, we understand, will remain a fixed rate.

If the levy stays on insurance, it should be capped for residential property and uncapped for commercial property

41. A residential cap remains appropriate. We support the Department's analysis on caps.[9] We note that property values and income levels are discordant, especially in Auckland. Some insurers note that higher value properties have a lower risk of fire, and so it would be fairer to those property owners to not have to pay disproportionately high levies. We also note the

[8] At pages 15-19 of the funding options document, above n 4.
[9] At pages 15-19 of the funding options document, above n 4.

costs to the Fire Service of attending a residential callout should be relatively stable. The costs of attending a fire at a lower value home are not lower for the Fire Service.

42. The level at which to cap the levy remains contestable. We understand that the Department is obtaining more modelling about the pros and cons of different cap settings and we would appreciate copies of any information or advice the Department receives in this respect. In our view the level of the Fire Service levy cap must be equal to the level of the EQC premium cap. The funding aspects of the existing EQC and Fire Service legislation are interwoven. Insurers' systems are historically interwoven for this reason. There would be large system change costs to insurers in disentangling the level to which EQC and Fire Service levies attach to insurance.

43. Irrespective of whether there is a higher residential cap in place or not, we submit that the residential rate must be reduced substantially to prevent the unfairness of residential consumers of insurance from subsidising Fire Service costs that are not related to residential property.

44. We support an uncapped commercial levy primarily for simplicity and ease of administration. We note the NZIER recommended of a two-tier abating rate for commercial property[10] and submit that while this would be a fairer levy, NZIER's advice was provided in the context of a funding regime that was fairer overall: that is, a levy charged on property through rates rather than on insurance. In a system that is inherently unfair anyway, we support a simpler attachment that minimises administration costs for insurers and insureds. Some of our members also argue that it is fairer for commercial property owners with large portfolios to pay more simply because they have more property at stake.

The levy must be removed from motor vehicle insurance

45. We strongly support a removal of the levy from motor vehicle insurance and on to motor vehicle registration. We support the reasons given by the Department that funding from motor vehicles is fairer (through collection from a wider funding base), avoids the 'free rider' problem (through ensuring those who don't buy comprehensive motor insurance contribute to the fire service's revenue) and is more transparent.

46. We would also add:
    - Fire Service attendance at motor vehicle accidents is primarily to protect the people, not the insured property (the motor vehicle).
    - The significant reduction in ACC charges would make a transfer of Fire Service costs to motor vehicle registration affordable because of the small impact on registration costs such a levy for motor vehicle callouts would have.

[10] See NZIER's report "Funding the Fire Service Levy on commercial real property" 9 May 2014. NZIER recommended given the large spread in values of commercial properties and commercial property portfolios that lower value commercial properties should be charged a fixed amount up to a cap, which would ensure that lower value properties were treated equitably amongst one another, and higher value properties above that cap would not be disproportionately charged.

47. As noted above a collection through motor registration would need to match the Fire Service's total costs in attending motor vehicle incidents to the greatest extent possible to be fair and equitable. For example, for the 2012/2013 financial year motor registration collection would need to come as close to $34.1 million as possible.

48. We do not accept, without more detail, that a switch to the NZTA revenue collection model would be significant or, more to the point, more significant than asking private insurers to be the revenue collection method for funding the motor-vehicle related aspects of the Fire Services.

49. Proliferation of electric vehicles and driverless cars are a significant disadvantage to the levy remaining on insurance or funding through road user charges or fuel excise. Use of these forms of private transport are increasing offshore. Transport Minister Simon Bridges has recently been promoting New Zealand as a potential leader in electric and driverless car technology.

50. The disadvantage of road user charges and fuel excise is evident in a country where the use of electric vehicles increases. Such a levy would not be universal to motor vehicle users and would also create an unfairness for drivers paying road user charges and fuel excise.

51. An uptake of driverless cars in New Zealand could fundamentally change the motor vehicle insurance line of business for the insurance industry, which could have a significant impact on that line of revenue for the Fire Services. Because humans would no longer be in control of vehicles, individuals would no longer be legally responsible for vehicle accidents involving damage to their car and damage to third parties. This means first party indemnity insurance for motor vehicle drivers may not be necessary, so we would see greater underinsurance by car owners as a minimum. Manufacturers of driverless cars may have liability to the owner of the car and to any third parties if a fault in the car caused an accident, but the levy does not attach to manufacturer's liability insurance products.

52. We have provided this example to illustrate the problem with attaching a levy to a product that is subject to market forces and change over time, with a practical example that may pan out in the foreseeable future. In our view this underscores why general taxation remains the best option for funding the Fire Service.

Whatever option, the Department should strive to simplify administration and compliance

Simplifying what the levy attaches to will assist compliance

53. We note that much of the complexity of administering the current levy relates to the difficulty of figuring out what the levy attaches to and what it does not attach to in terms of insurance products and the assets insured under those products. For example, hay is levied when in a barn but not in an open field. This is typical of the Schedule 3 exemptions to the Act which are simple in theory but difficult and costly to administer in practice.

54. A simpler way of determining what the levy attaches to will be easier for insurers to administer. Simplicity will also make the Commission's audit function easier and its revenue stream more predictable.

55. To ensure simplicity, we submit that exemptions from levy attachment should be minimised as much as possible. In our view there needs to be a clear case for exemption where the benefits of exemption strongly outweigh the costs. The following paragraphs contain three examples of areas where we think the benefits of exemption strongly outweigh the costs.[11]

56. With this in mind, we submit that forests should continue to be exempt from the levy. Our members strongly support the separate regime for funding the costs of forest fires through the *Forest and Rural Fires Act 1977*. The existing user-pays funding mechanism for forest fires is more equitable than a levy on insurance covering a forest would be. Many private forests have sophisticated fire parties who are well-equipped and well-trained, and have robust plans to fight forest fires. We also note there is difficulty accurately valuing a forest for sum insured and levy purposes. Forest value fluctuates according to marketplace forecasts of prices of wood, and owners of forest blocks will often own different forests of different ages but insure them under the same insurance policy. This would make insurance-based levy revenue for forests uncertain. Finally, a large number of forests are uninsured, such as national parkland forests owned by the Crown through the Department of Conservation.

57. Determining whether the levy attaches to certain risks covered under marine insurance policies is also problematic and currently inequitable. The levy attaches to trailer craft but not marina-based craft, even though the Fire Service would attend fires at both types of craft. We are also aware that brokers have incentives to minimise levy for clients who are exporters. If export stock is insured under a marine throughput policy it is exempt from levy, but if it is insured under a material damage policy then levy is payable.

58. Applying the levy to all property covered by a material damage policy against all perils would include marine cargo while in international waters, which is obviously outside the scope of the Fire Service's bailiwick and would make levy on that broad basis inequitable in the absence of an exemption. We note that some ports and marinas have firefighting facilities of their own to manage their fire risk. In our view there is a case for exempting marine insurance policies from the levy and replacing it with a user-pays type recovery for callouts in like fashion to the forestry example above.

59. For similar reasons, we submit an exemption for travel insurance would be warranted.

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[11] The fourth area would be motor insurance which is covered at paragraphs 45-52 above. We expect a specific exemption would be required from a levy that attached to all material damage policies, unless the levy only attached to all buildings insured under all material damage policies.

Insurers should be allowed to comply with the legislation by electronic means

60. We wrote to the Fire Service Commission on 12 May 2015 to ask that it permits electronic compliance with the audit provisions of the Fire Service legislation.[12] We have not heard back from the Commission to date. Our view is the *Electronic Transactions Act 2002* permits electronic compliance with the audit provisions, though we seek clarification of this point for certainty. Insurers should be allowed to comply with legislation by keeping electronic rather than paper records. Insurers are moving towards business models that rely on electronic technologies, processes and record keeping. E-business improves efficiency and reduces the costs of record keeping. Having paper-based compliance requirements seems out of place in a jurisdiction with access to an increasing reliance on modern technologies. And, of course, reducing insurers' business costs will reduce the cost of insurance.

61. We expect that an attachment to sum insured would mean that the requirement to obtain a valuation as part of the Fire Service statutory declaration is no longer required. We note that the need to obtain a valuation and make a statutory declaration is costly and expensive for policyholders, and complex and costly for insurers to administer. We would appreciate confirmation that a valuation of insured property would no longer be a requirement of the Fire Service legislation and that, as argued above, compliance with Fire Service legislation can be done electronically.

Fire Service levy changes should align with EQC premium changes

62. We understand a review of the Earthquake Commission is forthcoming from Government. We also understand this review may include changes to the premiums payable to the Earthquake Commission under their empowering Act. Those 'premiums', like the Fire Service Levy, are another direct tax on insurance products.

63. We submit that the lead-in to any changes made to the Fire Service Levy should align with the lead-in to any changes to the Earthquake Commission's premiums. Aligning these two sets of changes will reduce the time and cost for insurers to comply.

Insurers need time to comply with changes

64. Finally, we note that most insurers will need 9-12 months lead-in time to comply with any new Fire Service Levy legislation. This timeframe will differ slightly depending on how much change is made to the legislation and how simple the amendments are to understand, test and comply with. As a generic guide to officials, our members have compiled a list of necessary compliance activities that insurers will need to carry out to comply with the new regime. That list is appended to this submission as 'Appendix A', and includes:
    - Changing internal systems and processes including IT and finance systems.
    - Changing documentation.

[12] Specifically, sections 48-51A of the *Fire Service Act 1975* and the *Fire Service Regulations 2003*.

- Allowing time for insurers to send out renewal documentation that complies with the new regime.
- Educating staff.
- Educating distributors.
- Aligning governance arrangements for appropriate signoff.
- Testing changes.

65. Allowing additional time for compliant renewals to be sent to insureds is particularly important. Insurers usually distribute renewal documentation in the three months leading up to the insured's renewal date. If the renewal date is, for example, the day after the date the legislation comes into force, the renewal documentation needs to have an accurate calculation and explanation of the new levy for the insured, which means the insurer's compliance programme needs to have been completed three months beforehand.

66. As a side note, while renewals dates occur throughout the calendar year, the months of March and June are traditionally much larger than other months of the year. Our members would prefer to avoid a situation where the new regime comes into force in one of these months.

67. We also note the concurrent EQC review and the potential for changes to the way EQC premiums (which currently attach to insurance and we expect will continue to do so) under the EQC legislation. Depending on the extent of changes to EQC premiums, insurers will have a similar workload to implement changes to comply with the new EQC premium collection regime. Having this dual workload will add additional stresses to insurers' resources. We submit that Government must be mindful of the doubling up when setting the lead-in time to when the legislation comes into force.

68. Finally, for clarity, we submit that any levy changes should only apply to new contracts of insurance and renewed contracts of insurance entered into after the date the new legislation comes into force. The legislation should not apply to changes to existing contracts of insurance. The cost to insurers of having to calculate additional levies for existing contracts of insurance (where, for example, a new endorsement covering new property is added to the policy) would far outweigh the benefits.

Whatever option, the realities of collection should be accounted for

Insurers should be compensated for collecting the levy

69. Insurers are compensated for collecting the Earthquake Commission premiums to acknowledge the administrative costs suffered by insurers. We submit that the same should apply for insurers' collection of Fire Service Levy, and insurers should be compensated for Fire Service Levy collection. We have previously estimated the costs of collection for insurers to be $2.5 million per annum in the aggregate (across all insurers).[13] This estimate was a preliminary estimate, and did not include the substantial costs that arise for insurers while they await

[13] Letter from ICNZ to the Minister of Internal Affairs, dated 12 November 2013.

payment from brokers and insurers, which is outlined in more detail below. We would support alignment with the EQC reimbursement practices. Both taxes are unique to insurance and both should therefore be acknowledged with payment for collection.

70. We reject any suggestion that insurers are receiving significant interest on levy payments from the start of the contract until that levy money is paid on to the Commission. This should not be used as a reason against compensating insurers for collection of the levy. For brokered business (which makes up the overwhelming majority of insurers' commercial business), any delays in payment between the start of the policy and the date of payment to the Commission do not originate with the insurer, they originate with the broker. The insurer does not have the insured's premium during this period; the broker does. Typically, the insurer will pay levies within two months of inception of the insurance contract, but does not receive payment from the broker until the third month after inception. In effect, the insurer is incurring interest on the debt due for that one month. We explain this in more detail below.[14]

71. For direct (non-brokered) business, our members have collectively estimated that between 56 percent and 90 percent of their direct business (depending on the insurer) is paid for by instalment – either quarterly or monthly – rather than annually and up front. For premiums paid by instalment, the insurer still pays the levy up front even though the insurer is drip fed the levy through the insured's instalment payments. Having to wear the costs of this debt on behalf of the insured creates significant cash flow costs to insurers.

Insurers should not be penalised for brokers' late collection and payment

72. The *Fire Service Act 1975* penalty regime for late payment or non-payment levy applies only to insurers. But for intermediated business, the insured's broker collects insurance premium from the insured to pass on to the insurer. If the broker is late in paying the premiums on to the insurer, and the insurer incurs a late payment fee from the Commission, then the insurer is being penalised for the broker's delay. It is patently unfair to penalise insurers for non-payment of the levy under the Act where the broker is responsible for non-payment.

73. We submit that for brokered business, the broker should be responsible for collection of the levy and payment to the Commission.

74. Irrespective of who is responsible for collecting the levy, we submit that the rules about when the levy attaches and what the penalty regime is should be revised. Currently the levy is a debt due from the inception of the policy. We submit that the debt should only be due from the point that the insurer receives payment from the insured. The reason is that it often takes some time after the insurance contract has incepted before the insurer receives payment of the premium and can on-pay the levy to the Commission.

75. For example, an insured can enter into a policy on standard terms and seek variations or endorsements which affect the final premium. It often takes a number of weeks to iron out

[14] See paragraph 74 below.

the specifics of cover including any endorsements or extensions to cover, and for the insured to disclose all material information or provide all necessary documents (for example, a registered property valuation if one were required). The final premium will usually be set and due for payment on the 20th of the following month. The broker will then pay the insurer the month after, which makes a total of three to four months after the policy was incepted, depending on the length of time taken to negotiate terms and provide documentation, and the length of time for the broker to pass the money on to the insurer.

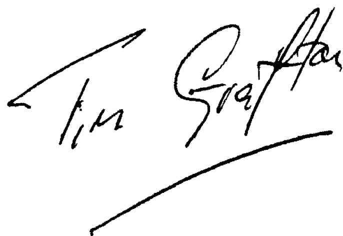
76. We note that brokers currently have an incentive to retain the money paid to them by the insured for as long as possible to earn interest on the insured's money before on-paying to the insurer. The same incentive does not exist for insurers because of the penalty regime.

77. Finally, the Act's penalty regime is draconian and should be removed. The penalties are far out of step with Inland Revenue's late payment regime, which in our view should be used as a basis for the Fire Service levy given the Fire Service is a public good. It is inconceivable that a levy regime used to fund the Fire Service should have harsher payment terms than the mechanism that collects revenue for the Crown and keeps Government running. To illustrate, we have appended as 'Appendix B' a calculation of what $10,000 paid one year late to the Fire Service, as compared to Inland Revenue, would generate in terms of late payment penalties. Finally, we note that, unlike Inland Revenue, the Fire Service does not allow any grace for honest mistakes where the insurer has unintentionally missed payment of levy and has declared this to the Fire Service.

Next steps

78. Thank you again for the opportunity to submit. You can contact our Chief Executive Tim Grafton on (04) 495 8001 or tim@icnz.org.nz, or our Legal Counsel Nick Mereu on (04) 495 8008 or nick@icnz.org.nz. We look forward to hearing from you.

Yours sincerely,



Tim Grafton
Chief Executive

Nick Mereu
Legal Counsel

APPENDIX A: COMPLIANCE WITH CHANGES TO THE LEGISLATION

This appendix lists some of the tasks that insurers will need to carry out to comply with any changes to the levy provisions of the *Fire Service Act 1975* and estimates of timeframes required to complete those tasks. Please note the time estimates are the shortest possible timeframe for most insurers to comply, rather than 'ideal' or 'comfortable' compliance timeframes.

Please note that these timeframes are cumulative rather than concurrent. Systems changes need to happen before testing, which needs to happen before training and communications, et cetera.

Systems: 6-9 months

- The typical number of different systems used across various distribution channels may be ten or substantially more for larger insurers.
- A typical change to the Fire Service Levy rate takes around 3 months to implement. Note this is just changing the levy rate not the underlying method of calculation.
- Given the additional system changes that will be needed, this is expected to need at least 6 months of development and testing.
- Decisions will also need to be made on how to manage changes to policies that were in place before any changes – what rates, insured value, caps, etc. are to be applied to any mid-term changes to these policies? This could impact the complexity of the system changes.
- Documentation changes will be needed over and above system changes to advise customers of these changes and show the new levies on the policy schedules.

Run-in time: 3 months

Renewal are sent out well ahead of their renewal date, allowing customers time to consider their renewal requirements. We need to allow for a 3-month run-in time for renewals that are in progress before the changes go live.

Broker systems: 3 months

- Communicating with brokers on the details of the changes.
- Brokers changing their own systems.
- There are up to three or more broker connectivity systems all used by a number of insurers.
- There would be conflict and resourcing issues with third party providers of connectivity systems when a number of insurers want these systems changed at the same time, which would cause delays in itself.
- Insurers and Brokers would need to test the integrated changes between themselves.

Training and Communication: 3 months

- Communicating with customers on the pending changes and any potential impacts.
- Training of front-line staff on the details of the changes, updating Guidebooks and managing customer queries.

Finance: 3 months

Confirming and implementing changes in the finance area, with regard to the changes, timing and actual payments.

APPENDIX B: COMPARISON OF FIRE SERVICE AND INLAND REVENUE PENALTY REGIMES

The table below compares the penalties for late payment of $10,000 between the Fire Service levy penalty regime and the Inland Revenue penalty regime. We understand overdue Fire Service levy is charged at 1.5 percent interest per month, with a surcharge every 6 months of 10 percent plus GST. For Inland Revenue, an initial 1 percent late payment penalty is charged on the day after the due date, a further 4 percent penalty is charged if the amount is still unpaid at the end of the 7th day from the due date, and for every month the amount owing remains unpaid, a further 1 percent incremental penalty is added.

	Fire Service penalty regime		**Inland Revenue penalty regime**
Month	**Interest**	**Surcharge**	**Interest**
1	150.00		100.00
2	152.25		101.00
3	154.53		102.01
4	156.86		103.03
5	159.21		104.06
6	161.60	1093.45	105.11
7	164.02		106.16
8	166.48		107.22
9	168.98		108.29
10	171.51		109.39
11	174.09		110.47
12	176.70	1195.63	111.57
	1956.24	2289.08	1268.29

For $10,000 outstanding for 12 months under the Fire Service penalty regime, a total of **$4245.32** in penalties is payable. This equates to a **42.45 percent per annum** interest rate.

For $10,000 outstanding for 12 months under the Inland Revenue penalty regime, a total of **$1268.29** in penalties is payable. This equates to a **12.69 percent per annum** interest rate.