INSURANCE AUSTRALIA GROUP

SUBMISSION TO

NEW SOUTH WALES PUBLIC ACCOUNTS COMMITTEE REVIEW OF FIRE SERVICES FUNDING

OCTOBER 2003

CONTENTS

EXECUTIVE SUMMARY

- New South Wales, Victoria and Tasmania are the States that have retained funding for fire services through an insurance-based fire services funding system. Insurance Australia Group contends that New South Wales is well placed to build on the experience of other States and Terrorties in relation to fire services funding reform.

- The current method of funding fire services is inappropriate, regressive and based on historical circumstances rather than any concept of tax equity. Insurance Australia Group regards the fire services levy as an historical anachronism that is inconsistent with the generally accepted principles of taxation of simplicity, efficiency and equity.

- Insurance Australia Group submits that the primary motivation for reforming the current fire services funding system in New South Wales is equity. The current system unfairly places a financial burden on insurance policy holders for a service that benefits the entire New South Wales community.

- The reliance on funding from insurers has a number of shortcomings from a community perspective. The main problems are: the system is inequitable because the funding burden falls only on those consumers who are insured by an Australian insurer even though all members of the community benefit from fire services protection; and, the system therefore increases the cost of insurance for New South Wales households and businesses.

- Reform of the current "insurance based" fire services funding model would also overcome the problem of commercial property owners who insure in off-shore insurance markets and avoid paying the fire services levy at all, even though they benefit from the protection of the fire services of New South Wales.

- Insurance Australia Group believes a fire services funding system, which encourages full value insurance, would result in economic and community benefits, especially as regards under-insurance.

- A system that is fair, consistent and more understandable to taxpayers and the community at large is needed. Insurance Australia Group believes that the most effective way of achieving this end is to implement a system that sees all New South Wales property owners sharing the responsibility for funding fire services.

- Insurance Australia Group, working with the Insurance Council of Australia, has commissioned the independent modelling of alternative fire services funding models. This modelling exercise will assist the current Inquiry by providing appropriate data for modelling the funding options.

- Insurance Australia Group stands ready to assist the New South Wales Government in working through the transitional funding arrangements moving from the current fire services funding system to a new property based funding system.

INSURANCE AUSTRALIA GROUP

Insurance Australia Group (IAG) is the largest general insurer in Australia and New Zealand. It provides personal and commercial insurance products under some of the most respected and trusted retail brands including NRMA Insurance, SGIO, SGIC, CGU and Swann Insurance in Australia, and State and Circle in New Zealand.

IAG's core lines of business include:

- Home Insurance
- Motor Vehicle Insurance
- Business Insurance
- Consumer credit Insurance
- Extended Warranty Insurance
- Compulsory Third Party (CTP) Insurance
- Workers Compensation Insurance
- Retirement financial advice
- Professional risk insurance

IAG is a member of the Insurance Council of Australia, the representative body of the general insurance industry in Australia. Some of the issues in IAG's submission have been addressed in a broader context in the submission prepared and submitted to the Inquiry by the Insurance Council of Australia. IAG supports the Insurance Council of Australia's submission to the current Inquiry.

FUNDING FIRE SERVICES IN NEW SOUTH WALES

The 2003-04 New South Wales *Budget Papers* indicate that the fire services levy will raise $379 million in 2003-04. Funding is provided through a charge on insurers with the State Government and Local Governments also contributing to the funding of fire services in New South Wales. Details are outlined in Table 1.

New South Wales, Victoria and Tasmania impose a charge on insurers to meet most of the cost of fire brigade services. These levies are determined as a percentage of the annual budget for the fire brigades, with insurance companies paying a pro rata amount in accordance with their market share. The fire service levy rates are determined according to predictions of the insurance company's premium income approximately one year in advance. Given the imprecise nature of this method, it is impossible in practice for insurers to align recoveries with their contributions to the fire services. The consequence is that insurers either under-recover or over-recover. In years of under-recovery the shortfall is drawn from the reserves of insurers. Conversely, over-recoveries result in excess funds being absorbed into insurers' revenues, distorting actual results. This is neither useful nor appropriate for the market. This is an inherent flaw in the current funding system.

INTERSTATE COMPARISON OF FUNDING FIRE SERVICES

An interstate comparison of emergency services funding is outlined in Table 1. New South Wales, Victoria and Tasmania are the States that have retained funding for fire services through an insurance-based fire services funding system (from the 1 July 2003 the Western Australian fire services levy funding system was replaced by an emergency services levy which is property based). The following alternative measures exist for the funding of fire services across Australia.

- **South Australia**: insurer contributions to fire brigade funding ceased from 1 July 1999 when a broadly based system was implemented to raise funds through all property owners, and owners of registered motor vehicles and boats. These funds are levied and collected by the Office of State Revenue.

- **Queensland**: the insurance based levy for funding fire and emergency services was abolished in the 1980s, in favour of a property based funding scheme implemented in two stages from 1 July 1984.

- **Australian Capital Territory**: from 1 July 2001, the insurance-based levy was abolished with a return to funding from consolidated revenue.

- **Northern Territory**: fire services are funded from consolidated revenue.

- **Western Australia**: from 1 July 2003, the Emergency Services Levy is a new system to fund Western Australia's fire and emergency services based on the gross rental value of property. It replaces the existing funding arrangements, which included a mix of levies on insurance premiums, State and Local Government contributions and volunteer fundraising. Local Government will collect the levy on behalf of the Fire and Emergency Services Authority by including it on Council rates notices.

  The Western Australian Government's decision to introduce a new system to fund fire services in Western Australia heralds an emergency services levy to replace *all* existing funding arrangements. These arrangements will ensure that all property owners contribute to these essential emergency services, removing the unfair financial burden on consumers who insure their property in Western Australia.

- **Victoria**

  The Victorian Government released its *Review of Victorian Fire Service Funding Arrangements* in July 2003. The Victorian Government will retain the current insurance-based system while boosting its transparency and equity.

  The Victorian Government's decision not to remove the cost burden of fire services from insurers contrasts strongly with the recommendation of the HIH Royal Commission Report relating to the taxation of insurance (discussed page 12).

  IAG also notes that the Review's findings by the Department of Treasury and Finance's Steering Committee contrasts with the findings of the independent Victorian Review released in 2001 (discussed page 10).

IAG contends that New South Wales is well placed to take advantage of the experience of other States and Terrorities, particularly Western Australia, which has so recently assessed fire services funding options and taken a decision to proceed with a Local Government property based scheme.

THE NEED FOR FUNDING REFORM IN NEW SOUTH WALES

The current method of funding fire services is inappropriate, regressive and based on historical circumstances rather than any concept of tax equity. IAG regards the fire services levy as an historical anachronism that is inconsistent with the generally accepted principles of taxation of simplicity, efficiency and equity.

IAG contends the primary motivation for reforming the current fire services funding system in New South Wales is equity. The current system arguably places a financial burden on insurance policy holders for a service that benefits the entire New South Wales community.

The reliance on funding from insurers has a number of shortcomings from a community perspective. These include:

- the system is inequitable because the funding burden falls only on those consumers who are insured by an Australian insurer even though all members of the community benefit from fire services protection; and

- by increasing the cost of insurance the fire services levy puts the cost of insurance beyond the affordable reach of many households and small businesses.

TAX	NSW	VIC	QLD	WA	SA	TAS	NT	ACT
EMERGENCY SERVICES LEVY	Fire Service Levy *In NSW fire fighting services are funded through the Fire Service Levy. Once the cost of operating the services are determined, this amount of the levy is allocated across insurance industry, Local Councils and State Budget in the following proportion:* Insurance: 73.7% Local Council: 12.3% State Budget: 14.0%	**Fire Services Levy** *In Victoria, Fire Fighting services are funded through the Fire Services Levy. Once the cost of operating the fire services are determined, the amount of the levy is allocated across the insurance industry, local councils and the State Government in the following proportions:* *Melbourne Fire & Emergency Services Board* Insurance Industry: 75.0% Local Government: 12.5% State Government: 12.5% *Country Fire Authority* Insurance Industry: 77.5% Local Government: 0.0% State Government: 22.5%	Fire Levy The Qld Fire and Rescue Authority is funded through a fire levy that is collected on behalf of the State Government through municipal rates. The levy varies according to property type and location.	Fire services within gazetted fire districts are currently funded by the State Government, local governments (12.5% each) and insurance companies (75%). Insurance companies recoup their contribution by including a “fire service levy” in property insurance premiums. This typically represents about 19% of the base premium for a residential property insurance policy and 26% of the base premium for a commercial/industrial property insurance policy. The above arrangements will be replaced by an Emergency Services Levy from 1 July 2003 which will be property based and collected by the local government authorities.	**Fixed Property** *Flat fee $50 ($20 for special community use category and $0 if outside Local Govt. Areas) plus variable Levy rate based on capital value adjusted for location and land use as follows:* $50 + variable component (Capital Value x Area Factor x Land Use Factor x Levy Rate). Concessions: Flat $40 concession applies to recipients of specified pensions and Government allowances and to qualifying self funded retirees. Mobile Property (Levy rates net of remissions) **Cars and larger capacity motor cycles:** $24.00 **Smaller capacity motor cycles:** $12.00 Commercial fishing vessels: $12.00 **Historical vehicles:** $6.00 (conditions apply) (Certain variations for country based mobile property apply.)	**Fire Services Levy** ***Insurance*** ***Loss by fire, Loss of Profits, Contractor's risk, Boiler explosion and other:*** *28% of gross premium.* **Marine and cargo:** 2% of gross premium Aviation: 14% of gross premium Local Council: Minimum levy of $25.00 applies. Rates are based on assessed annual value (AAV) of properties. Motor Vehicles **Registration of motor vehicle:** $11.00 per vehicle.	Not imposed.	**General Insurance Levy** Abolished 1 July 2001.

Source: NSW Treasury Interstate Comparison of Taxes – October 2002

FUNDING BURDEN ON THE INSURED

Australian Bureau of Statistics (ABS) data indicate that nationally, taxes on insurance totalled $2,836 million in 2001-02, up $433 million or 18.0% on 2000-01 ($2,403 million) and accounted for 1.3% of total taxation revenue collected in Australia in 2001-2002 (latest data available).

	1999-00	2000-2001	2001-02	Change 2000-2001 to 2001-02	Contribution to total taxes 2001-02
	$m	$m	$m	%	%
Taxes on Insurance	2 139	2 403	2 836	18.0	1.3

Source: ABS (2003), Taxation Revenue Australia 2001-02, Cat.No. 5506.0, May 2003.

The ABS data indicate that in 2001-02 revenue from taxes on insurance increased in all States. **New South Wales accounted for 43.7% of total insurance taxes collected by Government in 2001-02, with New South Wales insurance companies contributions to fire brigades accounting for 52.8% of total insurance fire brigade revenue collected in 2001-02.**

Taxes on Insurance 2001-02

	NSW	VIC	QLD	SA	WA	TAS	NT	ACT	TOTAL
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Insurance companies contributions to fire brigades	**347**	235	-	-	64	10	-	-	656
Third party insurance taxes	**18**	91	35	53	-	-	-	-	197
Taxes on insurance nec	**873**	413	238	170	203	41	16	29	1 983
TOTAL	**1 239**	738	273	223	267	52	16	29	2 836

nec not elsewhere classified
na not available

Source: ABS (2003), Taxation Revenue Australia 2001-02, Cat.No. 5506.0, May 2003.

INSURANCE TAXES - IMPACT ON NEW SOUTH WALES BUSINESS AND HOUSEHOLD CONSUMERS

The insurance tax burden is worsened by the cascading effect of a Fire Services Levy applied to a basic premium, then GST applied to both, then Stamp Duty applied to the premium plus Fire Service Levy plus GST - a tax on a tax on a tax. The cumulative impact of "taxes" on the cost of insurance (and subsequent affordability) can add up to 50.1% to the cost of business insurance in New South Wales.

By way of explanation, a hypothetical basic premium of $100 is used to demonstrate the taxation impost of insurance taxes (including the Fire Services Levy) on final premiums to New South Wales businesses and households. Details are outlined in the following Tables.

Impact of Government Taxes/Charges on Business Insurance Premiums – Metropolitan

	Basic Premium $	Fire Levy $	GST $	Stamp Duty $	Total Cost $	Impact of Govt taxes %
NSW	**100**	**30**	**13.00**	**7.15**	**150.15**	**50.1**
VIC*	100	28	12.80	14.08	154.88	54.9
QLD	100	-	10.00	9.35	119.35	19.3
WA*	100	28*	12.80	14.08	154.88*	54.9
SA	100	-	10.00	12.10	122.10	22.1
TAS	100	28	12.80	11.26	152.06	52.1
ACT	100	-	10.00	11.00	121.00	21.0
NT	100	-	10.00	11.00	121.00	21.0

** In country Victoria the fire services levy is 47%, with the total cost of a $100 premium $177.87 as a result of Federal and State Government taxes/charges.*

** The Western Australian Government announced on 12 June 2002 that effective 1 July 2003 the Fire Services Levy on insurance policies would be replaced with an emergency services levy based on the Gross Rental Value of property and would be collected by Local Government. The removal of the insurance-based fire services levies and charges will occur gradually during 2003. Policies that are issued after 1 January 2003 will include the fire service levies and charges only to the portion of the premium covering the period up to 31 December 2003. Any cover from 1 January 2004 onwards will not be subject to these charges.*

It should be noted the Terrorism Insurance Act 2003 came into effect on 1 July 2003 and was introduced by the Federal Government to provide terrorism cover under eligible commercial insurance policies. Premiums on all eligible policies will rise to reflect the cost of the terrorism reinsurance cover provided by the Australian Reinsurance Pool Corporation (ARPC). The ARPC has taken a zone approach to the reinsurance premium to be applied, based on the postcode of the risk: a 2% reinsurance premium for non-urban areas, a 4% reinsurance premium for urban areas and a 12% reinsurance premium for Central Business Districts. . Premium increases will apply to eligible policies that begin on are due for renewal from 1 October 2003. These increases are subject to government taxes and charges (such as GST and stamp duty), and any applicable Fire Services Levy.

Impact of Government Taxes/Charges on <u>Home</u> Insurance Premiums - Metropolitan

	Basic Premium $	Fire Levy $	GST $	Stamp Duty $	Total Cost $	Impact of Govt taxes %
NSW	**100**	**17**	**11.70**	**6.44**	**135.14**	**35.1**
VIC*	100	13	11.30	12.43	136.73	36.7
QLD	100	-	10.00	9.35	119.35	19.3
WA*	100	19*	11.90	13.09	143.99*	44.0
SA	100	-	10.00	12.10	122.10	22.1
TAS	100	-	10.00	8.80	118.80	18.8
ACT	100	-	10.00	11.00	121.00	21.0
NT	100	-	10.00	11.00	121.00	21.0

** In country Victoria the fire services levy is 19%, with the total cost of a $100 premium $143.99 as a result of Federal and State Government taxes/charges.*

** The Western Australian Government announced on 12 June 2002 that effective 1 July 2003 the Fire Services Levy on insurance policies would be replaced with an emergency services levy based on the Gross Rental Value of property and would be collected by Local Government. The removal of the insurance-based fire services levies and charges will occur gradually during 2003. Policies that are issued after 1 January 2003 will include the fire service levies and charges only to the portion of the premium covering the period up to 31 December 2003. Any cover from 1 January 2004 onwards will not be subject to these charges.*

Source: Derived from Insurance Council of Australia data.

IAG believes the taxation impost on insurance policyholders highlights the need for a change in the current fire services funding system in New South and its impact upon insurance affordability. Reform which leads to a reduction in State taxes on insurance would prevent potential future liabilities to State Government budgets that are called upon when businesses fail following non-insurance or under-insurance, or to support community members who lose assets for the same reasons.

The recently released Trowbridge Deloitte Report, *"Effect of State Taxes on Insurance for Small Business"* (July 2003) stated that State taxes "…add significantly to the cost of insurance premiums. Given that the cost of insurance is a significant factor for non-insurance, it can be inferred that the cost of state taxes contribute to non-insurance."

The Victorian *Review of State Business Taxes* (2001) highlighted "the invidious situation of taxes being charged on other taxes" as it relates to the fire services levy, stamp duty on insurance and GST. The Report noted: "another of the inefficient and unfair taxes is the fire services levy (FSL), which is currently collected through the insurance industry". The Report stated: "the levy is a cause of concern in the community. It contributes too great an impost on insurers and insured alike, leading to under-insurance, self-insurance or free-riding". The Report also stated:

> *"the Committee favours the shifting of the burden of the fire service to all property owners. The revenue could be collected fairly by being levied through the same mechanism as local rates. Such an approach is currently in use in South Australia, and Victoria should be able to learn from the experience of that state. If all Victorian properties had the same rateable value and the same*

risk rating, each property would pay $122 per year to fund the service. In reality, rateable values and risk ratings vary greatly, and most ratepayers would pay much less than $122. Existing fire services levy payers should normally pay less, because funding is spread across a wider base" (Review of State Business Taxes, February 2001).

The *State Chamber of Commerce (NSW) and NRMA Insurance Local Business & Regional Affairs Survey* is the only regular survey of outer-metropolitan and regional businesses in Australia, and is conducted on a quarterly basis. The January 2003 survey based on 613 responses received from businesses across New South Wales indicated that in relation to business taxes, insurance taxes impose the second greatest financial burden on businesses in terms of the amount of tax paid on business (after payroll tax).

Which of the following State taxes imposes the greatest financial burden (in terms of the amount of tax paid) on your business?

Payroll tax	32%
Insurance service taxes	31%
Not sure	13%
Land tax	8%
Contracts & Conveyancing duty	7%
Lease duty	7%
None of the above	18%
No Answer	3%

Local Business & Regional Affairs survey results for January 2003 also highlighted that businesses surveyed were not aware of the level of taxes and charges on their current insurance premiums.

What level of taxes and charges do you think you are paying as part of your current insurance premiums?

Less than 10%	17%
10-20%	36%
20-50%	12%
More than 50%	2%
Not sure	32%
No answer	1%

In January 2003, businesses were also asked if the cost of insurance premiums was reduced by a reduction in taxes and charges whether they would take out more insurance on items currently insured or take out insurance on items currently uninsured. Survey results are detailed below.

If the cost of your insurance premiums was reduced by a reduction in taxes and charges, would you?

Leave current insurance policies in place	60%
Not sure	13%
Take out more insurance on items currently insured	13%
Take out insurance on items currently uninsured	12%
No answer	1%

The *HIH Royal Commission Report* highlighted that in relation to fire service levies, "all property owners (whether insured or not) benefit from fire protection services and the insurance industry generally passes the levies on to customers. This means that in the relevant states the costs of providing fire protection services are borne disproportionately by property owners who choose to take out insurance.

Ideally, the cost of providing fire services levies should be met by all property owners. This question was also considered by the *Victorian Review of State Business Taxes*, which recommended,

> *Shifting the funding for fire services away from those who currently insure their properties to all property owners, as a separate item on local government rates notices, would achieve greater equity in supporting the fire services."*

The Commission recommended that those States that have not already done so abolish fire services levies on insurers *(Recommendation 56, page 279, Volume 1)*.

NON-INSURANCE

Impact on Businesses Consumers

A national research report *Business Insurance: A National Survey of Small and Medium Size Businesses* (July 2001) commissioned by NRMA Insurance found that while the large majority of businesses have some form of insurance, close to half (47%) either do not have relevant cover or have cover which is judged inadequate. The survey of 1,253 small/medium businesses across Australia was undertaken to provide a better understanding of the business insurance market.

A business may be underinsured because its existing cover is inadequate or if it is not covered for a significant risk for which insurance is available.

Survey results indicate that:

- While the majority of businesses have some form of insurance (91%);
- 47% of businesses do not have a relevant cover or have a cover which is judged inadequate;
- Overall cover for damage to buildings, contents and stock due to fire or other events

such as storm, explosive, vehicle impact or vandalism was the most common insurance held by businesses (85% covered);

- Cover for loss of profit due to damage from fire or other defined event was the least common (53%) (business interruption); and

- The most common reason why a business was not covered by an applicable insurance was the cost of premiums. 39% of businesses stated this as the main reason, while 11% stated they do not have enough time to arrange insurance (see *Appendix 1*).

In addition to the issue of non-insurance and under-insurance amongst businesses there is a certain level of avoidance/evasion of the fire services levy through the use of offshore insurance markets. For example, the 1994 *Review of the Funding Arrangements for the Fire Service of New South Wales* highlighted the practice of using captives and the off-shore insurance markets: "the use of off-shore captives or the off-shore insurance markets are opportunities for the owners of the captives or the policy holders to evade statutory charges including FSL. This may be through ignorance of their obligations, or by the manner in which premiums are paid to the captive, its re-insurers or its co-insurers" (p.32).

Impact on Household Consumers

Research commissioned by NRMA Insurance in relation to household non-insurance *Home and Motor Vehicle Insurance: A Survey of Australian Households* (October 2001), indicate that one in six Australian households do not have buildings and contents insurance. Applying the survey result to the total population, an estimated 1.2 million households are without building and contents insurance.

An estimated one in five passenger motor vehicles are not insured comprehensively.

The most common explanation householders give for why they do not have insurance relates to the cost of premiums. Similarly, the reason most frequently given by drivers for why their motor vehicles do not have comprehensive insurance or third party property damage insurance related to the cost of premiums.

Survey data suggest that a substantial reduction in the cost of contents insurance would increase its incidence, particularly in rental households. Survey results also suggest that a reduction in the cost of motor vehicle insurance would increase its incidence (see *Appendix 2*).

BENEFITS OF POSSIBLE FUNDING REFORM

When the Federal Government announced that it would fundamentally reform the Australian taxation system by introducing a Goods and Services Tax (GST) it also announced that the revenue would go to the States and Territories. The stated intention was that the GST, as a growth tax, would build revenue for State Governments and as a result an opportunity should be created to reduce certain State Government taxes.

IAG understands and acknowledges that each State Government will make the decisions it believes are in the best interests of the community and that are based on sound financial management principles. However, it is worth noting in the this context that Access Economics' 2000 review of the State taxes and charges on general insurance post GST (*The Overwhelming Case For Cutting State Taxes and Charges On General Insurance Post-GST, September 2000*) found a clear economic case for reducing state insurance taxes ahead of many other taxes, in particular payroll tax.

Using an economy wide approach, Access Economics took into account the interactions between consumers, producers and investors. They then used a highly sophisticated economic model called the computable General Equilibrium Model, which has been used to produce reports for Federal and State Governments. This model was used to estimate the economic impacts of reducing each State/Territory tax by $100 million (in total, for all States/Territories). The result from this modelling provides a clear economic case for reducing State/Territory insurance taxes ahead of many other taxes.

Access Economics concluded that reducing stamp duties on insurance would result in gains to economic welfare, GDP and investment that are many times greater than the gains that would arise if payroll taxes were reduced by the same amount.

Access Economics noted that in broad terms, the results indicate that taxes that fall on investment (such as stamp duties on non-residential conveyancing and insurance) lead to the greatest economic costs, and would therefore provide the greatest economic benefits if they were to be reduced.

ALTERNATIVES TO THE CURRENT NEW SOUTH WALES INSURANCE BASED FIRE SERVICES FUNDING SYSTEM

IAG believes that the most feasible alternative to the current New South Wales insurance system of fire services funding is a property-based charge.

The main advantage of a property based funding system is that it is broadly based, meaning that all actual and potential beneficiaries of the fire services contribute to its funding. Thus it overcomes the key weakness of the current system, which is that only the insured pay for fire services funding even though all members of the community benefit from the existence of the fire services.

There are a number of potential types of property-based charge that should be considered by the current Review.

'Flat' levy across all properties

The most simplistic 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. The most important would be that it is relatively inequitable in that all property owners pay the same levy irrespective of the value of property or the expectation of service.

'Flat' levy within sectors

A slightly more sophisticated and fine-tuned charging system is 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. 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 between and within sectors. The following methods are similar to those currently used in other States:

1. Allocate between sectors according to their shares of a measure such as unimproved capital value or gross rental value, and within each sector based on the same measure. 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 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 has adopted a “hybrid” system under which funding is collected from a combination of a property based charge and a motor vehicle registration levy. This system appears to be relatively equitable in that the amount paid increases in line with the value of the property, and thus the potential benefit from fire services.

Apart from the above 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. The situation is further complicated by the fact that the benefit or potential benefit from the existence of fire services may not be directly correlated to the value or type of property (i.e. all properties benefit from the protection that the existence of fire services provides).

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 fire 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 fire 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.

Given that a property based funding system offers the most feasible alternative to the current insurance-based fire services funding system it is important to devise a system that is equitable and relatively simple to administer. To achieve this detailed modelling and assessment of the range of options will need to be carried out. The range of options that could be examined include:

- allocation between and within sectors according to capital value;
- a flat charge for residential properties and a differential charge for commercial/industrial property based on capital value;
- a flat charge per property plus an additional charge based on location and land use; and
- the charge for residential property set according to type of fire brigade servicing that region and charges for commercial/industrial set according to type of property.

Consideration also needs to be given as to how a user pays system can be introduced for particular categories of property or types of user.

ADMINISTRATIVE AND COLLECTION COSTS

The other major issue that needs to be addressed in designing a new funding system is the process and cost of collecting a property based charge. Minimising the administrative and collection cost will be important from the point of view of ensuring efficiency of the new 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 would appear 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 fire services 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.

Role of Local Government

In Western Australia the Emergency Services Levy was included on Local Government rates notices as this was the most cost effective and efficient method of billing all property owners. Local Governments will be paid an annual administration fee in recompense for billing, collecting and remitting the levy.

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)*

MODELLING OF ALTERNATIVE FUNDING ARRANGEMENTS

IAG working with the Insurance Council of Australia has commissioned the independent modelling of alternative fire services funding systems. This modelling exercise will assist the current Inquiry and the New South Wales Government by providing appropriate data for modelling the funding options.

Transitional mechanism will be necessary to ensure that there is no revenue shortfall in changing from an insurance-based funding system to a property-based funding system. IAG stands ready to assist the New South Wales Government in working through the transitional funding arrangements moving from the current funding system to a new property-based funding system.

APPROPRIATE FUNDING ARRANGEMENTS FOR MEETING THE EXTRAORDINARY COSTS ASSOCIATED WITH FIGHTING MAJOR BUSHFIRES

Insurance companies calculate the risks of events occurring and price cover accordingly. The premiums paid by large groups of people cover the losses incurred by small groups. This is the fundamental nature of insurance. However, the probability and severity of losses associated with fighting major bushfires are not calculable in advance and therefore unsuitable for funding through a pre-funding scheme or "fire fighting reserve".

Any pre-funded scheme – or "fire fighting reserve" - will cost money to administer, which, if there are no claims, is arguably a waste of funds. This cost includes not only the pool of funds, but the costs associated with collections, on-going compliance costs and transferring collections to the "fire fighting reserve".

IAG believes that there is no need for a "fire fighting reserve" if people prudently insured their assets.

If a "fire fighting reserve" were developed, a post-event funding scheme rather than a pre-funded model would be a more appropriate funding mechanism. Under this model, the costs associated with fighting major bushfires would be known, the Government could raise the immediate funding required, funding would only occur if a major bushfire event occurred and the costs could be borne by those affected, which could well be the whole community. Funding could then occur, for example, in the form of a specific levy. This option has an additional advantage in terms of simplicity of implementation.

CONCLUSION

IAG appreciates the opportunity to raise this important public policy matter with the Committee and reiterates its readiness to continue to assist the New South Wales Government to find an equitable and practical solution to fire services funding in New South Wales.

IAG commends this submission to the consideration of the Public Accounts Committee.