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2 May 2023

Transitional Levy Consultation
Fire and Emergency New Zealand
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Email to: TransitionalLevy2023@fireandemergency.nz

Dear Sir/Madam,

ICNZ SUBMISSION ON PROPOSED INCREASE TO THE FIRE AND EMERGENCY TRANSITIONAL LEVY FOR THE 2024/25 AND 2025/26 FINANCIAL YEARS

Thank you for the opportunity to submit on the proposed increase to the fire and emergency transitional levy for the 2024/25 and 2025/26 financial years (**Transitional Levy**).

Insurance Council of New Zealand/Te Kāhui Inihua o Aotearoa (**ICNZ**) members are general insurers and reinsurers that insure about 95 percent of the Aotearoa New Zealand general insurance market, including over a trillion dollars' worth of Aotearoa New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel, and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

Key points raised in this submission are:

- The Auditor General's Report highlights that while many of FENZ's activities are a public good (it not only fights fires but attends medical emergencies and undertakes SAR functions), the Crown's annual contribution is only $10 million out of a $661.2 million budget.
- FENZ should look for operational efficiencies before increasing the levy, or at least to mitigate levy increases.
- Risks of over collecting levy and appropriateness of large cash reserves held by FENZ.
- Any levy increase will have a material impact on the cost of motor and property insurance products that will make insurance affordability even more challenging in our now high cost of living environment.
- Insurers need a full 12-month notice lead time once any levy rate regulations are passed to undertake the required insurer system changes.

Before answering the specific questions from the consultation document, we have some general comments.

GENERAL

ICNZ supports an efficient and effective fire and emergency service that is integrated appropriately with other emergency services and properly funded. The current FENZ insurance levy is a historical anachronism that is flawed because it increases the costs of insurance (creating a barrier to uptake), is unfair because the levy is only paid by those with insurance and also pays for public good services, is out of step with the funding of emergency services here and overseas and is costly to collect. While we maintain this view, insurers continue to collect the levy effectively from their customers pursuant to the legislation and regulations. We do however maintain a keen interest in the FENZ levy design and rate given its direct impact on the prices paid by policyholders, compliance costs for insurers and their distribution partners, and ultimately on the affordability of insurance in New Zealand.

The implication of the proposed levy rate rise is that the amount of revenue received by FENZ (collected by New Zealand general insurance companies) is not keeping pace with the cost of providing all the services FENZ delivers. Yet, we note the large reserves (excess collected levies) currently held by FENZ, which reveal there have been healthy annual surpluses in recent years with revenue (levy) outstripping costs. We welcome the discussion in the consultation of what an appropriate level of reserves should be and note that this is substantially lower than the current level, which is albeit seemingly insufficient to meet the increased cost profile over coming years following the wage settlement.

We also question the appropriateness and fairness of funding the increased costs entirely through the levy on insurance and significantly raising the levy on insurance contracts when large portions of the cost of FENZ services are not related to property damage (increased activity for general services such as medical response and Search & Rescue (SAR) and false alarms).

The Auditor-General's (AG) Briefing to the Governance and Administration Select Committee 22 February 2023 asks why FENZ does not report on the cause of fires and trends in fire incidents. This would be critical information to inform fire reduction programmes and spur efficiencies. As a recipient of levy funding, FENZ should seek all ways possible to help levy payers minimise the amount or need for the levy being imposed.

Insurance companies and their policyholder customers would benefit from more knowledge around the cause of fires and better ways to prevent or mitigate the damage from fires (this would reduce the amounts being paid out by insurers and could reduce premiums for customers, especially if it led to reduced fire response activity from FENZ, thereby reducing the levy cost).

We believe this would be a welcome and key outcome for the stakeholder group that provides 97% of FENZ funding.

QUESTIONS FROM THE CONSULTATION DOCUMENT

1. Do you agree that reducing costs for the years 2024/25 and 2025/26 would compromise Fire and Emergency's ability to provide services to communities and result in a failure to meet its commitments under the agreement with the NZPFU?

   This is an assessment that cannot be made in any detail by ICNZ based on the information provided in the FENZ consultation document.

   The consultation document appears to consider only redundancies and reduced capital spend as options for cost reduction. There is no discussion of any efforts by the organisation to design and implement efficiencies into its operations or mixed options (i.e., some cost savings and/or a larger government loan and/or a greater government contribution - along with a smaller rate increase). The AG's Report for example speaks of a need to improve the FENZ procurement process, noting that contracts are in place for too long without an open market process.

   With respect to operational costs, the only analysis is to fund the pay round entirely from a cut to operational expenditure. No analysis is done on a partial cut to fund part of the increased revenue requirement. In fact, FENZ have advised that there was not enough time to do the analysis. And yet, with less access to information and understanding of the operational model, and with only fourteen business days to prepare a submission (across the Easter and school holiday period), stakeholders are expected to provide meaningful feedback on the proposal.

   The same applies to a reduction in the capital spend – no analysis has been done on a partial cut to fund part of the revenue needed and we received the same excuse of not enough time to analyse. In relation to both the rushed timeframe for consultation and the lack of analysis provided in the discussion paper it is also noted that the settlement with the NZPFU was reached in December 2022 and presumably FENZ had already realised some time before this that the scale of the increase was going to require it to materially reduce its costs and/or seek a higher levy rate (i.e., the agreement committed to was essentially unfunded) and so it should have been exploring cost efficiencies and other options since at least the second half of 2022. The Government announced on 18 December that it had provided Fire and Emergency New Zealand with additional financial support through a $75 million loan “so that a better offer could be put forward to firefighters”. It was as late as April 2023 before FENZ advised it intended to pass through the costs in a levy increase..

The Auditor-General’s (AG) Briefing to the Governance and Administration Committee asks why FENZ is not looking at efficiencies in its capital expenditure by sharing buildings. As FENZ is increasingly becoming a general first responder, should it be matching its fleet with its actual activities better? What has FENZ done, if anything, to co-locate with others such as St Johns Ambulance? What about closing older stations and co-locating in more modern ones than renovating old buildings?

Options for other sources of revenue for FENZ have not been addressed, such as:

- Seeking recovery of costs for false alarms:
    - One third (34%) of responses were false alarms.
    - It is very inefficient to spend a third of operational time responding to ghost calls without acting to disincentivise that behaviour (fines, recouping costs) and educating people on how to avoid false alarms in future.
    - The ability for FENZ to charge building owners for false alarms was removed with the FENZ Act 2017. Given that one third of responses are false alarms, consideration should be given to reinstating this ability. The previous Fire Service Act 1975 allowed the Fire Service to recover false alarm costs as a measure to promote the proper maintenance of building fire alarm systems that is important for day-to-day public safety.
- Seeking an increased contribution from Government:
    - The AG Report suggests that FENZ activities that could be categorised as “public good” have increased, especially as both FENZ and AG note that the service is responding to a wider range of non-fire damage incidents (e.g., medical emergencies, SAR).
    - The level of contribution has been fixed at an arbitrary level of $10 million for many years now without any analysis being made available of what proportion of FENZ’s activities are public goods and/or should otherwise be funded directly by central government or other sources. It means that, as FENZ costs and activities increase each year the Government is contributing proportionally less and less to the service – meaning even greater costs impact insured property owners. The Government’s share of funding for the public good activity is negligible, with FENZ levy payers expected to fund a range of public good activities without any clear rationale existing for this. To illustrate how small the fixed contribution is – the increase in GST paid on FENZ levies as a result of the proposed rate increase will be greater than the current Government contribution.[1]
    - The increased levy rate is being substantially attributed to the salary increases agreed by the Government with the Union. The Government provided a loan at that time to FENZ to support this but despite the Colgan Report[2] again identifying the extent of public good activity undertaken by FENZ, no increase in the Crown contribution was made.

The AG notes the exemption of a levy for forestry. ICNZ has advised previously that there is low uptake of

[1] If the rate increase leads to $85m more per annum in FENZ Levy being paid as predicted then this would lead to $12.75m more GST being paid on FENZ levies.

[2] Recommendations for Settlement of a Collective Agreement between Fire and Emergency New Zealand (FENZ) and the New Zealand Professional Firefighters Union Inc (NZPFU), 14 October 2022, https://fireandemergency.nz/assets/Documents/Collective-bargaining/Final-Report-PDF-Recommendations-for-Settment-FENZNZPFU.pdf

fire insurance among forestry owners and so a levy on forestry-related insurance could prove to be inequitable to those landowners who do take out insurance. ICNZ has encouraged DIA and FENZ to engage with the forestry industry to understand the level of insurance cover in place for commercial forests in New Zealand and how FENZ could respond given that many forests are inaccessible to FENZ current firefighting capability.

Insurers recognise the issues associated with removing the exemption but also that forestry is a major fire risk and one that is likely to grow in the future due to climate change. Given the limited coverage of insurance it may be appropriate for Government to explore a non-insurance solution for securing funding from forest owners to fund FENZ's forestry related activities (such as a direct levy) given that vegetation fires are a material proportion of FENZ's activities. Exempting such a large risk profile from the levy may be inequitable to other levy payers, particularly given the ability to recover firefighting costs from landowners was removed in the 2017 Act.

Again, we note the inherent failings and limitations of a funding system based solely on an insurance contract levy. As such, we feel it necessary to include an extract from our submission in 2020 on the fire service funding review (refer to ***Appendix One***).

2. Do you agree with the proposal to increase the transitional levy for the 2024/25 and 2025/26 years to fund the increased costs outlined in this discussion document?

In 2016 we expressed concern that the new FENZ arrangements would drive costs up and lead to further levy rate increases. So, while we do not welcome the proposed increase, it is not unexpected. However, the size of the increase is substantial.

FENZ carries significant reserves and, as ICNZ has previously noted in submissions, the levy is meant to ensure that FENZ is funded to meet its needs on as needed and on time basis; this should avoid excessive levies. Any excess levy should be treated as an advance payment of levy and the "reserves" should more accurately be described as "advances from levy payers". It is important that monies accounted for as reserves should be reviewed to determine whether they are appropriate, or whether some, or all, of those reserves could be applied to reduce or smooth transitional costs. As noted above we welcome consideration being given to the appropriate level of reserves and note that the level proposed is substantially lower than the current level, which is albeit seemingly insufficient to meet the increased cost profile over coming years following the wage settlement.

3. Do you agree that applying the increase as proposed is the simplest way to distribute the costs across different groups of levy payers?

Yes, it would be, however insurers IT costs to program these levy rate changes and undertake other required changes (i.e., to documentation) across all levy payer groups (Household, Motor, Commercial Property, Marine & Construction Risks) is going to cost insurers around $10 million. These costs are ultimately passed onto insured customers and so along with the direct levy rate increase further impacts the affordability of insurance.

The concern we have is the increase in FENZ levy rates will increase the cost of insurance and will make insurance less affordable for many households and businesses. The cost of insurance has risen significantly in the last few years due to the higher costs of claims brought about by increased frequency and severity of weather events and inflation as well as the increase in the residential EQC levy from 1 October 2022 in some parts of the country.

4. If you answered No to question 3, please provide details of any alternative you would recommend and why you recommend it:

Given the circumstances of the consultation and the lack of any analysis to justify the distribution of costs across different groups – we don't have any alternative to recommend at this time. Therefore, you should avoid representing limited responses on alternative options from ICNZ and others as a justification for what you are proposing.

5. Do you agree with the assumption that there will be growth in levy revenue of 2% per annum, to reflect inflation and increases to the number of policies, across all policy holder groups?

The consultation document assumes 2% inflationary growth when between 2017-2022 the growth rate averaged 3% (it was over 5% for the latest completed financial year 2021/ 2022). We are now in a much higher inflationary environment, which suggests FENZ may receive a higher level of levy income than forecast without an increase in the rate. To increase the rate could therefore mean more revenue is collected than is needed (see comments in response to Question 1 regarding excess levy collection).

This is clearly already the case (growth provides more levy than needed) as FENZ has accumulated $198 million in reserves from levy payers over the last five years.

6. Do you consider this growth projection a realistic assumption? No, it is likely to be higher.

7. If you answered **No** to question 6, please provide details of any alternative you would recommend and why you recommend it:

(See above, answered in response to Question 5)

8. Are there other ways you think the levy could be increased to recover the additional costs? Yes.

9. If you answered **Yes** to question 8, please provide details of your proposed alternative and the benefits and downsides of your suggested approach(es):

There are other ways the levy could be increased to recover the additional costs, but as noted above there is an absence of evidence to support any more nuanced approaches. There are of course other ways in which FENZ's funding could be increased to cover the additional costs.

- As noted above as well as, or instead of, increasing the levy rate the Crown could increase its direct contribution to better reflect the public good work undertaken by FENZ that levy payers are currently called on to fund. This could reduce the required levy rate increase, or if sufficiently large avoid it entirely.
- FENZ should charge for false fire alarm call outs (reinstate this ability that was taken out of the FENZ Act 2017)
- Charge landowners for rural firefighting costs associated with fires on or threatening their land (reinstate this ability that was taken out of the FENZ Act 2017). Landowners used to purchase additional liability insurance for these rural firefighting expenses for a modest premium cost.
- The levy could be removed, and all funding sourced from general taxation. New Zealand is out of step with most other countries with its fire & emergency service funding. The funding of firefighting services varies across different OECD countries and New Zealand is the only OECD country (apart from NSW Australia) that funds such a critical service from a tax on insurance. Insurance is a spend, it's not compulsory. Those that do not purchase insurance do not contribute to the funding of FENZ however they will still benefit from the FENZ protection.

10. What impacts will the proposed increase to the transitional levy have on you? (For example, do you think it could impact your insurance costs or choices, spending on other goods and services, or non-financial impacts you think are relevant?)

The 12.8% increase in the FENZ Levy will have the following cost increase impacts for residential, other property such as commercial and motor insurance. It's important to remember that gst is added to the levy amount.

- Home Insurance policies will see an increase of $13.50 in levy plus $2.02 in GST. Total increase of $15.52.
- Home contents policies will see an increase of $2.70 in levy plus $0.41 in GST. Total increase of $3.11.
- Motor vehicle policy (under 3.5 tonnes) will see an increase of $1.08 in levy plus $0.17 in GST. Total increase of $1.25.
- This means a family with home and contents insurance and an insured motor vehicle will pay an additional $19.88 per annum (including GST).
- Commercial building policy with an indemnity value of $1 million will see an increase levy of $135.00 plus $20.25 in GST. Total increase of $155.25, noting this is not capped.

These proposed levy increase will come on top of.

- Premium increases related to claims costs from the recent weather events, not just in New Zealand, but globally, and the cost to insurance companies of obtaining reinsurance on the global market is rising.
- The cost of repairs and the services of the professionals to do those repairs (such as homes, commercial buildings and motor vehicles) are increasing as the cost-of-living pressures hits the across the economy.

Has FENZ given any thought to the impact on its own funding and operations due to lower levels of insurance uptake because of levy increases of this order? Any impact on insurance uptake will not just affect FENZ revenue but will impact the vulnerability of New Zealanders.

11. Are there any other matters you consider relevant for implementing the proposed increase to the transitional levy

12. If you answered Yes to question 11, please provide details of matters you consider relevant:

13. If you are an insurer, how much time would you need to implement this change?

We consider based on previous FENZ levy rate changes and other similar changes (e.g. EQC levy rate changes) that insurance companies would need a minimum of 12 months' notice for a levy rate change. They would need to know what the new levy rate will be as part of that 12 months' notice. The 12 months' notice would be for a levy rate change only. This timeframe would not provide for any other changes to the levy design, for example changes to levy caps for residential, which would necessitate a longer period.

Insurers need at least nine (9) months to give effect to any levy rate change into their insurance systems. The levy rate changes will need to be programmed across many operating systems, including operating systems used by independent underwriting agents and insurance brokers that cover the varying classes of property business where the levy is required to be charged. As part of the operating system changes, testing will need to be undertaken to ensure the new levy rate will be calculated and be shown correctly on the customers insurance policy invoice or brokers closings. Being provided sufficient time to ensure that changes have been undertaken accurately is critical for insurers and entirely reasonable given insurers are the conduit for essentially all of FENZ's funding and are responsible for any errors in collection. Any levy calculation errors could be costly to the insurer, as if they do not collect enough, they will have to fund any shortfall from their own revenue and potentially pay penalties to FENZ, and if they collect too much they are (rightly) required to remediate their customers and potentially be subject to regulatory oversight from other regulators.

Once the levy rate programming and system testing is complete, then there is a 3-month lead time for insurance renewals via intermediaries (and up to 2-months for direct insurance) as all system work and updated documentation needs to be done before renewals can be offered/sent to the customer in advance of the renewal date (i.e. for renewals due 1 July 2024, everything needs to be completed and ready to go by the end of March 2024). This 3-month period will be the case for nearly all commercial policy contracts, and this may well be the case for domestic policy contracts that are intermediated.

If insurers were advised by 30th June 2023, at the latest, with absolute certainty what the new levy rate will be and that it will not change, then insurers would be able to collect that new levy rate from 1 July 2024. If regulations giving effect to the new rates are not issued by 30 June 2023 that gives effect to the levy rate change, then to have 12 months, insurers would be expected to dedicate resources and start investing time and money in implementing a change that is not yet law, and with increased policy uncertainty due to a General Election being imminent. This would be unreasonable and unacceptable and so if a sufficient level of certainty cannot be provided by 30 June 2023 – then the commencement period should be adjusted to provide at least 12 months from when that certainty can be provided. Government needs to engage closely with insurers over coming months leading into this key decision point at the end of June.

We understand that the approximate costs to the insurance industry for a levy rate change will be in the order of $10 million. These costs will be in addition to likely greater costs that will be required to be spent to give effect to the levy changes planned to come into effect in July 2026.

Thank you again for the opportunity to submit on the proposed levy increase. If you have any questions, please contact ICNZ's Insurance Manager by emailing john@icnz.org.nz.

Yours sincerely,

[redacted]

[redacted]

Tim Grafton
Chief Executive

John Lucas
Insurance Manager

APPENDIX ONE

Extract from ICNZ Submission on FENZ Funding Review (February 2020)

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

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

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

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

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

There are fundamental problems with using an insurance-based levy.

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

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

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

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

FENZ services have significant public good aspects

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

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

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

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

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

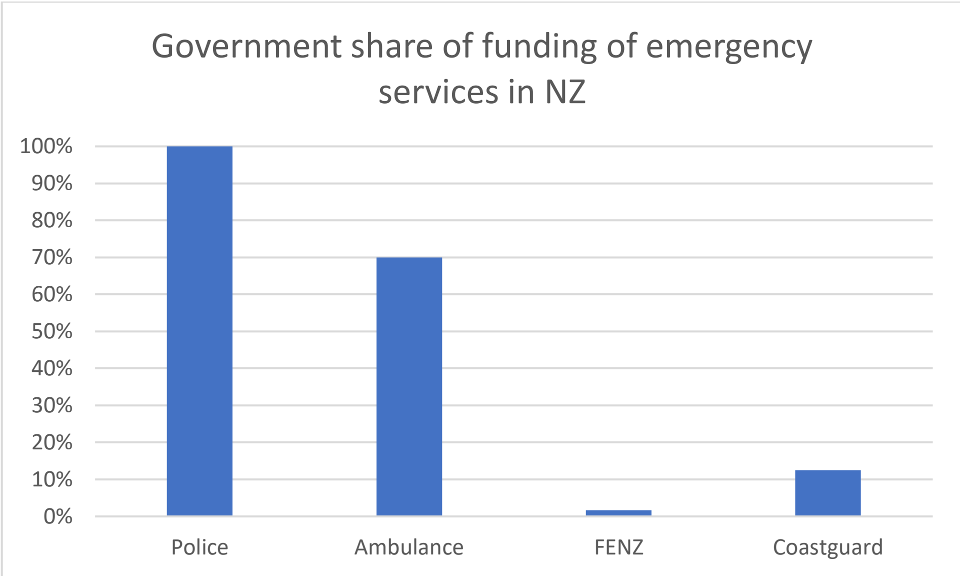
As identified in the consultation document, the funding of FENZ relying almost entirely on a levy on certain insurance policies (currently policies of fire insurance) is out of step with approaches in Australia and many other overseas jurisdictions (including the United Kingdom and certain states of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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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