SUBMISSION ON NSW GOVERNMENT DISCUSSION PAPER - FUNDING OUR EMERGENCY SERVICES

October 2012

SUMMARY

- The current Emergency Services Levy (ESL) regime imposes a tax on people who protect their property, businesses and personal possessions by insuring them. It is their taxes that pay for the fire fighting and protection services that are provided to the entire community. Ensuring that property owners pay for these services would provide for a fairer and more rational system that would spread the burden equitably.

- IAG believes that the most effective way of achieving this end, is to implement a system under which all property owners share the responsibility for funding emergency services. IAG believes that all revenue sources for the ESL should be replaced by a property levy.

- IAG contends that New South Wales is well placed to build on the experience of other States in relation to emergency services funding reform.

- IAG does not support the introduction of a charge on motor vehicle registrations as a contribution to meeting the future funding needs of emergency services in New South Wales. Call outs are not a good proxy for the overall cost of providing emergency services.

- Minimising the administrative and collection cost will be important from the point of view of ensuring efficiency of any new emergency services funding system. IAG agrees Local Government should be the preferred collection agency.

- IAG is mindful of the importance of the emergency services reform and the need to ensure that the transitional arrangements in the run up to the introduction of a property-based charge are seamless and well understood. Similarly, IAG's position is predicated on removing the risk of a 'funding gap'.

- IAG would support an audit conducted at the beginning of the transition period and one at the conclusion, to satisfy the Government and the community that the industry was contributing the full amount recovered from the ESL, and that the ESL was removed at the conclusion of the transition period.

INTRODUCTION

INSURANCE AUSTRALIA GROUP (IAG)

IAG is the parent company of an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite over $8 billion of premium per annum and paid around $6 billion in claims per annum. IAG employs more than 13,000 people of whom around 9,000 are in Australia. Across our portfolio of brands IAG insures 7.0 million cars, 2.5 million homes, 93,000 farms, 122,000 employers and 470,000 businesses. IAG had more than 16.2 million policies in force in financial year 2011.

Within Australia, IAG's Direct Insurance business provides personal insurance products as well as business insurance packages targeted at sole operators and smaller businesses in NSW, ACT, Queensland and Tasmania primarily under the NRMA Insurance brand. SGIO is the primary brand in Western Australia, and SGIC in South Australia. In Australia, IAG also has a distribution agreement with RACV (underwritten by Insurance Manufacturers of Australia – owned 70% IAG; 30% RACV) in Victoria. Products are distributed through branches, call centres, the internet and representatives.

Within Australia, IAG's intermediated insurance products are sold nationally, primarily under the CGU Insurance and Swann Insurance brands through a network of more than 1,000 intermediaries, such as brokers, agents, motor dealerships and financial institutions. CGU is also a leading provider of workers' compensation services in Australia.

IAG'S INTEREST

IAG believes the current regimes for the taxation of insurance in New South Wales, are indefensible upon the generally accepted taxation principles of simplicity, efficiency and equity. These tax regimes are inappropriate, regressive and based on historical circumstances rather than equity. These regimes contribute to under-insurance and non-insurance, with consequential negative fiscal impacts when the public purse is inevitably called upon in times of climate related disasters.

Put simply, the current Emergency Services Levy (ESL) regime imposes a tax on people who protect their property, businesses and personal possessions by insuring them. It is their taxes that pay for the fire fighting and protection services that are provided to the entire community. Ensuring that property owners pay for these services would provide for a fairer and more rational system that would spread the burden equitably.

A number of Government reviews and inquiries have argued for emergency services funding reform - the IPART Review of State Taxes (2008), the Henry Tax Review (2009), the Victorian Bushfire Royal Commission (2009), the Johnson Report into Australia as a Financial Centre Forum (2009), Tax Forum (2011), Lambert Report (2011), the ACT Taxation Review (2012) and the Productivity Commission Draft Report on Barriers to Effective Climate Change Adaptation (2012).

RESPONSE TO SPECIFIC QUESTIONS

1. Which of the following revenue sources associated with emergency services funding should be replaced by a property levy:

- **The emergency services levy payments by insurers and the associated stamp duty;**
- **Local government contributions; or**
- **The portion of emergency services funding currently provided from general NSW government revenue?**

IAG contends that New South Wales is well placed to build on the experience of other States in relation to emergency services funding reform. The Australian Capital Territory (2006–07), Western Australia (2003), South Australia (1999), Queensland (1985) and Victoria (effective 1 July 2013) have introduced funding systems for fire and emergency services that require property owners to contribute via a levy on property.

IAG believes that the most effective way of achieving this end is to implement a system under which all property owners share the responsibility for funding emergency services. IAG believes that all revenue sources for the ESL should be replaced by a property levy.

A broad-based property levy would be most equitable and efficient. The main advantage of a property-based funding system is that it is broadly based, meaning that all actual and potential beneficiaries of the emergency services contribute to its funding. This would in turn, eliminate the free-rider effect.

2. Should a property levy be raised as a fixed amount per property, as a proportion or percentage of property value, or some combination of the two?

3. Should different rates of tax be applied to different property types?

4. Should different tax rates be applied in different parts of the State? If revenue amounts are zoned geographically, where should the boundaries of those zones be?

There are a number of potential types of property-based charges that could be considered.

'Flat' levy across all properties

The simplest approach would be to apply a flat levy to all New South Wales properties regardless of value, location or use. Although relatively simple to calculate a flat levy system would have a number of disadvantages. In particular, it would be inequitable in that all property owners pay the same levy irrespective of the value of property, its use or the expectation of service.

'Flat' levy within sectors

A slightly more sophisticated and finely-tuned charging system would be to apply a different charge according to the type of property, but a flat charge within each property sector (e.g. residential, commercial etc).

For this type of system a decision has to be made as to what proportion of the total amount to be collected should be allocated to each sector. There are a number of possible allocation options.

The first option would be to allocate the funding in proportion to the amount currently collected (or assumed to be collected) from each sector. A second option would be to allocate between sectors according to a measure of rateable value such as unimproved capital value or gross rental value.

RESPONSE TO SPECIFIC QUESTIONS (CONTINUED)

For example, if the commercial sector accounts for 60% of capital value it would contribute 60% of the total funding. A flat levy would then apply to each property within the sector.

The advantages of either of these systems are:

- it is more equitable than a uniform levy for all sectors because payment is more closely related to potential benefit from fire services; and
- it would be relatively easy to administer as there is only one rate of levy within each sector and most of the information requirements, such as capital values, are already available from Government sources.

The main disadvantage is that some relatively arbitrary judgement would still have to be made about how to allocate the levy across sectors.

Differential levy system

Taking the above approach one step further, another option would be to set different levies even within sectors. Again, some decision may have to be made about the relative proportions to be paid by each sector in aggregate.

There is a range of methods available for allocating charges between and within sectors. The following methods are similar to those currently used in other States:

1. Allocate the charge between sectors according to their shares of a measure such as unimproved capital value or gross rental value, based on the same measure within each sector. The advantages of such a system are that it is relatively equitable in that each property holder pays according to the value of property at risk, and secondly the information required is already available.

2. Allocate the charge to properties according to the type of fire brigade that services that area and the level of risk for each property. This is essentially the system that is used in Queensland. Under this approach the charge for residential properties varies according to the type of brigade that services that area. Charges for commercial and industrial properties are set on the basis of the risk for each type of property.

   As with the other systems, a decision has to be made about the relative allocations between sectors e.g. the allocation between residential versus commercial.

   The advantage of this system is that it allows fine-tuning of the charges according to the potential fire risk for a particular property. It also builds into the charging structure the ‘expectation of service’ principle in that the residential charge varies according to which category of fire brigade services that property.

The main disadvantage with this approach is that it may be overly cumbersome to administer if there are a large number of categories of property. There could also be definitional issues for some properties.

3. South Australia adopted a “hybrid” system under which funding is collected from a combination of a property based charge and a motor vehicle registration levy.

RESPONSE TO SPECIFIC QUESTIONS (CONTINUED)

Apart from the aforementioned three systems, other types of differential charging would be possible. The key decision that needs to be made is the basis for allocating the amount to be collected between and within sectors. In general, a more finely tuned system may be more equitable, but it may also be more complex to administer and may also require much more information.

User pays/cost recovery

Several of the above approaches contain elements of a user pays system, although this may not be a straightforward concept to apply to emergency services because a substantial proportion of the cost of the service is the cost of equipping and maintaining the service rather than responding to actual fires and incidents. Nevertheless, it would be possible to implement a more direct user pays system in some instances.

The main example of where a direct user pays approach could apply would be in relation to emergency service requirements for industry, particularly hazardous materials. For example, industries that use or store hazardous materials could be required to pay a special levy or charge.

5. Should some proportion of emergency services funding be raised as an annual charge on vehicle registration?

IAG does not support the introduction of a charge on motor vehicle registrations as a contribution to meeting the future funding needs of emergency services in New South Wales. While the *Discussion Paper* notes motor vehicle incidents account for around 17% of call outs, call outs are not a good proxy for the overall cost of providing emergency services. The cost of providing emergency services largely reflects the fixed costs of equipment and labour to maintain a standing force.

6. Should pensioners receive concessional rates for a new property levy that funds emergency services?

Eligible holders of pensioner concession cards are currently eligible for a concession on their rates. This concession should be extended to a new property levy to cover emergency services.

7. How should the revenue target be set each year to take account of changing costs of fire and emergency services?

Given the capital expenditure that periodically creates a spike in funding requirement, it is appropriate to consider a rolling triennial funding with the revenue target set to recover an average annual amount over the triennium.

8. Should revenue from a land based levy be collected by local governments or the Office of State Revenue?

Minimising the administrative and collection cost will be important from the point of view of ensuring efficiency of any new emergency services funding system.

One option for collecting the property charge would be through a central agency such as the Office of State Revenue. This is the approach adopted in South Australia. The advantage of this system is that it appears to be administratively efficient. The feasibility of this approach would depend on the information used to calculate the charge (e.g. property values) being available to the central agency.

A further option is to collect the property charge at the Local Government level. Local Governments would need to be reimbursed for the cost of collecting the charge and the emergency services

RESPONSE TO SPECIFIC QUESTIONS (CONTINUED)

charge would need to be clearly identified on rates notices as being a State Government charge. This approach is used in Queensland and Western Australia.

The Local Government Association of New South Wales outlined in January 2003 a preferred funding model under which the proposed replacement model for funding fire services would be largely financed by all property owners. Importantly, it was proposed that "councils collect the fire services property levy on a fee for services basis. Based on the experience in other states the commission would be expected to be in the range of 4% to 5%. Councils should not be responsible for the collection of bad debts".

"Local Government is the preferred collection agency as it already uses property valuations as the basis of rates and that they maintain comprehensive data on property within their boundaries. Further, they already have billing systems in place for the collection of rates that can be easily adapted for the collection of the property levy.

While some councils may have objections to acting as a tax collector of the State Government, establishing a separate collection system would significantly and unnecessarily add to the cost of administration. It will be important, however, that the levy is clearly identified as a separate charge, being a State Government fire levy that is not determined by Council and is distinct from rates or other council charges" *(Local Government's Role in the Provision of Fire Services in NSW", A Discussion Paper, January 2003, Local Government Association of NSW).*

As the Discussion Paper notes: IPART (2008) recommended that the levy on insurance companies should be replaced by an equivalent, transparent property based levy collected by local councils.

IAG agrees Local Government should be the preferred collection agency.

9. Is a transitional period required for adjustment of the emergency services levy, and if so how should any funding gap arising from a transitional period be recovered?

IAG recognises the importance of the emergency services reform and the need to ensure that the transitional arrangements in the run up to the introduction of a property-based charge are seamless and well understood. Similarly, IAG's position is predicated on removing the risk of a 'funding gap'.

To reduce uncertainty in the lead up to the removal of the insurance tax, a two year transition period is suggested, with a fixed funding contribution by the insurance industry set at the beginning of the two year period. The industry would then have two years to phase out the ESL recovery from customers. A tapering rate which phases down should also apply during the transition. The phasing method would allow for a potentially lower average rate to be applied in year 2 of the transition which would be more equitable for insureds.

An alternative measure might be for the Government to legislate so that the premium calculation was on gross earned premium in the relevant financial year, and not gross written premium which spans financial years. This would allow insurers to recover the contribution for that portion of the insurance contract that applies to the transition year and not beyond.

IAG also proposes a quarterly monitoring of premium collection by insurers. This would entail all insurers providing the relevant NSW authority (for example, the Office of State Revenue or the Treasury) their premium collection by product type. The NSW authority could then aggregate the premium and provide that figure to insurers. This would enable insurers to calculate their market share and thereby assist them in assessing whether the rate applied is adequate to recover their contribution. This measure would also help reduce the risk of over or under collection.

RESPONSE TO SPECIFIC QUESTIONS (CONTINUED)

IAG notes recent commentary regarding the fire services levy transition in Western Australia and the potential for this to be used as a model in NSW. We note that, in Western Australia, the insurance industry provided the Western Australian Government with a loan to assist in funding the collection gap resulting from the transitional process. The insurance industry would not be in a position to provide a loan of the size required in NSW. As such, we don't believe the Western Australian model could be wholly adopted in NSW.

Still, IAG believes some aspects of the Western Australian transition model could be implemented. It should be noted that in Western Australia, at the time of the transition, the insurance industry (through the Insurance Council of Australia) maintained an advisory FSL rate under which a tapering methodology was applied. IAG believes re-introduction of an industry advisory calculation instrument is integral to smooth and equitable transitional arrangements in NSW and recommends adoption of a similar approach by the NSW Government. IAG's preference would be for the NSW Government to enact an express competition law exemption to allow an industry advisory rate to be issued as part of any transitional arrangements.

IAG believes the there are a number of other important issues which need to be taken into account in considering the transition to a property based system and notes the Insurance Council of Australia's submission outlined the following implementation and transitional issues:

- *The scope, given timing issues (council levies are paid in arrears while statutory contributions are collected in advance), that consumers may respond adversely to the possibility of paying for the fire services "twice". (ie once on their insurance premiums and shortly thereafter through the property based charge).*
- *The risk that insureds either delay or avoid renewing their insurance arrangements to "avoid" meeting fire levy obligations until such time as these levies are abolished.*
- *Similar to the above, the risk that insureds either independently or through their intermediaries, seek to "game" arrangements by "shorting" their policies at or close to the end of any transition year and renewing thereafter in the post transition year so as to benefit from the remittance of any unearned fire contribution.*
- *The risk that significant shifts in market shares by industry participants occur potentially resulting in large collection variations and the paradox of the "winners curse". (i.e where a collapsing market would artificially inflate market shares and as a consequence, contributions payments for some individual insurance providers adjusts sharply).*
- *The trade off between tapering of insurance premiums and full funding of the fire services. As the Discussion Paper emphasises, a taper which phases down on a daily basis would reduce the amount collected from the insurance industry by 50%, leaving a funding shortfall or "gap" to be funded. (ICA submission, p.13-14)*

IAG believes close collaboration with the general insurance industry is needed to ensure an orderly implementation to any property based funding system.

10. What arrangements are needed to ensure that any reductions in insurance taxes are passed on to consumers?

IAG would support an audit conducted at the beginning of the transition period and one at the conclusion, to satisfy the Government and the community that the industry was contributing the full

RESPONSE TO SPECIFIC QUESTIONS (CONTINUED)

amount assessed by the Government and that the ESL was removed at the conclusion of the transition period.

However, IAG believes any monitoring arrangements established to ensure any reductions in insurance taxes are passed on to consumers must necessarily take into account premium adjustments arising from the nature of insurance (eg rising reinsurance costs, claims cost increases and other inflation related increases) and accordingly, flexibility should be built into the terms of engagement for any monitoring by IPART.

As the Government is aware, the Sigma Plus Consulting's *Emergency Services Levy Insurance Compliance Review: Final Report* in relation to the effect of the phase-out of the Fire Services Levy (FSL) in Western Australia indicated the removal of FSL in Western Australia contributed to Western Australia having one of the most price competitive insurance markets in Australia in 2003 and consumers responded to cheaper insurance by increasing their insurance cover to more adequately protect themselves.
http://www.fesa.wa.gov.au/emergencyserviceslevy/ESL%20Docs/insurance_Compliance_Rprt_April_2004.pdf

CONCLUSION

IAG looks forward to working with the government and other stakeholders on the development of the most appropriate options to achieve the social and economic policy objectives, and to support a move towards a more equitable funding model for emergency services in New South Wales.