

# Impact Summary: Delay to commencement of sections 80 to 140 of the Fire and Emergency New Zealand Act 2017

## Section 1: General information

### Purpose

Cabinet is being asked to initiate a first-principles review of the Fire and Emergency New Zealand (FENZ) funding regime. As a consequence of that decision, Cabinet is also being asked to further postpone the commencement of sections 80 to 140 (which relate to the FENZ levy regime) of the Fire and Emergency New Zealand Act 2017 (the FENZ Act).

This Regulatory Impact Analysis (RIA) relates to the decision to postpone the commencement of sections 80 to 140 of the FENZ Act, which includes decisions about legislative amendments that would be required to make these sections fit for purpose. It does not relate to Cabinet's decision to initiate a first-principles review of the FENZ funding regime.

The Department of Internal Affairs (the Department) is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet.

### Key Limitations or Constraints on Analysis

The analysis in this impact summary is constrained by:

- Range of options considered (there are limited legislative options to address the problem); and
- The full impacts of delaying the transition to sections 80 to 140 of the FENZ Act are unknown because of data quality constraints due to the confidentiality of insurance arrangements. The costs of implementing sections 80 to 140 of the FENZ Act, and particularly the extent that these may be wasted if committed before the review is completed, cannot be fully predicted.

### Responsible Manager (signature and date):



Raj Krishnan

General Manager

Policy Group

Department of Internal Affairs

27/2/19

## Section 2: Problem definition and objectives

### 2.1 What is the policy problem or opportunity?

Cabinet is being asked to initiate a first-principles review of the FENZ funding regime (the review). This decision will have consequences for FENZ's funding arrangements.

The FENZ Act was passed in 2017. Most of the FENZ Act is currently in force. The exceptions are sections 80 to 140, which deal with the levy on property insurance that funds FENZ. Presently, a transitional levy regime applies, which continues much of the levy regime under the Fire Service Act 1975.

Cabinet has previously agreed to legislation that would delay the commencement of sections 80 to 140 to 1 July 2021, because the current commencement date of 1 July 2019 is not achievable. Complex technical amendments must be made to make these sections fit for purpose, and insurers and brokers have stated that they will then need 15 months to make changes to their systems and processes once the changes become law.

The following key dates relate to the FENZ funding regime:

- **1 July 2017:** The majority of the FENZ Act came into force, including a transitional funding regime (Schedule 1 of the FENZ Act) that continues much of the previous funding regime under the Fire Service Act 1975.
- **1 July 2019:** Sections 80 to 140 of the FENZ Act, which relate to a new insurance levy-based funding regime, are due to come into force. The transitional funding regime will cease. This is the **legislative status quo implementation date**.
- **1 July 2021:** The date when sections 80 to 140 of the FENZ Act will come into force as per the current drafting of the Fire and Emergency New Zealand (Levy) Amendment Bill (unless brought forward to 1 July 2020 by Order in Council). The Bill was introduced to the House in October 2018 and is currently at Select Committee. This is the **policy status quo implementation date**.

The timing for the review (and implementing any changes that may arise from it) will conflict with the policy status quo implementation date for the new levy regime. The review may result in recommendations for a new funding regime that will commence, at the earliest, from 1 July 2021.

Continuing with both the review and amendments to sections 80 to 140 in the same time period would be problematic because:

- Significant work on making sections 80 to 140 fit for purpose will need to be undertaken by Government, FENZ and insurers and brokers, at the same time as the review is taking place. This could jeopardise resources made available for both projects. Insurers would need to invest significant time and money to prepare for the new regime.
- Sections 80 to 140 will come into force at a similar time as decisions are proposed to be made as a result of the review. Sections 80 to 140 may then only be in force for a short period of time before the funding arrangements recommended by the review come into effect.

A RIA was not required when the decision to delay the commencement date for sections 80

to 140 from 1 July 2019 to 1 July 2021 was made, because this decision was unavoidable given the unworkability of sections 80 to 140. The Department of Internal Affairs sought and gained an exemption at that time.

The present decision of whether to further delay the commencement beyond 1 July 2021 stems from the Cabinet decision to initiate the review and is therefore not unavoidable. A RIA is therefore required.

## 2.2 Who is affected and how?

Affected parties include:

- FENZ, which is funded almost entirely by levy;<sup>1</sup>
- Insurers and brokers, who administer much of the levy collection infrastructure;
- Every party who owns a policy for property insurance in New Zealand, who pay levy on their insurance contracts (unless exemptions for fire levy apply);<sup>2</sup>
- Parties potentially liable to pay under a future funding regime.

## 2.3 Are there any constraints on the scope for decision making?

There are limited legislative options to address the problem.

There are interdependencies with the proposed review of the regime. The initiation of the review means that resource from insurers, brokers, FENZ and Government will need to be devoted to the review.

---

<sup>1</sup> In the year end 30 June 2018 FENZ's total revenue was \$612m, of which \$568m was from levy. FENZ's costs and revenue have increased following amalgamation, as it has taken on more responsibilities and the levy rate has increased from 7.6c to 10.6c per \$100 of insurance. Revenue immediately prior to amalgamation (year end 30 June 2017) was \$418m, of which \$392m was from levy.

<sup>2</sup> The levy rate on property is 10.6c per \$100 sum insured. This is subject to upper limits and special calculations for a number of items such as: residential buildings (maximum levy payable of \$106); domestic contents (maximum levy payable of \$21.20); motor vehicles (flat rate of \$8.45 per motor vehicle not exceeding 3.5 tonne gross laden weight). Commercial property is not subject to these limits, so for example the annual levy payable on a commercial building insured for \$10 million is approximately \$10,600.

## Section 3: Options identification

### 3.1 What options have been considered?

**Policy status quo implementation date:** Proceed with implementing sections 80 to 140 of the FENZ Act on either 1 July 2020 or 1 July 2021, in parallel with undertaking the funding review.

- This is the current Government intention [refer Cabinet minute GOV-18-MIN-0056].
- This option would result in positive outcomes by minimising the duration of the transitional funding regime, because the implementation date would allow time for:
  - sections 80 to 140 of the FENZ Act to be made fit for purpose, which would mean that the benefits these sections are designed to realise (a modernised, more equitable funding base for FENZ) would be able to be realised (and, if the review results in a recommendation for no change, the new regime will be ready to go); and
  - insurers and brokers to adapt their systems and products to successfully implement sections 80 to 140 of the FENZ Act.
- This option would also potentially result in negative outcomes, because:
  - Significant work on making sections 80 to 140 fit for purpose will need to be undertaken by Government, FENZ and insurers and brokers, at the same time as the review is taking place. This could jeopardise resources made available for both projects. Insurers would need to invest significant time and money to prepare for the new regime.<sup>3</sup>
  - Sections 80 to 140 will come into force at a similar time as decisions are proposed to be made as a result of the review. Sections 80 to 140 may then only be in force for a short period of time before the funding arrangements recommended by the review come into effect, if the review recommends new funding arrangements.

**Proposed approach:** Delay work on the implementation of sections 80 to 140 of the FENZ Act and postpone the commencement of those provisions to 1 July 2024.

- This option would see the commencement of sections 80 to 140 delayed to allow time for the review to be conducted. The Department considers that a delay to 1 July 2024 would give sufficient time for the review to be conducted. If the outcome of the review is that ultimately that the regime intended to be implemented by sections 80 to 140 should be implemented, these sections could then be amended to make them fit for purpose prior to implementation (this work would occur in 2021-2024).

<sup>3</sup> For example, in its submission on the Fire and Emergency New Zealand (Levy) Amendment Bill, IAG estimates that preparation for implementing sections 80 to 140 would take three months of investigation (ten staff); five months of technical build (c.75% of internal technology capability (c.150 staff)); four months of testing and deployment (more than 90% of internal testing capacity (c.40 staff)).

- This option would result in positive outcomes, because:
  - Sections 80 to 140, which are not currently fit for purpose, would not come into force;
  - Sufficient time and resource would be made available for the review to be conducted;
  - FENZ and the insurance sector would not have to adapt to sections 80 to 140 shortly before the option ultimately recommended by the review comes into force, minimising disruption for FENZ, insurers, and the general public.

**Options not considered:** Options not considered include amending the FENZ Act to remove sections 80 to 140 completely, or removing the deadline for commencement of sections 80 to 140. These options were discarded, because it is considered important to signal that transitional regime is not intended to continue in perpetuity, and that it would be poor legislative design to have no backstop for a transitional regime.

### 3.2 Which of these options is the proposed approach?

The proposed approach is to delay the implementation of sections 80 to 140 of the FENZ Act to 1 July 2024.

This option will be the least disruptive approach to addressing the problem. It will continue present arrangements until the review is complete. FENZ will continue to be funded.

## Section 4: Impact Analysis (Proposed approach)

### 4.1 Summary table of costs and benefits [N/A: see discussion in 4.2]

### 4.2 What other impacts is this approach likely to have?

Impacts of the delay to the commencement of the new levy regime are difficult to measure, because while we have information on how much levy payers are paying now under the transitional regime, we do not know exactly how sections 80 to 140 would have affected policyholders as:

- the rate of levy to be collected under those sections has not been set;
- there are still uncertainties as to the design of sections 80 to 140; and
- in some cases, liability will depend on private insurance structures.<sup>4</sup>

Likely equity gains from sections 80 to 140 (if they are made fit for purpose and then implemented) will be further delayed. The principal change that will occur under these sections will be a shift from the present levy being charged on fire damage to the levy being charged on the amount insured against physical loss or damage.

Some cost increases for some stakeholders will be delayed. For example, sections 80 to 140 would likely increase costs for some large property owners with “split perils” policies, where the property is insured for a lower sum against fire damage than for physical damage.

Other elements of sections 80 to 140 will also broaden the levy base, for example to include contracts of third party insurance on motor vehicles (currently not subject to levy), which would more fairly reflect the ambit of FENZ’s responses.

Significant implementation costs for insurers and brokers adapting their systems and processes to sections 80 to 140 would be delayed and potentially avoided.

There is a risk that the credibility of the review may be undermined by Parliament making explicit provision for the implementation of a modified insurance-based levy system from 1 July 2024. However, the alternatives were not considered desirable (see **Options not considered** in section 3.1 of this document).

Overall, the impact of the preferred option is the continuation of present arrangements until 2024.

<sup>4</sup> Due to commercial confidentiality, we do not have comprehensive information on details of the thousands (or millions) of private insurance contracts which will be subject to levy under the new regime. To assess the problem, we rely on information provided by colleagues at FENZ and from the insurance sector with detailed working knowledge of the current levy regime. Nevertheless, we cannot comprehensively assess the impact of the proposed change, as we cannot be absolutely certain of the impact of our proposal on every policyholder affected.

## Section 5: Stakeholder views

### 5.1 What do stakeholders think about the problem and the proposed solution?

FENZ and other relevant Government departments were consulted on the proposed option as part of consultation on the initiation of the funding review generally. No objections to the preferred option were raised during consultation. Wider consultation has not occurred due to the confidentiality of the primary proposal (to review FENZ's funding regime); it is not possible to separate the issue of delaying commencement of sections 80 to 140 from the primary proposal.

## Section 6: Implementation and operation

### 6.1 How will the new arrangements be given effect?

The proposed approach will be given effect by legislation.

The Fire and Emergency New Zealand (Levy) Amendment Bill is currently before the Governance and Administration Committee. This Bill will amend the commencement date for sections 80 to 140 of the Fire and Emergency New Zealand Act 2017, from 1 July 2019 to 1 July 2021. Due to the proximity of Cabinet decisions to initiate a review of FENZ's funding system to the Committee's report back date, it would be challenging to include the proposed approach in amendments recommended by the Committee.

Therefore at the Committee of the Whole House stage, the Minister's intention is to amend the Bill by Supplementary Order Paper (SOP). The SOP will amend the commencement date for sections 80 to 140 of the FENZ Act to 1 July 2024.

FENZ, insurers and brokers, will be responsible for the ongoing operation of the arrangement. As the new arrangements continue present operating arrangements, there will be sufficient preparation time for regulated parties.



## Section 7: Monitoring, evaluation and review

### 7.1 How will the impact of the new arrangements be monitored?

The “new arrangements” will be the continuation of the present transitional levy arrangements in Schedule 1 of the FENZ Act until 1 July 2024.

At a systems-level, FENZ is a Crown Entity and the Crown Entities monitoring framework applies. The Minister of Internal Affairs is the responsible minister, and the Department of Internal Affairs is the monitoring agency. Regular monitoring of FENZ is undertaken under this framework.

Implementation will be monitored by the Department alongside the review of FENZ’s funding regime. The backstop date of 1 July 2024 will be re-assessed as part of the implementation of the recommendations of the review.

### 7.2 When and how will the new arrangements be reviewed?

In terms of the operation of the levy rate, the Minister of Internal Affairs will have the option to review the levy rate that applies during the extended transitional period, if required.