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URGENT

4 March 2016

[INSERT MINISTER NAME]
[INSERT MINISTER TITLE]

Emailed to: [INSERT MINISTER EMAIL ADDRESS]

Dear [INSERT MINISTER NAME],

RE: Funding the Fire Service for its road safety related activities

Summary of our letter

Cabinet will shortly consider options for funding the New Zealand Fire Service ("NZFS"). We understand one of those options will be an extension of the current levy on private motor vehicle insurance policies, to include all third party liability ("TPL") insurance policies.

We strongly urge you to reject this option because:

- A levy on motor vehicle insurance is not a viable medium-term option to fund the public good the NZFS provides because of imminent disruptions and innovations to the transport and insurance sectors.
- An extension to levy TPL policies will be costly, complex and uncertain, and will lead to unintended consequences.
- Funding NZFS' road safety-related activities through motor vehicle registration ("rego") is the best option because it is fairer, simpler, more efficient to administer, more adaptable, more transparent, aligns with ACC and reduces cost to business.

We outline our reasons in more detail below.

Background information

NZFS is currently funded through a levy on all private property insurance policies. ICN's long-standing position is that the Fire Service is a public good and should be funded by the public instead of levied from those who insure property. However, we acknowledge Cabinet's decision to rule out removing the levy from private insurance policies at this time.

Cabinet invited submissions on removing the levy from motor vehicle insurance in a public discussion document released by the Department of Internal Affairs (DIA) last year. That document investigated two options. One was essentially the status quo. The other removed the levy from all motor vehicle insurance. Removing the levy from motor vehicle insurance was officials' preferred option. Initially, officials favoured funding NZFS road response costs – which save lives and minimise injuries – from the National Land Transport Fund (NLTF). The alternative was to fund NZFS road response costs from road user charges and, most appropriately, rego, which is used to collect the ACC levy to fund road accident costs.

We understand Minister Bridges does not favour funding the NZFS road response from the NLTF because of a desire to prioritise expenditure on road infrastructure.

The annual size of the NLTF is over $3 billion. Annual NZFS road response costs are only $34 million and could be funded either from the NLTF or, if not, the rego. The NZFS response is to save lives and assist the injured, not to recover the vehicle. The Ministry of Transport estimates the annual social cost of fatal and injury crashes in 2014 to be $3.47 billion. The social cost of each fatality it estimates at over $4 million, each serious injury, $430,000 and each minor one at $23,000.

We understand a new option that has not been consulted on publicly will be presented to Cabinet. This option proposes to extend the levy from comprehensive motor vehicle policies to include third party liability ("TPL") insurance policies. The only feasible reason for this is to reduce the free rider problem where only insured drivers pay the NZFS public good costs for all road users. As we outline below, this creates more significant problems and the rego option captures all road users and so is more equitable in addressing the free-rider issue.

We oppose this new option in the strongest possible way and urge Ministers to consider applying the NZFS cost on rego if the option of funding it from the NLTF is not adopted.

About us

ICNZ represents 28 general insurers, who insure over $600 billion worth of New Zealand's assets.

Reasons why rego is the best option for funding NZFS' road-related activities

We submit the key arguments for funding the NZFS through rego are:

1. Rego is fairer, as all road users would be paying for NZFS road-related activities, which are a public good. Comprehensive insurance is only taken out by 79 percent of road users, meaning there is a free rider problem as mentioned above where the insured road users are subsidising the costs of uninsured road users.

2. It reduces cost to business, as all motorists would share the cost of the NZFS, not just 79% of road users.

3. It is simpler and more efficient for one central agency (that already collects and distributes road-related revenue) to administer than for multiple private insurers (that have different

systems and levels of resources to dedicate to compliance) to individually collect and distribute those funds.

4. Rego aligns with ACC. The significant reduction in ACC charges would make a transfer to rego affordable. As the levy only needs to fund $34m worth of NZFS road-related activities, the impact on registration costs would be minimal. Further, road accidents are funded through rego, so it makes sense to fund road emergencies attended by NZFS to save lives through rego too.

5. Rego is adaptable, as NZFS activities would be funded by all users and not dependent on existence of motor insurance or demand for traditional fuels that fuel excise is taken on.

6. Rego is transparent, as road users can see the exact itemised cost of their NZFS contribution when they go to pay rego.

7. NZFS attendance at motor vehicle accidents is primarily to protect the people, not the insured property (the motor vehicle). This puts the levy at odds with the product it is levied on.

Problems with levying motor vehicle insurance policies generally

Continuing a levy on motor vehicle insurance policies will seriously impact NZFS funding in the medium term. This is because of changes to the transport sector and the insurance sector in general, and digital disruption and innovation in those sectors in particular. These changes make reliance on a private market to fund a public service unreliable.

Those changes are:

1. Digital disruption will change transport and insurance as we know it. It is already changing the nature of risk and insurance markets rapidly.

2. The problem is acute for motor vehicle insurance. 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.

3. 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.

4. Alternative insurance products, such as manufacturer's warranty, personal accident and baggage and cyber insurance, may be developed and prevail in a market with reduced motor accidents and thefts. It is very important to be prepared for these sorts of changes because of how heavily regulated the transport and insurance sectors are.

5. Warranties are not currently considered to be insurance contracts by the Reserve Bank, which could mean a large section of "insurance" goes relatively unregulated.

6. The Minister of Transport has recently promoted uptake of ridesharing technology in New Zealand, where multiple road users can hire a car off the owner for a period. Increased ridesharing will mean the total number of users of the road remain but the number of insurance policies will decrease. Careful attention will need to be paid towards whether appropriate insurance cover is available for private motor vehicle owners who lease out their vehicle from time to time. Insurers have been historically reluctant to mix and match personal and commercial risk insurance policies. Some work will need to go into ensuring a smooth transition to a ridesharing future from an insurance and transport perspective.

These changes mean a levy on motor vehicle insurance policies is the worst revenue stream for funding NZFS' motor-vehicle related activities when compared with the NLTF and rego options.

Specific problems with levying third party liability insurance policies

We also note the following specific problems with extending the levy to include third party liability ("TPL") insurance policies, which only 10% of drivers take up:

1. It will increase the cost to business. Insurers selling motor insurance would all need to change their IT and administrative systems and add resources to administer this change to the levy, instead of one central agency making changes to its one system to accommodate a levy on rego. This will disproportionately affect most insurers, who have medium-small sized businesses, and who do not have existing resources to absorb the system changes as easily as our largest insurers.

2. It will be complex to define and create uncertainty. TPL policies are liability policies, not property policies. They cover the driver (liability to third parties), not the vehicle (the property). This poses three problems:
    - First, a levy on TPL is conceptually at total odds with a levy for the rest of NZFS' activities, which will be levied on property insurance policies.
    - Second, many other types of non-motor vehicle liability insurance policies would be unintentionally caught if the levy focussed on liability. Types of policies that could possibly be caught are inbound student travel insurance, corporate travel insurance and expat corporate travel insurance. This would create undue complexity and cost to administer, and reduces transparency.
    - Third, the levy would easily be avoided by designing multi-risk liability insurance policies that are not specific to motor vehicles. There are already examples of insurance brokers having incentives to avoid the levy, as seen in the *IBANZ v NZFS* litigation.

3. A levy on TPL policies will be distortionary and less equitable. TPL policies are usually taken out by young drivers with low-value cars who cannot afford the premium of a comprehensive policy. This poses two problems:
    - By failing to spread the costs through levying 90% of road users rather than 100% of road users, a disproportionate share of costs will be borne by an additional group who can least afford it.
    - Adding cost to insurance policies taken out by low incomes earners for low value cars will mean less people insure.

Concluding remarks

The criterion added by DIA officials after public consultation had closed ("the impact of reform on other government funding regimes") is a relevant consideration, but does not outweigh the adverse impact of expanding the levy to third party motor, and should not be weighted so heavily as to swing officials' advice on all other considerations, which shows clear benefit from removing the levy from motor insurance.

We strongly urge you to reject a levy on motor vehicle insurance to fund NZFS.

We strongly urge you to reject making the current situation worse by extending that levy to include TPL.

In our view, rego is the best option.

The Cabinet could consider requesting a good faith gesture by motor insurers to meet the one-off cost of transferring the collection of NZFS road response costs to the rego or other road user charges.

Yours sincerely,

Tim Grafton
Chief Executive