INSURANCE COUNCIL OF AUSTRALIA

SUBMISSION TO THE VICTORIAN GOVERNMENT OPTIONS PAPER

VICTORIAN FIRE SERVICES: PROPERTY LEVY

September 2011

Introduction

The Insurance Council of Australia (ICA) welcomes the opportunity to respond to the Victorian government's Options Paper "*Victorian Fire Services: Property Levy*" (hereafter Options Paper). The ICA welcomes the commitment of the Victorian government to implement the recommendation of the Victorian Bushfire Royal Commission to abolish the current system of statutory contributions and to replace the system with a broad based property levy.[1] The Insurance Council contends that the reform of the statutory contributions system for the funding of fire services represents a significant economic reform for Victoria and further, is the first major tax reform measure included as part of the Review of Australia's Future Tax System (aka the "Henry Review") that has been implemented at the State government level.[2]

The Insurance Council has on previous occasions, submitted the inequities of the current fire service contributions system, and in particular, concern over the presence of "free riders" who inadequately contribute to the funding of a public service. [3] Further, the ICA has also drawn attention to the horizontal inequity of the fire service levy given that it applies to the total ad valorem premium irrespective of the type or nature the of risk applicable.[4] The ICA is pleased to note that the weakness of the fire service contribution system has been formally acknowledged by policy makers and that a pathway to reform is being implemented.

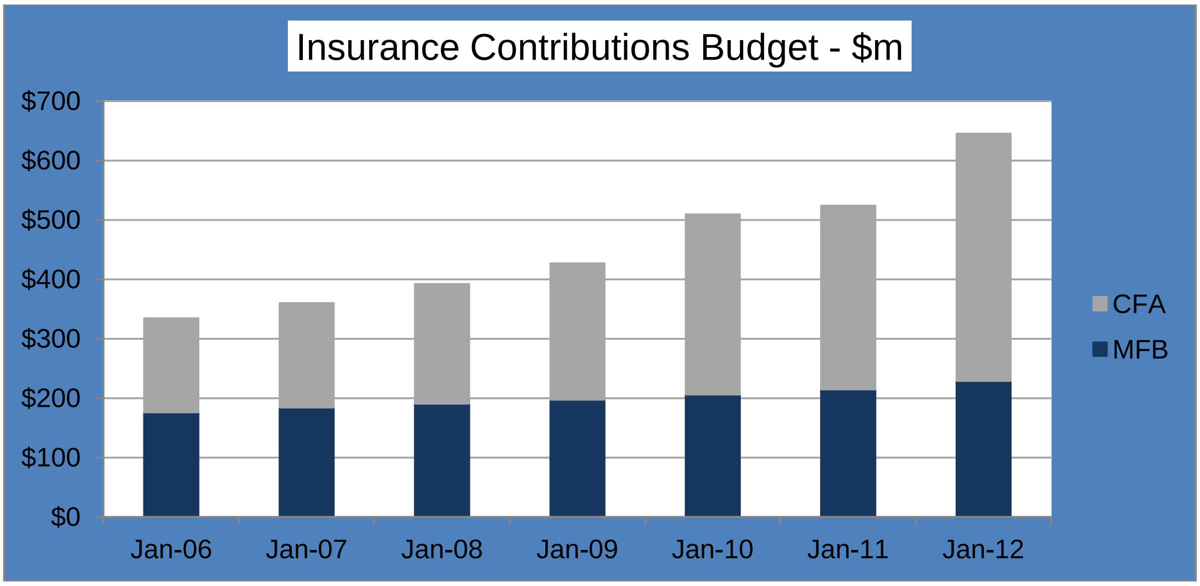
Notwithstanding these sentiments, the ICA wishes to emphasise that there remain significant challenges associated with transitioning away from statutory contributions in particular, the proposal in the Options Paper to "taper" FSL contributions. The ICA submits that tapering FSL contributions without concomitant relief from insurer contributions, would have adverse capital effects on the industry, and given strict regulatory and prudential settings for general insurance[5], would simply be unable to be accommodated. The industry fundamentally disputes the premise in the Options Paper that the general insurance industry stands to "*receive significant long term financial and economic benefits following the abolition of the statutory contributions model*" [6]and with that, the implication that the industry should bear the bulk of any transition costs. In contrast, the ICA contends that the advantages of a more equitable fire funding system will be shared by the whole community and moreover, as demonstrated by the experience of other jurisdictions, reform of statutory contributions does not provide any material financial benefit to the industry. [7]

[1] Recommendation 64 of the Victorian Bushfire Royal Commission said that "the State replace the Fire Services Levy with a property-based levy and introduce concessions for low-income earners". See Victorian Bushfire Royal Commission (2009)
[2] Recommendation 79 of the Review of Australia's Future Tax System stated, inter alia, "*All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad based tax on consumption*".
[3] See Insurance Council of Australia (July, 2010) "*Submission to the Victorian Government Green Paper: Fire Services & the Non Insured*"
[4] For example, two homeowners premium may equate (and hence FSL equate) despite differences in their risk profile/mix.
[5] The general insurance industry is subject to prudential regulations and controls set by the Commonwealth's Australian Prudential Regulation Authority (APRA)
[6] Victorian Department of Treasury & Finance (2011) "*Victorian Fire Services: Property Levy. An Options Paper"* at page 24
[7] See Sigma Plus Consulting (2004) "*WA Emergency Services Levy: Insurance Compliance Review: Final Report* "at http://www.fesa.wa.gov.au/emergencyserviceslevy/ESL%20Docs/insurance_Compliance_Rprt_April_2004.pdf

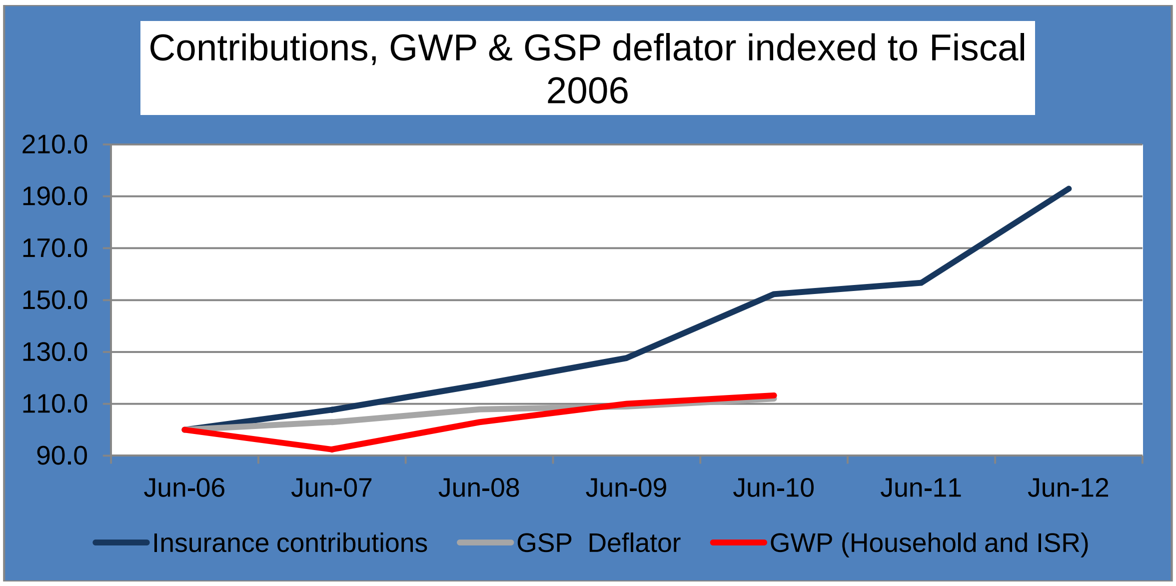
Current Settings – The Existing Contributions System & Fire Service Funding

The Current Victorian Fire Services Budget

A key challenge in implementing the new fire funding system is the need to ensure that the Victorian fire services continue to receive adequate resources to maintain an effective emergency service capability. In this regard, the ICA notes that the contributions from insurers to the budgets for the Victorian fire services have enjoyed considerable increases in recent periods.



Source: Insurance Council of Australia



Source: Insurance Council of Australia

As the above graphs demonstrate insurer contributions to the budgets of the Metropolitan Fire Brigades and the Country Fire Authority have escalated substantially over the last five years and the increase in contributions has outpaced growth in both inflation and premiums for property classes in Victoria.

As has been noted in previous ICA submissions to DTF on fire funding systems, insurers recover the cost of their fire contributions from policy insureds and accordingly, as contributions to the fire services increase, the FSL recovery increases concomitantly. [8]Moreover, the impact of additional FSL recoveries on policy holders is aggravated through the effects of tax "stacking" after taking into account GST and stamp duty effects.[9]

Fire Funding Models

The Options Paper outlines a range of fire funding models utilised in Australian jurisdictions and in New Zealand. The outline of models expressed in the Options Paper, however, remains incomplete, and in particular ignores alternative revenue sources for the fire services *in addition* to property-based charges.[10] For example, in South Australia, in recognition of the role played by the fire services in emergency rescue events (such as in motor vehicle accidents), the South Australian Transport authority collects a $24 charge on motor vehicle *registrations* as an emergency service levy. [11] Similarly, the Tasmanian government collects $15 per motor vehicle registration with the gross amount recovered through this measure amounting to some $6.5 million or around 9% of all Tasmanian fire services revenue.[12]

The ICA contends that, given the approaches in South Australia and Tasmania, it remains feasible for Victorian policy makers to consider the introduction of a charge on motor vehicle *registrations* as a contribution to meeting the future funding needs of the Victorian fire services. In that regard, the ICA estimated using call out data from the CFA that some 11% of all CFA call outs were for motor vehicle events. [13]. It is also noted that in its 2003 Review of Fire Funding Arrangements, the Victorian Department of Treasury & Finance recommended the introduction of a charge on motor vehicles in recognition of the role played by Victorian fire authorities in motor vehicle call outs/events. [14] The ICA respectively suggests that given the expected budgetary pressures potentially arising from the preference to phase in or "taper" FSL in the transition year (see below), the Victorian government would be well placed to consider revenue sources beyond those highlighted in the Options Paper (see below also).

The Revenue Upside from Fire Funding Reform in the Options Paper

As highlighted in its submission to the Green Paper, transferring the revenue needs of the Victorian fire services from the fire services statutory contributions system to a property-based system is expected to generate an improvement in Victorian economic welfare. [15] As a result of this improvement in overall economic welfare, it is expected that the

[8] The ICA issues FSL advisory calculations to its members, although the precise amount to be recovered is a commercial matter for individual insurers. Reflecting the substantial increase in the CFA Budget over the last five years, the ICA advisory rate for commercial properties in the VIC CFA district has escalated from 40% in March 06 to 85% today.

[9] *For example, a $100 risk premium for a commercial property in the CFA district would cost the consumer $223.85 after taking into FSL at 85%, GST and stamp duty effects.*

[10] See ICA (2010) *Submission to the Victorian Government Green Paper, Fire Services & the Non Insured* at page 21

[11] See South Australian Transport Authority at www.transport.sa.gov.au

[12] See Tasmanian State Fire Commission (2009/10) *Annual Report*.

[13] See ICA (2010) Submission to the Victorian Government Green Paper, Fire Services & the Non Insured at page 10.

[14] See Victorian Department of Treasury & Finance (2003), "*Review of Victorian Fire Services Funding Arrangements*".

[15] The welfare benefits from FSL reform arise as a result of moving to a relatively more efficient tax base and with that, the removal of deadweight costs to the Victorian economy. See Deloitte Access Economics modelling included in

Victorian government will generate an overall revenue "upside" which can be taken into account when assessing the benefits to the Victorian budget.
The ICA commissioned Deloitte Access Economics to utilise their general equilibrium model to estimate the revenue upside from transferring fire service statutory contributions to a municipal based property charge under various scenarios. The result of these simulations is provided overleaf.

	Welfare Increase	**Revenue Upside**
Replace insurance statutory contributions by an increase in municipal rates	0.152%	$16.74 million
Replace insurance and State government statutory contributions by an increase in municipal rates, with a decrease in government collections spread evenly across all sources of State revenue	0.165%	$14.01 million
Replace insurance and State government statutory contributions by an increase in municipal rates, with decrease in government collections targeted to most inefficient State taxes (i.e. motor vehicle taxes)	0.182%	$29.21 million
Notes: Welfare increase is the increase in household consumption *Source: Deloitte Access Economics (2011)*		

As the Deloitte Access modelling suggests, the reform of the statutory contributions arrangements will generate economic welfare benefits and with that, improvement to the Victorian government's revenue position. Indeed, the revenue benefits are maximised in the event that all statutory contributions are removed (including that of the State government) and the resultant revenue "windfall" to the State government is deployed to remove the most inefficient State taxes (in this case, motor vehicle taxes). [16]

The Options Paper Discussion - Transition Arrangements

The Tapering Approach

The Options Paper nominates 2012/13 as the transition year under which statutory contributions will cease to be payable prior to the commencement of the property-based charge from 1 July 2013. The Options Paper suggests that the transition year potentially carries significant risk and "...must be carefully managed". Nevertheless, despite observing that transition issues require careful management, the Options Paper settles upon the "tapering" method as the preferred approach for the transition year. The ICA contends that there are significant issues associated with the tapering approach that require careful attention prior to policy makers settling on this method as the preferred approach.

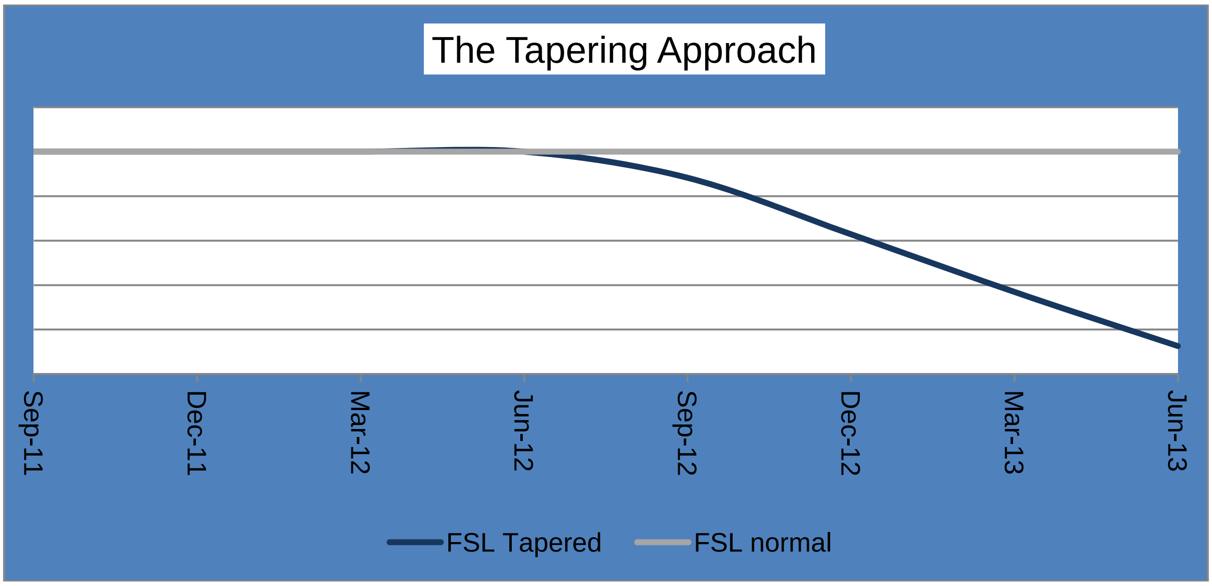
ICA (2010) *op cit* at page 26. See also, ICA (2009) *Submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Government Taxation & Debt* at page 23
[16] The ICA notes that the short run effect of removing the FSL from insurance policies will be to reduce stamp duty receipts.

As mentioned above, the Option Paper, proposes that FSL recoveries be tapered to "phase out" insurance contributions prior to the introduction of the property levy. The Options Paper sets out the tapering model as follows:

> *"Under the 'tapering' model, insurers would reduce the FSL paid on insurance premiums in the 2012/13 financial year on a pro-rata basis (for example, by 1/365th for each successive day in which an insurance policy is renewed or taken out during the year)."*

The Options Paper suggests the benefits of the tapering model to be its successful experience in Western Australia including its ease of implementation along with its accessibility for consumers. The Options Paper also draws attention to potential concerns over policy "arbitrage" whereby insureds defer insurance renewals in the months prior to the start up year (i.e. 2013). However, notwithstanding the above, a major omission in the Options Papers is the absence of the implications of the tapering model on existing fire service funding arrangements.

Assuming the current timetable, it is apparent that the tapering option sees the property levy to be introduced from 1 July 2013 and that tapering of FSL will occur in the 12 months prior to the introduction of the property levy. Accordingly, the FSL collected in the 2012/13 financial year will relate to the statutory contribution for the 2012/13 financial year notwithstanding that "tapering" will restrict the amount recovered under FSL by insurers. The impact of these settings is that insurers will only be able to recover half the statutory contributions payable[17] notwithstanding that the fire services require the full statutory contributions to meet their service obligations. Simply put, the tapering model sees a "funding gap" of 50% of the existing statutory contributions budget, which assuming 2011/12 receipts, would result in a deficit in funding of approximately $323 million. [18] The tapering model is best outlined in the chart below.



Notes:
FSL Normal denotes the level of FSL funded by the industry in a normal year. This equates to what the industry collects
FSL Tapered denotes the level of FSL collected in the tapering year.
Source: Insurance Council of Australia

[17] Assuming a normally-distributed renewal profile.
[18] 2011/12 statutory contributions to the Victorian Fire Services totalled $645 million.

Accounting for FSL

Regrettably, the Options Paper does not set out the consequences of the funding gap or the agency/body expected to meet the deficit. Nevertheless, subsequent to the release of the Options Paper, and as part of its stakeholder discussions, the Victorian DTF released a further paper examining the accounting treatment of the fire services levy by insurers (hereafter the FSL Accounting paper). [19]

The DTF FSL Accounting Paper reiterated the preference for tapering arguing that "*...the most equitable way of transitioning to the property-based levy for property owners is by using a 'tapering' model*". Furthermore, the FSL Accounting Paper indicated that "*...insurance companies would charge a pro-rata amount of FSL, during the transition year, proportional to the number of days remaining in the financial year when an insurance policy is taken out or renewed. During the transition year, insurance companies would still be required to pass on to the fire services the financial contribution equivalent to a full financial year*".

The FSL Accounting Paper then explains the impact of this methodology on insurers given the application of Accounting Standard AASB 1023. The paper states, inter alia, that:

> "*Assuming that this accounting standard is being followed by insurance companies then half of the contributions linked to the transition year would have been collected in the year prior and accrued. The "unearned" income or the FSL linked to the second half of the policy, collected in second half of 2011/12 and accrued, together with the money collected during 2012-13 should be sufficient to cover the contribution to the fire services during 2012-13. **<u>This would not result in a funding gap during the transition year for insurers</u>**". (Emphasis added).* [20]

The ICA fundamentally rejects the DTF analysis and understanding of the accounting treatment for FSL. At the very least, receipts for recoveries for fire service contributions are paid to the fire services and any requirement that stipulates full contributions be payable but simultaneously limits recovery, will result in a cash shortfall by insurers. The ICA emphasises that efforts to "cost shift" to the insurance sector any funding gap experienced through the transition will necessarily have capital adequacy and market implications. In brief, the insurance industry is simply unable to bear the burden for any funding gap arising from tapering and a full contributions approach.

Furthermore, notwithstanding the above, the industry firmly rejects the *technical* understanding of AASB 1023 and its implication for the tapering model. In accordance with accounting standards, both the ***revenue received*** and the ***payments made***, are both respectively earned and amortised through an insurer's profit and loss statement. In simple terms, the DTF FSL Accounting Paper highlights the "unearned income" aspect of insurance premiums and how such income is earned in the profit and loss statement after final receipt of FSL payments from policyholders. Regrettably however, the DTF FSL Accounting Paper ignores the accounting implications arising from the actual payment of FSL where it is recognised as a deferred expense and where a commensurate amortised expense is charged to the profit and loss statement. For the majority of the industry, deferred FSL is generally recognised as deferred acquisition costs in an insurer's

[19] See Department of Treasury & Finance "*Accounting Treatment of Fire Services Levy*," August 2011.
[20] See Department of Treasury & Finance "*Accounting Treatment of Fire Services Levy*," August 2011 at page 5

balance sheet and as such is not readily separately identifiable within the statutory accounts of most Australian insurers. Accordingly, the DTF FSL Accounting Paper mistakenly infers that AASB 1023 provides an additional source of earnings, when in fact none exist. [21]

The ICA is carefully reviewing the DTF FSL Accounting Paper and its implications. In this regard, an independent examination of FSL accounting in the Victorian insurance industry is under consideration by the industry and will be made available to Victorian DTF upon completion. In the interim, the insurance industry categorically rejects any suggestion that the insurance sector can meet the funding shortfall arising from tapering. A reform requirement which insists that insurers taper the FSL recovery whilst simultaneously fully meeting the budget contributions of the fire services, has marked implications for the prudential strength of the industry and potentially the availability of insurance cover in Victoria. Moreover, as the ICA submission to the Green Paper observed, in any given year the gap between premiums collected and claims payable for property classes varies according to the claims environment[22]. This fundamental feature of insurance further validates the industry position that it is simply unable to meet funding deficits without such arrangements having a profound effect on the prudential strength of the industry and the market provision of insurance itself.

The Decoupling Model

The DTF Options Paper refers to an alternative approach to tapering in the transition, referring to this Option as the "Decoupling Model". The term decoupling is used to describe the understanding that the FSL recovery is "decoupled" from the insurance contract and as such, bears no relationship to the insurance agreement. In other words, the starting point for the Decoupling Model is that the fire service levy represents an annual payment for what is a hitherto public good and it is this payment that is used to fund the fire services. Seen this way, the FSL bears no relationship to the insurance contract at all, and depending on when the insurance policy is taken out, the FSL payment would either be in arrears (i.e. when payable at year end) or in advance (when payable at the beginning of the year).

The DTF Options Paper indicates that the Decoupling Model allows for an arrangement under which a 50% discount to statutory contributions could be implemented allowing for a 50% reduction in the FSL recovery. Together with the 50% reduction in statutory contributions, the implementation of the property- base charge would be staggered whereby 50% of the fire services budget would be collected from property in the transition year, increasing to 100% in the full implementation year.

A graphic depiction of the Decoupling Model is presented below.

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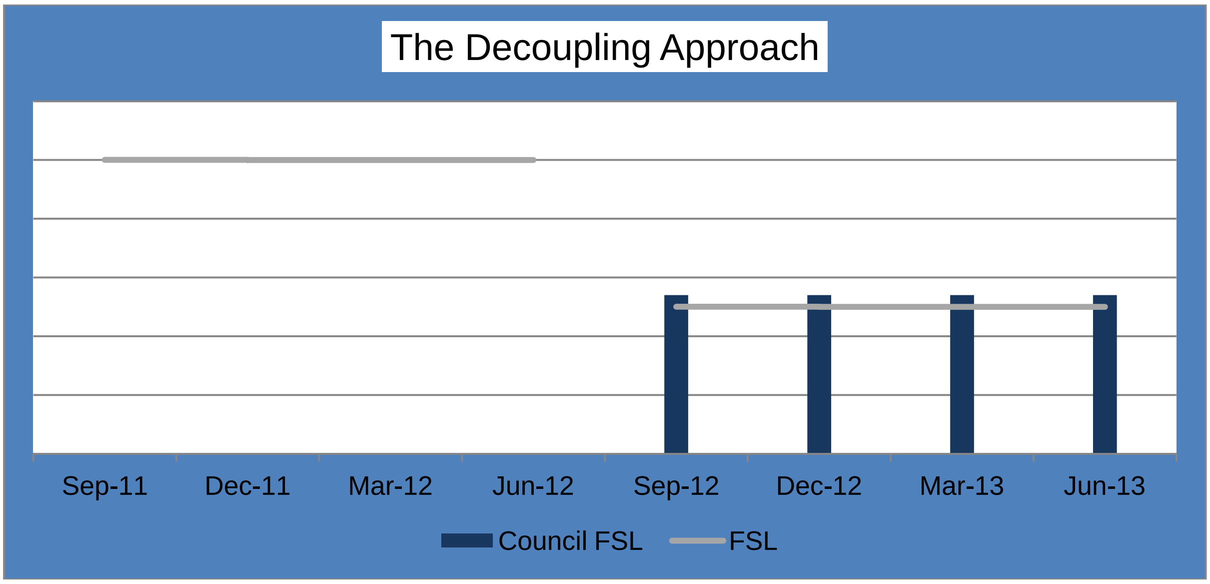
[21] See Allianz, "*Advice on Accounting Treatment of Fire Services Levy*", August 2011.

[22] For example, a "benign" claims environment would see a lower claims outlay for the industry while for a year of major catastrophes, the reverse would be true. The basic nature of insurance is that those who purchase insurance are providing for their future contingencies themselves, rather than being reliant on other parties (i.e. government). In 2009, the gross claims deficit (i.e. the difference between gross premiums and gross claims was $243 million for residential classes. In 2010, the gross deficit was zero. (Source: Australian Prudential & Regulatory Authority)



Source: Insurance Council of Australia

The DTF Options Paper makes the case against the Decoupling model on the basis of policy arbitrage and/or gaming of policy purchase. That is to say, in the absence of tapering (which the decoupling model would be), a policy holder would be subject to FSL (albeit reduced) on the 30 June in the transition year 2012, but a like policy holder with a renewal on 1 July 2013, would not be subject to FSL leading to the risk of non insurance for a temporary period.

The Options Paper also discounts the Decoupling Model on the basis that the option has not been successfully implemented in other jurisdictions. However, the Options Paper fails to mention that the Decoupling Model (or at least the 50%/50% variation) was recommended by the NSW Public Accounts Committee in its 2004 Review of Fire Services Funding.[23] Recommendation 7.2 of the Public Accounts Committee stated, inter alia:

> *"If a property-based system is introduced, then there should be a transitional period where both the old and new funding systems operate concurrently. During this period, the property levy should be paid at half the required rate, as well as any insurance policy that is renewed during the transitional period, up to and including the last day of the transitional period. Any part of the annual premium that spans the end of the transitional period should be charged FSL*".

The major advantage of the Decoupling Model is that it avoids the funding deficit for the fire services that arises from tapering. [24] However, the ICA acknowledges that the Decoupling Model poses challenges with respect to incentives and policy arbitrage as well as requiring the collections system for the property-based charge to be available in the transition year.

Alternative Transition Arrangements

[23] See NSW Public Accounts Committee (2004) "*Review of Fire Services Funding: Report No. 5/53 (148)*

[24] *As outlined previously, the funding deficit arises from the need to fully fund fire services yet mandating that recovery for FSL contributions be tapered according to policy term.*

The insurance industry is mindful of the importance of the FSL reform and the need to ensure that the transitional arrangements in the run up to the introduction of a property based charge are seamless and well understood. The ICA recognises that the conditions for successful FSL reform will be highly dependent on the transitional arrangements and that policy makers will focus considerable attention to these aspects of the policy. The ICA also recognises that equally, given constrained budgets policy makers will seek to ensure that reform of FSL does not adversely impact on the overall fiscal position in Victoria or compromise existing fire service resource allocations. With this in mind, the ICA seeks to offer alternative transitional pathways for consideration. These are outlined below.

Tapering with commitment to remit all FSL collections in the transition year

As identified above, although the Tapering Model has the benefit of minimising the risk of policyholder arbitrage, it results in a funding deficit as FSL recoveries are tapered and the fire services require full budget contributions. In addition, and as clearly enunciated previously, the insurance industry is not in a position to meet this funding deficit without adverse implications for prudential settings and market conduct. It has also been demonstrated in this submission that accounting standards as they apply to FSL take into account both the premium and the costs of FSL remittances and accordingly, that any suggestion that existing accounting standards dismiss the funding deficit are technically incorrect.

Nevertheless, given the apparent policy preference to taper FSL receipts, the ICA contends that it is feasible to mandate that *all* collections for FSL by insurers in the transition year be remitted to Victorian authorities. The advantage of this approach would be that any *potential* upside arising from over collections would be passed directly to the Victorian authorities to assist in meeting the funding shortfall. [25]

It is also contended, that his approach could be enhanced by a requirement that insurers observe disclosure requirements for FSL recoveries as is the case in NSW. For example, Section 80 of the NSW *Fire Brigades Act* requires insurers to disclose any recovery from policyholders for contributions payable by an insurance company to the NSW Fire Services. [26] The disclosure of FSL recoveries to the consumer would assist in improving the transparency of the transition, and further, allow decision makers to submit to the public that all proceeds identified as FSL contribution recoveries would be remitted back to the fire services.

Block or Step Down Tapering

An alternative to tapering according to a daily arrangement (as suggested in the Options Paper) would be for policy makers to consider a “block” or step down approach to tapering, whereby FSL is reduced according to a staggered formula. The advantage of this approach is that the amount collected for FSL will be larger than tapering according to a daily basis and as such, would assist in reducing the funding deficit. It should be emphasised, that, in the same way that the insurance sector would be unable to meet a funding deficit in the event of daily tapering, the insurance industry is not in a position to support funding under a “step down” taper. Nevertheless, the ICA

[25] Note, the nature of contributions remittances and FSL recoveries is that under and over collections are an intrinsic feature of the system. As the Options Paper itself observes, discrepancies between collections and payments are likely to be the result of estimating premium income in advance of revenue collections. See DTF “op cit” page 7.
[26] See Section 80 of the *NSW Fire Brigades Act 1989*

contends that there exists merit in policy makers considering such an approach as it assists in providing some relief to the funding deficit.

A "block" taper would see FSL rates step down according to the following formula.

- From 1 July 2011 to 30 September 2011, the amount collected would be based on 100% of FSL recovery on 1 July.

- From 1 October 2011 to 31 December 2011, the amount collected would be based on 75% of the advisory rates on 1 October.

- From 1 January 2012 to 31 March 2012, the amount collected would be based on 50% of the advisory rates on 1 January, and:

- From 1 April 2012 to 30 June 2012, the amount collected would be based on 25% of the advisory rates on 1 April.

Adhering to this approach, 100% of the Gross Written Premiums (GWP's) in each quarter would have the applicable proportion of the FSL applied. If the GWP's in each quarter are equal (that is to say, each quarter has 25% of annual GWP) then the same proportion of the needed fire services budget would be collected each quarter and the total FSL collected would be 62.5% of the budget. [27]

The key point to note is that all premiums in the first quarter of the year would pay 100% of the FSL rate, even if the policy is renewed at the end of the first quarter. (As a result, 100% of FSL would be payable as opposed to a daily taper which would require only 75% being payable). However, given the large Fire Services budgets and the concomitant size of the funding deficit, policy makers may see some merit in reducing the funding deficit from 50% of the fire services budget under a daily taper to that of 37.5% under the step down "block" approach.

The ICA acknowledges that the "block" taper carries some risk in terms of consumer perceptions around tapering and in particular the relative fairness of such an approach. The ICA also concedes that block tapering may exacerbate gaming or policy arbitrage, particularly for those policyholders whose insurance expires close to the end of the "block" quarter. However, the ICA contends that together with an obligation to remit all FSL proceeds, the block tapering approach has material benefits in terms of reducing the funding deficit. It is for this reason that the ICA considers the suggestion worthy of consideration by Victorian policy makers.

Shifting the Taper – the WA Approach

The Options Paper makes reference to the experience of Western Australia upon its change from the statutory contributions system to a property-based charge. In discussing the Western Australian approach the Options Paper states:

> "*Western Australia adopted a tapering approach as part of their transition model, which proved to be feasible and easy to communicate to stakeholders*". [28]

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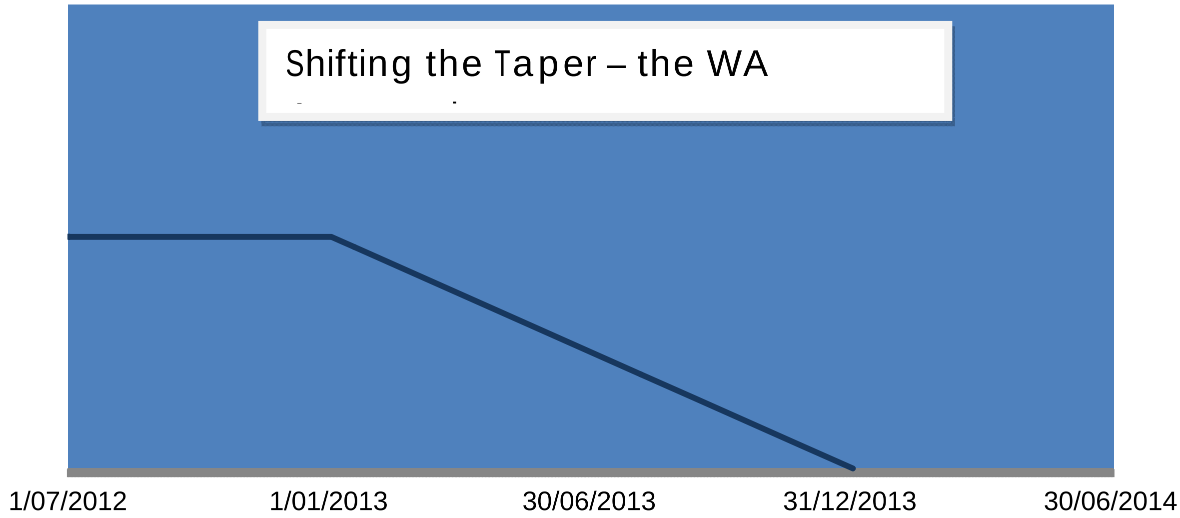
[27] That is, FSL collections = Budget * (100% * ¼ + 75% * ¼ +50% * ¼ + 25% * ¼) = 62.5% of Budget
[28] See DTF Options Paper at page 24

Nevertheless, the Options Paper does not indicate that the preferred tapering approach in the transition year differs materially from that experienced in the WA transition. In the case of WA, the industry tapering period commenced six months prior to the commencement of the property-based levy and continued for six months after the introduction of the property-based levy. [29]

Although the ICA contends that shifting the taper has clear advantages in terms of reducing the funding deficit, it is also conceded that this same approach has challenges in terms of stakeholder perceptions. In particular, it is recognised that consumer perceptions around the equity of the measure may impede its success, although in the case of Western Australia, appropriate information and advertising efforts succeeded in ameliorating a number of these impacts.



Source: Insurance Council of Australia

Other measures to assist in meeting the funding deficit

The above alternative proposals are designed to assist with the challenge of ensuring an effective transition to a property-based system simultaneously as ensuring such a transition does not impact adversely on the State's fiscal position. As previously outlined, the insurance industry is simply not in a position to endorse proposals that require tapering of FSL recoveries, while at the same time, mandating that 100 per cent contributions be payable.

With the above in mind, the ICA contends that the Victorian government would be well placed to consider a range of options to meet the funding deficit. For example, the ICA would look favourably on a measure that seeks to recover the capital cost of any funding deficit into the future by adjusting the property- based charge in the short to medium term. Given that a property charge has the benefit of capturing non insureds in the funding base, the ICA contends that such an approach would be equitable and efficient. In a similar vein, the ICA considers that Victorian policy makers could consider extending the 2012/13 transition year to include the property-based charge and thereby

[29] It should be noted that the insurance industry was committed to pay 75% of the Career Fire & Rescue Services (CFRS) recurrent budget between June and December 2003. That is to say, the industry remitted 37.5% of the total budget of the CFRS for 2003/04. (Source: Fire & Emergency Services Authority of WA (June 2002) "*A Replacement Funding System for Emergency Services*" and Minister for Police, Emergency Services, Local Government, June 2002.

facilitate an approach whereby insurance contributions and property based charges are levied simultaneously. [30]

Irrespective of the chosen transition path, the ICA agrees with the Options Paper that the transition to a new property-based system requires "active management" and in that regard, would welcome the continuation of consultative arrangements between the industry and the government. The ICA contends that only through ongoing consultation between government and the industry can the expectations of all stakeholders be satisfactorily met.

[30] This is essentially the decoupling approach recommended by the NSW Public Accounts Committee with a 50/50 split between contributions and property.

Other Issues

Timetable for Implementation

The Options Paper sets out the timetable for implementation of a property-based system from 2013/14. [31] In particular, the ICA notes that legislation is planned to be introduced in "early 2012" with the transition period commencing 1 July 2012.

Although the insurance industry is agreeable to the broad implementation timeline, including and in particular, the start up date of the property based charge, the insurance industry is concerned that the period between the introduction and finalisation of the relevant legislation and the commencement of the transition period may be insufficient to meet any mandatory system change requirements. In particular, given the time needed to implement the relevant system changes and the lags associated with the renewal process, it is respectively suggested that the time between passage of legislation and the start of any transition may be insufficient.

Nevertheless, the industry proposes that in lieu of the above concerns, that consideration be given by Victorian decision makers to the issuance of draft legislation in late 2011prior to the formal introduction of the same legislation in 2012. The advantage in issuing draft legislation is twofold. Firstly, the draft legislation will serve to provide an understanding to the insurance industry (and other stakeholders) of the key system changes needed to meet transition requirements (for example, tapering). Further, the issuance of draft legislation would also provide a further opportunity for community/stakeholder discussion prior to the legislation entering Parliament, thereby assisting with a more seamless passage of the legislation in the Parliament.

Monitoring

The Options Paper identified the need to put in place effective monitoring systems to "*…strengthen the incentives for insurance companies to fully pass on premium reductions and demonstrate premium reductions*". [32] In that regard, the Options Paper nominates the Victorian Essential Services Commission (ESC) as the appropriate agency to undertake such monitoring.

The insurance industry understands stakeholder and policy makers desire to put in place effective monitoring measures post FSL abolition and that the ESC is appropriately equipped to undertake such a task. However, the industry contends that caution needs to be exercised to ensure such monitoring measures do not stray into default price/premium setting and that appropriate allowance is made for adjustments arising from the normal course of the insurance cycle and specific events. As the Options Paper itself suggests "*…the nature of the insurance industry and significant events such as the recent floods may make it difficult to identify savings to insurance policy holders, particularly in the residential sector*".[33] The insurance industry submits that any monitoring system must necessarily take into account premium adjustments arising from the nature of insurance and accordingly, flexibility should be built into the terms of engagement for any monitoring exercise by the ESC.

[31] See Options paper at page 26
[32] See Options Paper at page 21.
[33] See Options Paper at page 24.

Conclusion & Summary

The Insurance Council of Australia welcomes the announcement by the Victorian government to abolish the fire services levy and the opportunity provided by the Victorian government to lodge this submission to the Options Paper consultative process. The ICA contends that abolition of the fire services levy in Victoria is a far reaching reform which will provide lasting benefits to the Victorian public, fundamentally strengthening community resilience to extreme weather events.

Notwithstanding the significant benefits to the public of abolishing fire levies, as this response to the Options Paper outlines, significant challenges associated with transitioning away from the statutory contributions system to a property-based charge do exist. The most notable of challenges is perhaps the matter of ensuring that the Victorian Fire Services are resourced adequately during the transition phase and that their funding is maintained throughout.

In that regard, the ICA has noted in this submission that the Options Paper preferred method of tapering during the transition, given existing Fire Service funding arrangements, would result in a funding deficit. Moreover, this submission reiterates the ICA position that the insurance industry is not in a position to meet such a funding gap given prudential and market circumstances. In the event that Victorian policy makers were to mandate a tapering system and at the same time demand full contributions in the transition year, the insurance industry would need to fundamentally reassess its position in terms of the Victorian market and the broader aspects of FSL policy itself.

Nevertheless, the ICA is willing to continue to work with the Victorian government in meeting the challenges associated with the transition away from FSL to a property-based charge. This submission seeks to assist with this process by offering solutions to the funding deficit challenge such as re-examining the benefits of the decoupling model; shifting the taper to include a longer transition; the inclusion of motor vehicles as a further funding source and also recovering the funding deficit into the future from adjustments to the property-based charge.

As the Options Paper identifies, the transition process needs to be managed carefully. The ICA concurs with this sentiment and respectfully suggests that the Options Paper should be seen as just the first step in the consultative process. The ICA submits that the Victorian government would be well served by ensuring ongoing and close consultation with the industry in the run up to the introduction of the property-based charge.