Proposals for Fire and Emergency NZ regulations

Transitional levy relief and

Calculation of levy on insurance covering different property types

 Discussion Document

**March 2017**

Foreword

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| In July this year the creation of Fire and Emergency New Zealand will mark one of the most significant changes to our fire sector since the 1940s.More than 40 separate organisations, over 600 fire forces and brigades, more than 12,000 volunteers, and approximately 3000 paid staff will be amalgamated into a single unified organisation for all of New Zealand.Enormous progress has been made since the Fire Services Review in 2015. Draft legislation to establish Fire and Emergency NZ has been introduced, reviewed by select committee, and reported back to parliament. A specialist team has been assembled and is hard at work to ensure that every aspect of the transition runs smoothly.We would not have got here without the time, energy and critical input of the public. Thank you.We now need your thinking on how elements of the levy regime which will fund Fire and Emergency NZ will operate.The Bill introduces a number of changes to the levy regime which currently funds the New Zealand Fire Service Commission. While the levy changes will not come into force until 1 July 2018 or later, it is essential to clarify how the new levy regime will work as soon as possible, to allow sufficient time for modelling and public consultation on future levy rates, and for implementation by the insurance sector and policyholders.This discussion document seeks your views on proposals for:* Transitional ‘levy relief’ (that is, partial exemptions to be granted to certain policyholders who face significant increases in levy liability as result of the Fire and Emergency NZ legislation); and
* How levy will be calculated on insurance contracts which cover any combination of exempt and non-exempt property, or residential and non-residential property, under the same policy.

I remain committed to listening to you as we work together to build a robust and flexible fire service that will serve New Zealand well for many decades.Please take the opportunity to have your say on these next important questions. |
| Hon Peter DunneMinister of Internal Affairs |
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# Introduction

## Background to fire service reform

On 1 July 2017, the New Zealand Fire Service (NZFS), National Rural Fire Authority (NRFA), and 38 Rural Fire Authorities (RFAs) will amalgamate to become one organisation, Fire and Emergency New Zealand (Fire and Emergency NZ). This will be the most significant reform of New Zealand’s fire services since the 1940s.

The reform aims to address four major issues relating to the existing governance and support for fire services:

* changing expectations of fire services, in particular that fire services are expected to, and do, respond to many non-fire emergencies (for example earthquake rescue, medical emergencies, and traffic accidents) outside the current legal framework;
* lack of coordination and variable leadership, in particular a lack of coordinated support for volunteers, sometimes poor operational coordination between NZFS and rural brigades, and the lack of national oversight of rural fire governance;
* inconsistent investment for community needs, which has led to under investment in the rural sector and in support for volunteer firefighters (both urban and rural); and
* differences in culture between rural and urban firefighters, and paid and volunteer firefighters, leading to operational issues.

Legislation to give effect to Cabinet’s decisions on fire services reform, the Fire and Emergency New Zealand Bill 2016 (the Bill), was introduced to Parliament in July 2016. It was considered by the Government Administration Committee and reported back to Parliament in December 2016.

The legislation establishing Fire and Emergency NZ is still before Parliament. We anticipate the Bill receiving Royal assent in March or April 2017.

## Purpose of this discussion document

This discussion document seeks views on two sets of regulations relating to the fire levy:

* Transitional levy relief
* Calculation of levy on insurance contracts covering different types of property.

The final shape of the two policies consulted on in this document, together with the levy exemptions policy (which we consulted on in July and August 2016), will affect future levy rates. Broadly speaking, if more transitional relief is granted, rates will increase for policyholders who are not granted relief.

So, while the levy changes will not come into force until 1 July 2018 or later, it is essential to set the policy on these regulations as soon as possible. Having these policy decisions will facilitate the accurate setting of future levy rates, including public consultation, and will allow the insurance sector and policyholders sufficient time to implement these changes in time for the commencement of the new levy regime.

We anticipate that Fire and Emergency NZ will publicly consult on new levy rates (that will apply from the commencement of the new levy regime) in mid or late 2017.

## Changes to the levy regime

### Timing of introduction of changes

Like the NZFS before it, Fire and Emergency NZ will be funded through a levy charged on insurance. However, the Bill will introduce a number of significant changes to the existing levy regime (as set out in the Fire Service Act 1975). These are described below.

While Fire and Emergency NZ will exist from 1 July 2017, the changes to the levy regime will come into force no earlier than 1 July 2018 and no later than 1 July 2019. The period after 1 July 2017 and before the levy changes commence will be a transitional period in terms of the reform of the fire levy regime.

In this transitional period, increased levy revenue will be required to fund the additional costs faced by Fire and Emergency NZ as compared to NZFS. These additional costs include rural fire costs previously funded from non-levy sources, new operating costs such as increased support for volunteers, transition costs, and repayment of the government capital injection.

Revenue to meet these new additional costs will be raised by a levy on the same asset base as under the old levy regime (that is, assets insured against fire damage).[[1]](#footnote-2) Consequently, levy rates are expected to increase in the transitional period. Levy rates will be reviewed when the levy base broadens.

The sequence of changes to funding and levy arrangements for Fire and Emergency NZ is shown graphically at Appendix A.

### Changes to levy under the Fire and Emergency legislation

The Fire and Emergency NZ legislation will introduce a number of changes to the levy regime. These changes will come into force no earlier than 1 July 2018 and no later than 1 July 2019. The most significant changes are:

* The levy base will be broadened from contracts of fire insurance, to contracts insuring property against physical loss or damage.
* Levy will be calculated on the ‘amount insured’ in an insurance contract, rather than the indemnity value of the property.
* The legislation will provide flexibility to set different levy rates and levy caps for residential and non-residential property; and to create or remove levy exemptions through regulation.
* Fire and Emergency NZ’s activities, costs, and levy rates will be reviewed at least every three years, following public consultation.
* An anti-avoidance regime for the levy will be introduced, including procedures for settling disputes over levy and a regime of shortfall penalties.

As described below, the Fire and Emergency NZ Bill also sets out the underlying principles of the levy regime.

### Rationale for changes

The broadening of the levy base from fire to physical damage reflects Fire and Emergency NZ’s broader statutory mandate (as compared with that of the NZFS) and the broader range of services delivered. In the 2014/15 year, for example, 38 per cent of NZFS responses were to non-fire incidents. Everyone benefits from the fire services’ response to earthquakes, floods and storms, and hazardous substances emergencies, but currently only those with fire insurance pay for this activity.

The shift away from applying levy to indemnity value will improve the clarity of the calculation. It is difficult to calculate the levy from indemnity value because it refers to the amount paid for assets when a claim is made. Amount insured means the maximum limit on the amount the insurer will pay out if insured property is damaged.

Providing the ability to set different rates of levy for residential and non-residential property will help minimise cross-subsidisation across these sectors. The power to set a cap by regulation on the amount levied from residential property insurance holders will allow the cap to be reviewed from time to time as house values change.

Removing the levy exemptions from the Fire Service Act, and introducing a new regulation-making power to allow exemptions according to explicit criteria, will improve the transparency and flexibility of exemptions policy. The Bill requires the Minister to have regard to the purpose of the levy regime (described in the next section) and the likely effect of an exemption of the cost-effectiveness and efficiency of the administration of the levy (clause 104(4)).

Given Fire and Emergency NZ’s broader statutory mandate and the broader range of services delivered, it is likely that most existing exemptions under the Fire Service Act will be removed. This is because a broader range of property types will potentially benefit from Fire and Emergency NZ’s mandated fire and emergency functions, than was the case when the Fire Service Act exemptions were established. Exemptions will be reviewed alongside Fire and Emergency NZ activities and levy rates, at least every three years.

The anti-avoidance provisions set out a regime of shortfall penalties (and reductions for past behaviour) and a process for settling disputes over levy, to ensure the correct amount of levy is paid.

### Principles of new levy regime

The principles underlying the levy regime are set out in the Fire and Emergency NZ Bill. Clause 69 states that the purpose of Part 3 of the Bill is to provide for a levy that is:

* A stable source of funding to support Fire and Emergency NZ in the performance of functions and duties and in the exercise of powers under the Fire and Emergency NZ legislation.
* Universal, so that Fire and Emergency NZ’s costs are generally shared among all who benefit from the potential to use Fire and Emergency NZ’s services.
* Equitable, so that policyholders should generally pay a levy at a level commensurate with their use of, or benefit from the potential to use, Fire and Emergency NZ’s services and with the risks associated with the activities that policyholders carry out (but without strict apportionment according to use, benefit, or risk having to be observed).
* Predictable, so that policyholders and levy payers are able to predict the amounts that they will need to pay and Fire and Emergency NZ is able to predict how much levy income it will receive.
* Flexible, so that the levy can adapt to changes in the use, benefit, or risk associated with those who benefit from the potential to use Fire and Emergency NZ’s services; variations in Fire and Emergency NZ’s costs; and changes to the expectations of the Crown and the strategic needs of Fire and Emergency NZ.

As noted above, when considering exemptions, the potential impact on the cost-effectiveness and efficiency of the administration of the levy must also be taken into account.

## How to respond to this consultation

Submissions can be emailed to: FireServicesTransition@dia.govt.nz

Submissions can also be posted to:

Fire Services Review
Department of Internal Affairs
PO Box 805
Wellington 6140

This document is a summary of information only. If you’d like more information on the decisions made by Cabinet on Fire and Emergency NZ and the latest news on the transition programme, please visit: <https://www.dia.govt.nz/Fire-Services-Transition>

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| **The closing date for submissions is Wednesday 19 April 2017.** |

## How your submissions will be used

All feedback received by the closing date will be taken into consideration before the government makes final decisions about the proposals in this discussion document.

Anyone can make a submission. If you have a view about the proposed regulations – please tell us what you think.

All submissions will be kept by the Department of Internal Affairs (the Department). The Department may publish the submissions it receives and provide a summary of them on its website www.dia.govt.nz. This would include your name or the name of your group, but not your contact details.

Submissions may be subject to a request to the Department under the Official Information Act 1982. Personal details can be withheld under this Act, including names and addresses. If you or your group do not want any information contained in your submission to be released, you need to make this clear in the submission and explain why. For example, you might want some information to remain confidential because it is commercially sensitive or personal.

The Department will take your request into account. The Privacy Act 1993 governs how the Department collects, holds, uses and discloses personal information about submitters and their applications. Submitters have the right to access and correct personal information.

# Part 1: Transitional levy relief

## Background and policy objectives

A suite of changes to levy will be introduced under the Fire and Emergency legislation.[[2]](#footnote-3) These changes reflect the broader mandate and statutory functions of Fire and Emergency NZ as compared with the NZFS. The key changes impacting on the levy paid by individual policyholders are:

* The broadening of the levy base from contracts of fire insurance, to contracts insuring property against physical loss or damage;
* Calculation of levy on the 'amount insured' rather than indemnity value of the property; and
* The removal of most levy exemptions.

Depending on their particular circumstances and insurance arrangements, some policyholders are likely to face significant increases as a result of these changes.[[3]](#footnote-4)

In April 2016 Cabinet agreed that regulations should be made to improve levy affordability where large public and private entities would be significantly impacted by the changes in the Bill.[[4]](#footnote-5) These regulations would set out the details of how the smoothing or capping would be applied and collected. Cabinet noted that as a consequence of making the levy more affordable for large public and private entities, small and medium businesses (whose property would be subject to neither the residential levy cap nor the proposed affordability measures) would pay more in levy.

These transitional relief measures are intended to be temporary, to allow time to adjust to the new regime. There is provision elsewhere in the Bill for making regulations to exempt property from levy on a longer term basis (discussed in Rationale for Changes section above).

The Bill provides for the making of ‘levy relief’ regulations to grant certain policyholders or classes of policyholder a whole or partial exemption from the levy for a period of up to seven years.[[5]](#footnote-6)

Before approving levy relief measures the Minister must be satisfied that they are necessary or desirable to ensure that the specified policyholders are not subject to an ‘unreasonable burden’ because of any increase in levy as a consequence of the Bill. In recommending regulations, the Minister must also have regard to the purpose of the levy regime (as set out in clause 69 of the Bill – see above), and the regulations’ likely effect on the cost-effectiveness and efficiency of the administration of the levy regime.

## Policy discussion

### Who should qualify for relief?

The Bill provides that regulations for levy relief specify the circumstances in which a policyholder may qualify for an exemption, and that these qualifying circumstances may be set out in a formula.

#### Setting out qualifying circumstances in a formula

A formula-based approach for determining when a policyholder would qualify for relief has the benefit of providing transparency and certainty for levy payers, policyholders, and for Fire and Emergency NZ. However, a rigidly applied criteria could create inequitable outcomes at the margins (for example where a policyholder’s liability falls one dollar short of the threshold for levy relief), and it would not allow Fire and Emergency NZ any discretion on who relief should be granted to.

Consistent with the Cabinet decisions described above, to qualify for relief a policyholder would need to:

* face a large increase in levy as a result of the Bill; and
* be a large public or private entity.

A formula would take account of the amount of levy a policyholder paid under the old regime, and the amount of levy the same policyholder would be liable for under the new regime (in the absence of any relief). A levy increase for a policyholder resulting from changes could be simply calculated as the additional levy paid under the Fire and Emergency NZ regime as a proportion of their levy liability under the Fire Service Act regime:

* LFENZ ÷ LFSA = burden

Where LFENZ = liability under the Fire and Emergency NZ regime (in the absence of any relief), and LFSA =liability under the Fire Service Act regime. LFSA could be calculated as either:

* the most policyholder’s most recent levy payment (that is, as calculated using the 2017/18 levy rates), or
* where there has been a material change in circumstances (for example a property has been revalued or additional assets have been added to a policy), then a notional levy assessment should be made as if the levy provisions of the Fire Service Act were still in force.

An ‘unreasonable burden’ would be one which exceeds a given threshold. For the purposes of this consultation document, we propose that policyholders facing a levy increase of three hundred per cent (or greater) would be eligible for relief.

#### Large entities

The second qualifying criteria to be applied relates to the size of the policyholder. As discussed above, Cabinet has agreed that relief should be available to ‘large public and private entities’. The administration of the relief regime will be more efficient and effective if it applies to a smaller number of policyholders (that is, only those at the top of the range), as compliance costs for insurers, brokers, and Fire and Emergency NZ in assessing and applying levy relief will be reduced.

Our preferred option is to limit levy relief to the largest policyholders, to minimise the additional cost burden on smaller entities, and to reduce compliance costs across the levy regime.

We propose that only policyholders liable for over $100,000 in levy under the Fire and Emergency NZ regime should be eligible for relief. Assuming for example a levy rate of 10 cents per $100 of insured value, an entity insuring $100 million in assets is liable for $100,000 in levy.

This figure is a starting point for discussion. While there are few if any useful points of comparison to draw on, we consider the threshold should be high, as the relief provisions are intended to apply to those entities facing the most significant impacts. By way of context, currently under the Fire Service Act regime, almost 250 organisations pay in excess of $100,000 levy per annum (and over 450 organisations pay over $50,000 in levy).

We consider that all types of property should be taken into account (residential, non-residential, and motor vehicles). Where a policyholder’s levy liability under the Fire Service Act regime was zero (that is, all property covered by an insurance contract that was formerly exempt), the liability could be treated as one cent for this calculation.

Note that rural policyholders currently contribute to the costs of fire services through charges and levies other than the fire levy. Some of these funding mechanisms are being discontinued. This will have the effect of reducing their LFSA because it does not take into account the contributions through other mechanisms, making rural policyholders slightly more likely to qualify for relief.

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| ***Questions**** Do you agree that setting out the circumstances under which a policyholder may qualify for relief in formula is the best approach? If not, why and what alternative do you suggest?
* Do you agree that only entities paying over $100,000 in levy (under the new regime) and facing a three hundred per cent increase should qualify for relief? If not, why and what alternative do you suggest?
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### How much relief should be granted, and how should it be phased?

The Bill’s transitional relief provisions provide that policyholders may be granted a full or partial exemption from the levy. To determine the amount of exemption to be granted regulations must either:

* provide for the amount of the exemption to be agreed between Fire and Emergency NZ and the specified policyholder, or
* specify a formula for the calculation of the amount of the exemption.

#### Determining amount of relief by agreement

If the regulations provide for exemptions by agreement, the regulations must specify the maximum amount of levy or maximum proportion of levy that may be the subject of an exemption by agreement. This will allow Fire and Emergency NZ to factor the impact of levy relief (across the whole system) into its modelling of levy revenue, before individual discussions on relief take place.

The regulations must also specify any matters to which Fire and Emergency NZ must have regard to, in considering whether to agree to an exemption. This will add a degree of transparency to the process.

A relief by agreement approach will provide greater flexibility for Fire and Emergency NZ. However, it could impose high costs on policyholders and levy payers (in applying for and agreeing relief with Fire and Emergency NZ) and Fire and Emergency NZ (in considering and processing applications for relief). It may carry some legal risk for Fire and Emergency NZ which could be subject to legal challenge by policyholders who apply unsuccessfully for relief.

There are also a number of implementation challenges with the ‘by agreement’ option, given that it may take some time for agreement to be reached between Fire and Emergency NZ and potentially hundreds of policyholders seeking relief. From an equity perspective, it would be difficult to ensure that policyholders with insurance renewal dates late in the year were not disadvantaged by relief decisions made earlier in the year (or vice versa).

#### Determining amount of relief by formula

Once again, a formula-based approach for determining when a policyholder would qualify for relief would provide transparency and certainty for levy payers, policyholders, and for Fire and Emergency NZ. It would also be relatively cost effective to administer for policyholders, levy payers, and Fire and Emergency NZ.

The levy payer (being the insurer or broker or in some cases the policyholder) could apply the relief and reduction formulas when making their levy return (using prescribed forms), and levy would be paid with relief reduction applied. Fire and Emergency NZ could then review the return and issue a notice of proposed adjustment if it considered that there was a shortfall or overpayment. This approach places the burden of compliance for calculating relief with the levy payer in the first instance. However, assuming the criteria are applied correctly, the levy payer would never be out of pocket from having paid excess levy in advance.

A formula-based approach would carry a risk that a rigidly applied criteria may create inequitable outcomes at the margins and it removes discretion from Fire and Emergency NZ on who relief should be granted to.

An example of a formula-based approach would be a percentage reduction to apply to any increase in levy, tapering off year on year. So, assuming a three year relief period it could look like this:

|  |  |
| --- | --- |
| Year | Reduction to levy increase (if eligible for relief)  |
| 2018/19 | 50% |
| 2019/20 | 25% |
| 2020/21 | 12.5% |
| 2021/22 | 0% |

Some examples of how this model would apply are given at Appendix B. The examples highlight some of the inequitable outcomes at the margins that occur with a simple formula. A more complex formula could be applied, with the disadvantage of increased complexity and compliance costs.

#### Phasing of relief

The Bill allows for levy relief to be granted for up to seven years. The intention is to assist eligible policyholders to adjust to the new levy regime by phasing in increases over time.

For illustration purposes, the example given above (and at Appendix B) shows a levy relief formula applying over three years. However relief could apply over up to seven years under either a formula-based or ‘by agreement’ approach.

Phasing over a longer period eases the transition for policyholders. However, a longer period of transitional relief also increases complexity, uncertainty, unpredictability, cost of administration, and risk. It will also increase the total cost of relief across the system over the transition period, which will disadvantage smaller non-residential policyholders who will collectively meet the cost of relief (as described above).

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| ***Questions**** Do you prefer a formula-based or ‘by agreement’ approach to determining the amount of relief for individual policyholders? Why?
* For the formula-based approach, do you agree with proposed reductions over three years? If not, why and what alternative do you suggest?
* For the ‘by agreement’ approach, what matters should Fire and Emergency NZ be required to have regard to in considering the amount of exemption?
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## Options

### Assessing impact of options

It is very difficult to accurately assess the impact of levy relief because:

* We do not have access to policyholder-level information on all current policyholders who might be affected by the changes.
* Modelling the impact of changes when several variables are changing all at once is inherently complex and uncertain. For example the levy exemptions have not yet been finalised, and levy rates have not yet been set.
* In particular, we lack information about insurance coverage for property currently exempt under Fire Service Act regime.
* There is also inherent uncertainty about the behaviour of policyholders and levy payers in response to changes.

Given these challenges, the options analysis in Table 1 below takes a principled approach to assessing different options against policy objectives.

### Table1: Comparison of options

|  |  |  |  |
| --- | --- | --- | --- |
| Policy objective | Option 1No levy relief | Option 2Amount of relief set in formula | Option 3Amount of relief by agreement |
| Policyholders not subject to an unreasonable burden as result because of levy increases | Does not meet – no relief for policyholders facing the largest increases | Partially meets – impact on some policyholders mitigated | Partially meets – impact on some policyholders mitigated |
| Stability – a stable source of funding to support Fire and Emergency NZ perform its functions | Meets – no reduction in levy revenue | Partially meets – will some uncertainty to modelling levy revenue | Partially meets – will some uncertainty to modelling levy revenue |
| Universality - costs are generally shared among all who benefit from the potential use of Fire and Emergency NZ  | Meets – levy payable by all policyholders | Meets - levy payable by all policyholders | Meets - levy payable by all policyholders |
| Equity - policyholders generally pay at a level commensurate with their potential use of Fire and Emergency NZ | Meets – no change to levy regime in Bill | Partially meets – cost of relief met by small and medium non-residential policyholders | Partially meets – cost of relief met by small and medium non-residential policyholders |
| Predictability – policyholders and Fire and Emergency NZ can predict how much levy is to be paid | Meets – levy regime is simpler and more predictable | Partially meets –* Policyholders can predict levy liability using formula in regulation
* Difficult for FENZ to model combined impact of relief on total levy revenue
 | Partially meets –* Very difficult for policyholders to predict levy liability
* Combined impact of relief on total levy revenue set in regulations
 |
| Flexibility - can adapt to changes in use, risk, or changes to costs and expectations of Fire and Emergency NZ  | Does not meet – no flexibility to grant relief to policyholders | Partially meets – design of regulation could provide for a variety of approaches | Meets – most flexible approach for individual policyholders |
| Cost effectiveness and efficiency of the administration of the levy | Meets – no additional compliance cost  | Partially meets – compliance costs likely to be lower than Option 3 | Does not meet – compliance costs likely to be high |
| **Summary** | **Does not meet** | **Partially meets** | **Partially meets** |

# Part 2: Levy on insurance contracts covering different types of property

## Background and policy objectives

The Bill provides for the making of regulations to set out how the levy should be calculated for a contract of insurance under which the property that is insured comprises two or more of the following property types:[[6]](#footnote-7)

* residential property,
* personal property,
* property that is exempt from the levy,
* a motor vehicle,
* any other type of property.

In practice, we think that the key areas where clarification will benefit parties are:

* contracts of insurance which cover property which is exempt from the levy and non-exempt property together under the same amount insured, and
* contracts of insurance which cover residential and non-residential property together under the same amount insured.

### Exemptions

Decisions on what types of property will be exempt from the levy are yet to be made (see page 5). We anticipate the policy being finalised in May or June 2017. Nevertheless, it is expected that levy exemptions will change significantly from the current regime.

The Bill as drafted excludes the following from levy:

* a contract of marine insurance, and
* a contract of insurance under which an aircraft that performs a scheduled international air service (within the meaning of section 87A of the Civil Aviation Act 1990[[7]](#footnote-8)) is insured.

Property can also be exempted from levy by regulation. Without prejudging Cabinet decisions, for the purposes of discussion, we have assumed that the final policy will reflect the Department’s initial policy advice on exemptions. That is, that all existing Fire Service Act exemptions will be repealed, and new regulations will create exemptions for:

* collection items of public museums (including public galleries);
* roads, bridges and related infrastructure (tunnels, cuttings, etc);
* water infrastructure including storm water assets, waste water and fresh water reticulation networks, reservoirs and other infrastructure (moles, groynes, breakwaters and dams, etc); and
* goods in transit internationally.

### Residential property

The definition of residential property will also change significantly under the new regime. This is important because residential property will remain subject to a cap on the total levy paid.

Under the Fire Service Act, a residential building is one defined as such under the Earthquake Commission (EQC) Act 1993. The EQC definition provides, among other things, that residential building means:

* any building, or part of a building, or other structure (whether or not fixed to land or to another building, part, or structure) in New Zealand which comprises or includes 1 or more dwellings, if the area of the dwelling or dwellings constitutes 50% or more of the total area of the building, part, or structure.
* any building or part of a building (whether or not fixed to land, or to another building, part, or structure) in New Zealand which provides long-term accommodation for the elderly, if the area of the building which provides long-term accommodation for the elderly constitutes 50% or more of the total area of the building, part, or structure.
* every building or structure appurtenant to a dwelling referred to in paragraph (a), or a building or part of a building referred to in paragraph (b), and that is used for the purposes of the household of the occupier of the dwelling or for the purposes of the residents of the building or part.

Under the Bill, however, residential property means a ‘household unit’ and any residential land. Household unit has the same meaning as in section 7 of the Building Act 2004, that is:

* a building or group of buildings, or part of a building or group of buildings, that is used, or intended to be used, only or mainly for residential purposes; and occupied, or intended to be occupied, exclusively as the home or residence of not more than 1 household; but
* does not include a hostel, boardinghouse, or other specialised accommodation.

The rationale for this change is that whereas the EQC regime is designed only to apply to residential properties, the fire levy is designed to apply to both residential and non-residential properties (including mixed-use buildings). The definitions of residential property and household unit used in the Bill are designed to ensure that the levy applies to both the commercial and residential components of mixed-use buildings, unlike the EQC definition which provides that the levy does not apply to the commercial parts of mixed use buildings where more than half of the building is residential.

For a retirement village comprising both residential and non-residential facilities, for example, the intent is that residential facilities will be levied as household units. Administrative buildings or areas of buildings on the other hand, should be treated as non-residential buildings.

Farm insurance may cover a residential household as well the non-residential farming operation containing agricultural, horticultural, or forestry assets, or some combination.

## Policy discussion

The key policy objective in making these regulations is the need to ensure the levy regime is predictable. That is, to ensure that policyholders and levy payers are able to predict the amount of levy they will need to pay and that Fire and Emergency NZ is able to predict how much levy income it will receive.

Regulations should set out high level principles by which levy is calculated on the types on insurance described. We anticipate that Fire and Emergency NZ may also produce non-statutory guidance to supplement regulations giving further detail and examples consistent with the regulations.

We also note that forms will need to be provided for levy returns.

### Insurance on exempt and non-exempt policy

Regulations are required to provide for the calculation of levy on a policy where the amount insured covers both exempt and non-exempt property. Subject to final decisions on exemptions, these could be, for example:

* A museum’s policy covering its buildings (non-exempt) and collections (exempt) under the same amount insured.
* An airline’s insurance policy covering exempt (those which fly scheduled international air service) and non-exempt aircraft under the same amount insured.

We propose that the levy payable should be calculated from:

* the proportion of the amount insured which relates to the value of the non-exempt assets.

This is straightforward in principle, which should ensure that a policyholder can predict their levy liability, and that the calculation of levy is not onerous. Some insurance policies may indicate the value of different assets covered under the same express maximum limit.

However, we anticipate that in many cases affected policyholders may not have separate valuations for different assets or component parts of the amount insured in a policy.

We would like to better understand how many insurance policies may cover exempt and non-exempt property under the same amount insured, and what kind of property is involved.

We would like understand what might be required of the policyholder, broker, or insurer to ascertain the value of non-exempt property covered under the amount insured in this situation. Would a valuation be required, or could information produced for mandatory solvency reporting requirements under the Insurance (Prudential Supervision) Act 2010 be used?

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| ***Questions**** Do you agree with the proposed approach to calculating levy on policies that cover both exempt and non-exempt property? If not why? What alternative approach do you suggest?
* How onerous would it be to ascertain the value of non-exempt property?
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### Insurance on residential and non-residential property

Regulations are required to provide for the calculation of levy on a policy where the amount insured covers both residential and non-residential property. Examples of this include:

* An insurance policy covering residential apartments and commercial office or retail space in the same mixed use building, under the same amount insured.
* An insurance policy covering both residential units and the administrative and other facilities of a retirement home, under the same amount insured.
* An insurance policy covering both a residential home and the operational portions of a farming property, under the same amount insured.

We propose that the levy payable should be:

* For residential areas, the residential levy rate and cap will apply to each household unit covered under the amount insured (the value of each household unit will be the proportion of the amount insured relating to the residential share of the property's floor space, divided by the number of units); plus
* For non-residential areas, the (uncapped) levy rate will apply to the proportion of the amount insured relating to the non-residential share of the property's floor space.

An example of such a calculation is given at Appendix C.

This approach requires some valuations of individual household units in order to ascertain whether the residential cap applies. In some cases, making an assessment of the value of individual residential units will be simple. Where such valuations are not readily available, they may need to be estimated, for example by dividing the value of the residential portion of a property by the number of household units.

A key consideration is whether the residential and non-residential portions of a mixed-use property are determined by floor space (m2) or value ($). We think that using floor space as the measure is probably the simplest and most certain option. It also means that similar buildings will attract a similar amount of levy, regardless of the relative value of the non-residential portion.

The application of the Building Act definition of ‘household unit’ will be critical to determining the amount of levy to be paid. Non-statutory guidance may be required to assist with interpretation.

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| ***Questions**** Do you agree with the proposed approach to calculating levy on contracts of insurance which cover residential and non-residential property together under the same amount insured? If not why? What alternative do you suggest?
* Do you think the non-residential portion of amount insured should be calculated on the basis of floor space (m2) or value ($)?
* How should this apply to first loss policies, where different properties are mixed use with different proportions of residential?
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### Insurance on exempt, residential, and non-residential property

Regulations will need to provide for the calculation of levy on a policy where the amount insured covers exempt, residential, and non-residential property.

We propose that the levy payable should be:

* The number of household units covered by policy x levy rate (subject to the cap on residential property), plus
* Total amount insured x (the proportion of the non-exempt property that is non-residential) x levy rate (uncapped)

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| ***Question**** Do you agree with the proposed approach to calculating levy on contracts of insurance which cover exempt, residential, and non-residential property together under the same amount insured? If not why? What alternative approach do you suggest?
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1. Summary of funding and levy changes over transition period
2. Examples of proposed transitional relief

All figures for illustration purposes only.

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|   | **Levy liability (no relief)** | **Relief criteria** | **Levy liability with relief applied** |
|   | FSA regime | Fire and Emergency NZ regime | Burden(Fire and Emergency NZ levy ÷ FSA levy) | Unreasonable? (burden ≥3) | Over threshold? ($100,00 levy under Fire and Emergency NZ regime) | Eligible for relief? | Increase in levy | Year 1(50% reduction on increase) | Year 2(25% reduction on increase) | Year 3(12.5% reduction on increase) |
| **Example A** | $10,000 | $50,000 | 5.00 | Y | N | N | $40,000 | $50,000 | $50,000 | $50,000 |
| **Example B** | $87,000 | $156,000 | 1.79 | N | Y | N | $69,000 | $156,000 | $156,000 | $156,000 |
| **Example C** | $135,000 | $380,000 | 2.81 | N | Y | N | $245,000 | $380,000 | $380,000 | $380,000 |
| **Example D** | $33,000 | $99,000 | 3.00 | Y | N | N | $66,000 | $99,000 | $99,000 | $99,000 |
| **Example E** | $33,500 | $100,500 | 3.00 | Y | Y | Y | $67,000 | $67,000 | $83,750 | $92,125 |
| **Example F** | $56,000 | $167,500 | 2.99 | N | Y | N | $111,500 | $167,500 | $167,500 | $167,500 |
| **Example G** | $56,000 | $178,000 | 3.18 | Y | Y | Y | $122,000 | $117,000 | $147,500 | $162,750 |
| **Example H** | $2,300,000 | $15,800,000 | 6.87 | Y | Y | Y | $13,500,000 | $9,050,000 | $12,425,000 | $14,112,500  |

1. Example of proposed calculation of levy on mixed residential property

**Example A**

A mixed building with a total amount insured of $12 million. Twenty residential apartments make up 80 per cent of the floor space. The remaining 20 percent is comprised of non-residential areas, including commercial offices and retail.

Assuming (for illustration purposes):

* a residential levy rate of 10 cents per $100 of insured value
* a residential levy cap of $200,000 of insured value
* a main (non-residential) levy rate of 10 cents per $100 of insured value (uncapped)

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| **Apartment** | **Apartment** | **Apartment** | **Apartment** | **Apartment** |
| **Apartment** | **Apartment** | **Apartment** | **Apartment** | **Apartment** |
| **Apartment** | **Apartment** | **Apartment** | **Apartment** | **Apartment** |
| **Apartment** | **Apartment** | **Apartment** | **Apartment** | **Apartment** |
| **Commercial premises** |

Levy payable:

* For the residential portion, based on a notional value for each apartment of $480,000 (80 per cent of $12 million, divided by 20), the cap of $200,000 will apply. This means the levy payable on each apartment is $200, giving a combined total for twenty apartments of $4000.
* For the non-residential portion, the rate of 10 cents applies to the notional value of that portion($2.4 million or 20 percent of $12 million). Levy payable is $2400.
* Total levy on the property is $4000 + $2400 = $6400
1. Consultation questions

**Part 1: Transitional levy relief**

**Who should qualify for relief?**

* Do you agree that setting out the circumstances under which a policyholder may qualify for relief in formula is the best approach? If not, why and what alternative do you suggest?
* Do you agree that only entities paying over $100,000 in levy (under the new regime) and facing a three hundred per cent increase should qualify for relief? If not, why and what alternative do you suggest?

**How much relief should be granted, and how should it be phased?**

* Do you prefer a formula-based or 'by agreement' approach to determining the amount of relief for individual policyholders? Why?
* For the formula-based approach, do you agree with proposed reductions over three years? If not, why and what alternative do you suggest?
* For the 'by agreement' approach, what matters should Fire and Emergency NZ be required to have regard to in considering the amount of exemption?

**Part 2: Levy on insurance contracts covering different types of property**

**Insurance on exempt and non-exempt policy**

* Do you agree with the proposed approach to calculating levy on policies that cover both exempt and non-exempt property? If not why? What alternative approach do you suggest?
* How onerous would it be to ascertain the value of non-exempt property?

**Insurance on residential and non-residential property**

* Do you agree with the proposed approach to calculating levy on contracts of insurance which cover residential and non-residential property together under the same amount insured? If not why? What alternative approach do you suggest?
* Do you think the non-residential portion of amount insured should be calculated on the basis of floor space (m2) or value ($)?
* How should this apply to first loss policies, where different properties are mixed use with different proportions of residential?

**Insurance on exempt, residential, and non-residential property**

* Do you agree with the proposed approach to calculating levy on contracts of insurance which cover exempt, residential, and non-residential property together under the same amount insured? If not why? What alternative do you suggest?
1. In late 2016, NZFS consulted publicly on proposed levy rates for 2017/18. It is expected that the new rates will be announced by April 2017. [↑](#footnote-ref-2)
2. As described above, these changes will commence no earlier than 1 July 2018 and no later than 1 July 2019. [↑](#footnote-ref-3)
3. More immediately, policyholders will also be impacted by rate changes from 1 July 2017. The transitional relief provisions discussed here will not apply to these changes. The intent of transitional relief is to address the impacts of the changes to the underlying levy regime introduced in the Bill. [↑](#footnote-ref-4)
4. EGI-MIN-16-0064. [↑](#footnote-ref-5)
5. Fire and Emergency New Zealand Bill 2016, Schedule 1, clauses 35 to 38. [↑](#footnote-ref-6)
6. Clause 104(3)(ba) of FENZ Bill 2016 [↑](#footnote-ref-7)
7. The Civil Aviation Act defines ‘scheduled international air service’ as a series of flights performed by aircraft for the transport of passengers, cargo, or mail between New Zealand and one or more points in any other country or territory, where the flights are so regular or frequent as to constitute a systematic service, whether or not in accordance with a published timetable, and which are operated in such a manner that each flight is open to use by members of the public; and, in relation to a New Zealand international airline, includes a ‘seventh freedom service’. [↑](#footnote-ref-8)