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THE TREASURY

Kaitohutohu Kaupapa Rawa

# 60/40 Cost Sharing Arrangement Reform – Update on Progress

February 2016

# Background

- Canterbury earthquakes had a significant impact on council insurance services
- LGNZ commissioned Craig Stobo to undertake a review, findings were:
  - “The 60/40 per cent co-funding arrangement with the Crown for underground infrastructure damage caused by a natural disaster has no basis for its formula, incentivises councils to avoid self-reliant risk management outcomes and creates funding uncertainties for both parties. This needs to change.”
  - Some councils are not engaging in systematic risk management processes due, in part, to a difficulty in accessing the necessary skills and expertise.
- Ministers agree to review 60/40 in April 2015. The Treasury, DIA and MCDEM to be responsible for it.

# Nature of the Review

## Principles underlying Crown support

- Local risks are a local responsibility.
- Financial assistance policies should incentivise effective council risk management.
- Risk mgmt costs should be borne by those who benefit.
- Risk should be mitigated and managed where possible.
- The Crown has a role in supporting welfare of communities post disaster.

## Objective of reform options

- Balance the role of the Crown in supporting community welfare with the responsibility of councils to manage local risks.
- Incentivise councils to better manage risks.

# 60/40 Parameters - Current

- **Assets covered**: “Essential infrastructure assets” and “other community assets” (where damaged by the failure of flood protection schemes).
- **Thresholds:** 0.002% or 0.0075% of a councils rating base.
- **Cost sharing ratio:** 60%/40% Crown/Local Authority.
- **Access obligations:** Adequate protection through asset and risk management **or** sound financial provision but councils are not monitored against these criteria.
- **Cost of risk sharing:** No cost.

# Assets Covered

## **Objective:** Clarify & Simplify Coverage

### Potential Changes

- *Include:*
  - Three waters infrastructure and flood protection assets.
    - Definitions aligned to national engineering standards.
    - Aligns coverage to critical infrastructure.
- *Exclude:*
  - Electrical and gas facilities.
    - Profit making , well-insured. No rationale for Crown financial assistance.
  - Other community assets where damaged by the failure of flood protection schemes.
    - Most are likely to be insurable and are not ‘lifeline utilities’.
- Assets covered irrespective of ownership arrangements.
    - CCO’s are included.
    - Rationale is that asset criticality is not linked to institutional form.

# **Objective:** Move to a more insurance centric with the Crown as an 'insurer of last resort'

## Potential Changes

- Crown takes a much lower share losses from more frequent, less severe events.
  - Preliminary evidence that insurance market for assets exists.
  - Strengthens incentives to manage risk.
  - Aligns costs and benefits.
  - Crown could underwrite 'top-up' insurance cover if the market cannot provide sufficient capacity in high risk regions e.g. Wellington, or in times of disruption e.g. post disaster.
- Crown takes a much greater share of losses from less frequent, more severe events.
  - Recognises Crown role in supporting community welfare post disaster.
- Probable Maximum Loss (PML) is used to define the boundary between the two layers.

# Supporting Regulations

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## **Objective:** Codify reforms & incentivise risk mgmt

### Potential Changes

- **Enhanced disclosure**: each council required to disclose its PML, and what its risk financing strategy is to meets its PML, in its annual report.

- **Risk management regulations** introduced into the Local Government Act. That is, councils must demonstrate that they are undertaking a robust risk management process in accordance with issued guidelines.

- The proposed **LGRA** would be well placed to assist rural and provincial councils with their PML assessments and/or their risk management process generally.

# Cost and Affordability

## Potential Affordability Issues

- Potential changes would place additional costs on local authorities. The materiality of these costs is being assessed. If these costs are material there are a number of ways to manage their impact:
  - Phased implementation – incremental changes to cost sharing arrangement made over 2-3 years.
  - Provide $ support directly to councils or to the LGRA.

# Next Steps

- Finalise evidence base to confirm approach.
- Continue to support LGRA Establishment Board process.
- Develop the reform options into a consultation paper with DIA and MCDEM – end of April 2016.
- Public submissions open for 6 – 8 weeks.
- Cabinet consider submissions and makes final decisions.
- Changes implemented over transition period.

# Disclaimer

- Potential changes in this pack are Treasury's view of the options that best achieve the objectives of the review.
- These options need to continue to be tested against the evidence base and other perspectives through the drafting of the consultation paper.