Submission

By

INSURANCE BROKERS ASSOCIATION OF NEW ZEALAND INC

To

Fire Review Panel
Department of Internal Affairs

On

Fire Service Review

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INTRODUCTION

The Insurance Brokers Association of New Zealand Inc (IBANZ) is the professional body representing the interests of virtually all general insurance brokers in New Zealand. Membership consists of 150 member firms employing approximately 2,000 brokers and risk managers. Insurance brokers handle over 90% of commercial insurance and a significant proportion of domestic insurance in New Zealand. Our members act for clients advising on risk management and where appropriate arranging insurance.

We have consulted with our members before preparing this submission and received their support for this submission to the Fire Review Panel.

IBANZ confirms it accepts the invitation to appear before the Fire Review Panel in support of this submission.

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EXECUTIVE SUMMARY

IBANZ welcomes the opportunity to participate in the Fire Service Review. We believe that a serious disconnect exists between the realities of fire service operations today and the legislation under which its operations are funded. We would make the following brief comment on each part of the review; our main submission will concentrate on funding.

Outcome 1: Fire service functions and operating platform

We believe that it is absolutely essential for the fire service to have a clear mandate and operating platform for the functions they perform. The demands of the community have widened the scope of the fire service far beyond that which applied 30 or 40 years ago. There is a need to recognise where this service now fits within the overall emergency services.

The fire service cannot be run entirely separate from other emergency agencies and providers it should operate within an overall co-ordinated management and funding framework.

Outcome 2: Effective and efficiently organised fire services

IBANZ fully supports the aim of organising the fire services in the most effective and efficient manner.

Outcome 3: Fire service funding

IBANZ has been involved in previous reviews which regrettably have failed to implement solutions. The problems with the current funding regime have been clearly identified by those involved in these exercises however implementing solutions has proved too difficult.

Our submission is focused on the funding system given this is currently based on an insurance tax. IBANZ believes that this funding system is outdated, inequitable, inefficient and has become increasingly administratively difficult. The current mechanism simply does not recognise the realities of today in relation to the role of the fire service and to the structure of insurance programmes.

We believe there is a serious flaw in the terms of reference for Outcome 3. The Panel has been asked to "assess the Commission's funding base data and identify future funding options, *based primarily on a levy on insurance contracts*;"

IBANZ contends that experience here and overseas shows this model is inappropriate.

To continue funding based on insurance contracts and will fail to meet the requirement set out in the terms of reference that any future funding base be sustainable, stable, equitable and commensurate with future functions.

Fire Service Funding

The insurance industry is a major stakeholder in this aspect of the fire service as the collectors of the levy, are responsible for its calculation and on payment to the Fire Service.

The New Zealand Fire Service Commission (the Commission) and the New Zealand Fire Service (NZFS) are funded almost exclusively from a levy added to the insurance premiums. The levy applies to all property covered against fire risk.

There has been widespread agreement among all stakeholders that reform is well overdue and the issues have been clearly identified. IBANZ has consistently over many years urged government to reform the current system for the following reasons:

- Payment of the levy is based on the voluntary purchase of property and contents insurance. Therefore the payment of the levy can be considered to be voluntary

- It is possible some parties are not paying their fair share either electing to:
  - self insure or simply not insure
  - electing to partially insure or underinsure

- There is a poor relationship between risk and the levy paid

- Some parties may choose to directly insure offshore and there is the possibility levies may not be paid direct by the property owner to the Commission. We are unsure how widespread this might be but are not aware of this being a major area of non – compliance. Where cover is placed via a broker with an overseas insurer the obligation is on the broker to remit the levies directly to the Commission.

- There is no incentive for entities, being businesses or individuals, to invest in risk mitigation

Unfortunately to date the challenge to fundamentally reform the funding system has proved too difficult for government to address. However the problems are not diminishing with time, in fact they appear to be worsening.

In their recent report the Government Administration Committee noted the concerns of the Commission regarding the efficiency and equity of using a levy on insurance as the primary basis of funding.

We believe that experience here and overseas has shown that this approach is seriously flawed. It is a concern therefore that the terms of reference for this review appear to imply that future funding options should be based primarily on a levy on insurance contracts.

If we are to look at Australia it is noted that the following States have moved away from collecting levies from insurance policies (per the 2009 Victorian Bushfires Royal Commission report):

- Queensland
- Western Australia
- South Australia
- Tasmania (hybrid model)
- ACT
- Northern Territory
- Victoria – moving to a property levy in 2013

The only state that is still funded largely by an insurance tax is the NSW fire service and brigade. It should be noted that NSW has now committed to abolishing taxes on insurance.

We submit that the Australian review of their funding model found many of the same negative implications we face in New Zealand. Levies encourage non insurance or underinsurance which has serious implications for community welfare and state liability.

Criteria for future funding systems

The terms of reference require an analysis of future funding options to be looked at against a number of criteria.

1. provide sufficient funding

The Commission has identified that problems with the current funding arrangements will lead to operating deficits over the next few years. There are several factors driving the shortfall in particular the impact of the global economy and the consequences of the Canterbury earthquakes. These effects are unlikely to change in the short term.

The cost of insurance has risen because international reinsurers have come to recognise the true natural disaster exposures they face in New Zealand. Increased awareness has produced a fundamental and permanent shift in their pricing models. The result is insurance has become less affordable both for the householder and for business. The Commission's prediction that the current levy rate is insufficient for the future means further increases leading to less affordability and therefore reduced uptake of insurance.

2. be administratively simple to calculate and collect

There are issues with the collection of insurance based levies because the nature of insurance has changed significantly since the Fire Service Act was enacted 35 years ago. The complexity of insurance programmes, particularly corporate and commercial programmes, means the existing system is not simple to calculate.

All those involved in the collection and auditing procedures of the insurance levy acknowledge that it is inherently complex and lacking in clarity. It is very difficult for insurers, brokers and their clients to ensure compliance. Equally the NZFS is forced to fund an audit system to ensure compliance.

In their annual report the Commission has noted audits show an error rate of 38% in levy calculations which we believe serves to emphasise the difficulty in calculating the levy under the existing system. A tax on insurance is very inefficient because it is costly to maintain and collect.

3. be stable and predictable

Recent events in New Zealand and elsewhere have changed the insurance market here in a significant way; the changes have been described as fundamental and permanent. The experience of our members supports this view. The local market is intimately connected to the global market and therefore subject to constant change from influences outside our control.

Insurance is a dynamic industry. This is evidenced by recent events in Christchurch. The result of those events is that insurance costs for all businesses have increased significantly as reinsurers assess their risks to New Zealand and as a result of the claims paid. As a result of the insurance costs increasing businesses are reviewing their insurance programmes, assessing whether they should take less cover and/or self insure and are questioning their programme structure in order to reduce their costs. Therefore this will put further pressure on the current funding model.

4. be equitable

All of New Zealand is able to receive the services of the NZFS, only a portion of them contribute. Funding relies on those who take out fire insurance; non insurance and under insurance is common. NZFS undertakes considerable amount of non-fire related activities which essentially rely on funding from fire insurance levies.

It is patently unfair to penalise those who voluntarily purchase insurance to manage their risks. Through their responsible actions they avoid having to call on government and therefore the tax payer for financial support in the event of a disaster. Government should not make it more difficult for householders and business to act responsibly.

Unfortunately a significant number in the community choose to underinsure or in some cases not insure at all. All these people still receive the services of the NZFS; they are essentially freeloading on the system.

Motor vehicles - accidents involving vehicles are another area where there is a disconnect between the services of the NZFS and the charging regime. Rarely do the services involve fire. Rather these tend to be rescue operations revolve around the saving of life not the protection of property. Indeed rescues almost always create further damage to property rather than minimise it. This is as it should be however any motor vehicle levy for these services is more appropriately collected as part of the registration process rather than being associated with insurance.

Including the levy with registration should also result increase the overall number of vehicles paying given the significant numbers of uninsured vehicles on the road.

Risk mitigation - no recognition of risk mitigation measures taken by business are recognised in the current levy system, unlike the insurance premium rate which reflects the level of risk. Sprinklers, fire alarm systems and private fire brigades are examples of how property owners and businesses can reduce their reliance on the fire service. An equitable system would recognise these and reduce the levy. This would then encourage greater investment in such responsible actions and thus leave more funds available for these measures.

5. minimise distortions in investment decisions, insurance price and coverage

The Fire Services Act is funded by levies imposed on contracts of fire insurance with those levies being quantified on the lesser of the sum insured or the indemnity value of the property. The indemnity value is determined by valuation or declaration by the owner.

This basis of determining the amount of levies has been in place for a number of years and the “concession” available to property owners to pay levies based on the indemnity value has generally been well understood and the “rules” associated with this observed by brokers and their clients. The Commission also undertake an on-going audit programme to identify non – compliance.

The Act also provides some mechanisms for the Commission to challenge instances where they believe the declared indemnity values are insufficient as well as the ability to impose significant penalties if levies are not paid.

For a number of years there has been legal uncertainty associated with the interpretation of section 48 of the Act. This has resulted in commercial property owners adopting policy structures which have the effect of reducing the amount of levies they pay.

In 2011 IBANZ together with an insurer initiated declaratory judgement proceedings to clarify the application of the levy provisions of the Act to certain policy structures. Those proceeding were heard in the High Court in front of Justice Heath over two days on the 10th and 11th of September 2012. While the decision will not be known for several months we would suggest that the Panel take into account the outcome in their considerations.

The issues which were the subject of the proceedings are aspects which require clarity for both property owners and the Commission and have an impact in terms of the criteria for future funding of the Commission.

The current levy causes distortions in the insurance market affecting buying decisions and influencing the structure of insurance programmes.

Alternative funding systems

IBANZ suggests there are viable more appropriate ways to fund the NZFS. We suggest the following alternatives which will widen the pool of revenue and take away the voluntary nature of the current funding.

- Property tax
- Motor vehicle registration levy
- Crown funding

Property tax

This is the approach which most states in Australia have moved to or are in the process of doing so. The advantage is that it will broaden the levy base to all property owners not just those who choose to insure. The process will be simple and transparent. This has been the preferred option for Australian states where their Emergency Service Levy extends to include other emergency services as well as the fire service.

Motor vehicle levy

A motor vehicle levy would be an addition to the property tax. A levy collected on motor vehicle registrations would effectively cover the rescue services performed following motor accidents. All vehicles whether insured or not would be caught by the regime which as part of the registration process will be cost effective to run.

Crown funding

The NZFS is a core emergency fire and rescue service which IBANZ suggests should be funded from central government. First response emergency services such as the NZFS and police are vital to all New Zealand communities. As stated on Outcome 1, we believe all such services need to be co-ordinated. To ensure an efficient and effective response to emergencies the various agencies should operate seamlessly. Any gaps or overlaps in the services should be identified and eliminated.

Conclusion

IBANZ submits that the current funding system fails to meet any of the criteria against which the Fire Service Review Panel must judge future funding options

We recommend that rather than attempt to address the significant issues with the current system the panel looks at viable alternatives that will meet the criteria set out in the Terms of Reference.

Experience here and in Australia clearly shows to achieve equitable, sustainable, administratively simple and stable funding requires a very different approach to a levy on fire insurance.

IBANZ recommends funding based on property and motor vehicle registration or Crown taxation offer the best solutions. They will also positively affect the government’s liability arising out of natural disasters.