



interactive games & entertainment association

Submission to the Department of Internal Affairs

**Response to consultation on the review of options for
funding the classification framework under the *Films,
Videos, and Publications Classification Act, 1993***

January 2020

Interactive Games & Entertainment Association

Summary of key views

- **The market for physical (boxed) video games has steadily diminished in scale over recent years.** Despite this, the number of video game submissions to the Office of Film & Literature Classification (OFLC) has remained relatively steady, suggesting that the profitability of each physical product being released is under sustained pressure.
- **The cost of submitting video games for classification is far greater than the cost of submitting films and DVDs/online.** Not only is the upfront cost more expensive, but almost half of film and DVD/online submissions also receive fee waivers. This suggests that our sector may currently be subsidising the OFLC's film and DVD/online activities.
- **New Zealand is one of the most expensive - if not the most expensive - markets for games businesses to submit content for classification.** It currently costs more to have content classified in New Zealand than in Australia for most games, and on a market size-adjusted basis it is many orders of magnitude more expensive to submit content for classification here than in Europe and North America.
- **We do not support any increases to the cost of submitting video games for classification.** Any increase in the cost of classification will have a detrimental impact not only on our industry and consumers, but on the New Zealand Government's budget as games will be withdrawn from physical release and the OFLC's falling revenues will accelerate.
- **Option 1 (full cost recovery) will result in the collapse of the physical video game market.** Option 2 (no cost recovery) is supported. Option 3 (partial cost-recovery) is considered fair and, depending on the level of cost-recovery, also supported. Any cost-recovery model that results in fees for video game submissions that are higher than those currently being charged is not sustainable.
- **We support a user-charge model and see no rationale for, or benefit in, the adoption of a levy model.** User charges for each kind of content should also be consistently proportional to the respective costs of classifying that kind of content. For example, the recovery of costs for our sector is at a much higher rate than the recovery of costs for the film and DVD/online sectors. Finally, we believe that the current 'urgent' fee is unfair as it costs more for games than other media.
- **This review should be holistic and not just focused on inward fees.** We encourage the Department to consider whether the OFLC's current budget is sustainable, and whether certain reform options should be considered to make the classification process more efficient.

Introduction

The Interactive Games & Entertainment Association (IGEA) is the peak industry association representing the business and public policy interests of New Zealand and Australian companies in the interactive games industry. Our members publish, market, develop and distribute interactive games and entertainment content and related hardware. We proudly represent a number of homegrown and independent New Zealand businesses that provide a range of games that New Zealanders love, and help to support retailers and storefronts across the country.

We appreciate the opportunity to contribute to this important review given the significant changes that have occurred in the media landscape in recent years. As an industry we pride ourselves on taking our classification responsibilities seriously and engaging cooperatively on policy discussions. This submission seeks to provide the Department with information about the direction of the local video game market, which will have implications for how classification is charged, and also responds directly to the reform options and discussion questions posed by the consultation paper. We believe that the issues raised in the discussion paper, and some others that we have also raised in our submission, will require further discussion following the end of this consultation period and we look forward to further conversations.

The classification of video games in New Zealand

In New Zealand, video games fall under the definition of 'film' in the *Films, Videos, and Publications Classification Act 1993* (the Act). Under the current system, all games with restricted content must carry a New Zealand classification label, but unrestricted games can be supplied in New Zealand carrying overseas labels that help to provide guidance to parents. This limited exemption from labelling requirements - which has existed since the Act came into force in 1993 - has enabled New Zealanders to access a wide range of video games that otherwise might not have been viable to be brought into New Zealand due to the cost of classification, while also ensuring that children are protected from content that might distress them. This exemption has continued to function effectively and safely for the better part of two decades and we are not aware of any community or regulatory concerns.

When a video game is classified in New Zealand, the classification assigned to it applies to all identical copies of the game. This means that a game that is classified on one device or platform carries that classification across all platforms as long as the game is the same. This is vital for video games given the prevalence of titles that are playable across various platforms, with some games distributed across all three major consoles, two mobile platforms and PC. A video game that is classified is not just classified for the applicant, but for any business that wishes to sell the game in New Zealand. This means that New Zealand distributors that pay to have their games classified are subsequently vulnerable to grey importers who bear no such costs and can 'piggy-back' on the classification. This has been a growing challenge for our industry.

There is no clear legal requirement for games distributed online, such as via downloading or streaming, to be classified and the OFLC has taken the position that it only requires games to be classified if they are distributed in New Zealand in hard-copy or if they are called in by the Chief Censor.¹ In practice, many of the most popular online games played by New Zealanders (that are not exempt from classification) are classified anyway, either voluntarily or because they have also been released in physical format.

The video games industry and partner ratings authorities around the world, including the Australian Classification Board, have since 2013 worked together to build the International Age Rating Coalition (IARC) system to ensure online games carry local classification information. The IARC system has now been successfully implemented on a range of storefronts, including Google Play, the Microsoft Store, the Nintendo eShop, the PlayStation Store, the Oculus Store and Origin. This has resulted in the classification of many hundreds of thousands, if not millions, of video games that would otherwise be impossible to classify by traditional manual rating methods. We understand that the OFLC has considered its participation in the IARC system.

¹ Office of Film & Literature Classification, Annual Report 2017-8, p. 8

The New Zealand video game market – Statistics and trends

Diminishing sales of physical (boxed) games

According to our research, the New Zealand video games industry generated \$548 million in 2018, a growth of 21 per cent from 2017.² However, this growth has not been evenly spread across the industry and much of this growth has been supported by parts of the industry that are not relevant to this review, including hardware, accessories and in-game items. Sales of physical console video games, the most important segment of the market for the purposes of this consultation, continues to fall as seen in the table below.

Table 1. Sales of physical (boxed) video games in New Zealand

Year	Sales	Annual growth/decline
2018	\$52.4 million	-1 per cent
2017	\$53 million	-11 per cent
2016	\$58 million	-10 per cent

Source: IGEA research

Video game submissions to the OFLC remaining steady

Over a number of years, there has been a slow downward trend of overall material that the OFLC has received for classification and revenue from the Film & Video Labelling Body (FVLB), including a 20 per cent reduction in revenue from games in 2018-9 compared to 2017-8.³ However, the number of video game classification decisions that the OFLC has performed over the past five years, as displayed in the table below, indicates that submission rates have remained more or less steady.

Table 2. Video game classification decisions made by the OFLC

Year	Video game decisions	Total OFLC decisions	Video games' percentage of total decisions
2018-9	67	1,468	5 per cent
2017-8	82	1,825	4 per cent
2016-7	75	2,293	3 per cent
2015-6	56	2,395	2 per cent
2014-5	57	2,361	2 per cent

Source: OFLC annual reports

This data shows some interesting points highly relevant to this review:

- First, the OFLC classified a greater number of video games in the financial years 2017-9 than it did in the financial years 2014-6. This is in stark contrast with the falling number of total OFLC decisions.
- It therefore indicates that the share of the OFLC's total industry revenue generated by the video games sector continues to rise steadily, particularly

² IGEA, New Zealanders' appetite for video games continues to skyrocket, May 2019, <https://igea.net/2019/05/new-zealanders-appetite-for-video-games-continues-to-skyrocket/>

³ Office of Film & Literature Classification, Annual Report 2018-9, p. 8

given the fact that video games applicants currently pay the most expensive classification fees.

- The relatively steady number of video game decisions, compared with the decline in the market of physical video games, suggests that the commercial gains from the games being submitted for classification, at least in terms of physical sales figures, is falling.
- In each of the last five financial years, there were fewer classification decisions than the equivalent number of restricted games classified in Australia, suggesting that some physical games could not find distribution in New Zealand. We have heard from some of our members that the current high cost of classification in New Zealand compared to the small market size of the country means that the economic viability of distributing games in physical format in New Zealand is becoming increasingly difficult. As a result, it is likely that New Zealand consumers will have less access to content (at least legally) than their Australian neighbors.

The cost of classifying video games in New Zealand

While acknowledging the fact that only restricted video games need to be classified, the cost of classifying video games in New Zealand has always been expensive compared both to other kinds of content as well as compared to jurisdictions overseas.

Table 3: Cost of classification and OFLC industry income in 2018-9

Type of media	Fee \$	Submissions	Waivers Waivers can be up to 75 percent of standard fee	Urgents Urgent fee: half of standard fee	Revenue received \$
Film	1,124.10	305	188	60	209,569
DVD/Online	1,124.10	466	156	8	225,866
Film trailer	511.10	11	0	1	5,877
Computer Game	1,431.10 (first 5 hours)	66	0	43	125,221
Totals		1726	344	112	568,246⁷

Source: Discussion paper

The cost of classifying video games vs. linear content

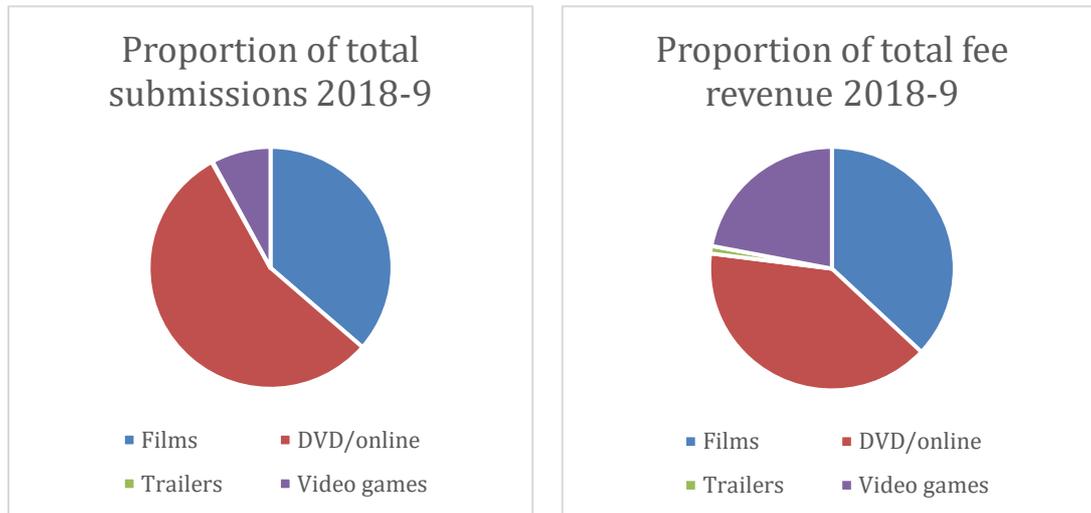
The cost of classifying a video game is \$1,431.10 for the first 5 hours plus \$102.20 per extra hour or part thereof. By comparison, the nominal cost of classifying a film, DVD or online program is \$1,124.40, which is almost a quarter less expensive than games. Furthermore, as the above table shows, more than half of all film applicants and a third of DVD/online applicants also received a waiver of up to 75 per cent of their (already lower) fees. No waivers were given to computer game applicants.

Furthermore, the urgent fee is an additional 50 per cent, which brings the cost of classifying a video up to \$2,146.65. In 2018-9, 43 of the 66 video games submitted for classification, which is to say 65 per cent of all video game applications that year, were submitted as urgent applications, bringing the average real cost of classifying video games in New Zealand to \$1,897.29. The decision to make an urgent application is often not a choice for local publishers and distributors as the period of time that they have between receiving a game and bringing it to market is often very small and entirely out of their control. By comparison, less than a fifth of film applications and less than 2 per cent of DVD/online submissions were urgent applications.

Taking into account the higher fee for computer game applications, the far higher need for urgent fees and the significant amount of waivers given to film and DVD/online applicants, the average cost for each video game applicant of \$1,897.29 in 2018-9 was over three times the cost of the average cost for each film/DVD/online applicant at just \$564.77. Extraordinarily, while the video game industry was responsible for less than 8 per cent of total submissions in 2018-9, meaning that only a small proportion of the OFLC's total workload was spent on classifying games, the revenue raised from video game businesses accounted for almost a quarter of the OFLC's total revenues from industry. This suggests that the fees collected from our

sector may currently be subsidising the OFLC’s under-collection of revenue from film, DVD and online distributors.

Table 4: Comparison of submissions made vs. fee revenue



Source: Extrapolated from table 3 above

Comparisons with the cost of classifying video games overseas

The discussion paper suggests that compliance with classification requirements in New Zealand is considerably less costly than in Australia and the UK and is not a significant burden on major distributors. While this may be true for theatrical film releases, particularly considering that the majority of film applications and over a third of DVD/online applications were given waivers in 2018-9, it is not an accurate reflection of the cost of getting video games classified in New Zealand in contrast with the rest of the world.

The cost of getting video games classified in Australia is either \$1,210 (NZD \$1,250) or \$890 (NZD \$920) depending on the ‘level’ of the game, while a demonstrated application, which is required for only a very small number of games, is \$2,460 (NZD \$2,540). A significant proportion of video game applications are able to access the cheaper \$430 (NZD \$440) fee for authorised assessment applications for certain games where the applicant can provide a recommendation to the Classification Board.⁴ The cost of a priority application is a fixed \$420 (NZD \$434), rather than the proportional cost used in New Zealand.

The cost of receiving classifications from other government-run rating systems can be even cheaper, as we have set out in the table below.

Table 5: Cost of classification by government-run ratings authorities overseas

Country	Indicative cost of a video game submission
Singapore	\$50 (NZD \$55) or \$200 (NZD \$223) for a priority request

⁴ While this scheme is unavailable for restricted games, it shows a potentially cheaper method of classification. For more information see <https://www.classification.gov.au/for-industry/apply-for-classification/classify-computer-game>

South Africa	R915 - R1831 (NZD \$98 - \$195) depending on the format
South Korea	The fee system is complex, but a typical localised 'AAA' shooting or action game on a console would cost ₩960,000 (NZD \$1,250) to classify, or ₩672,000 (NZD \$875) for small to medium-sized publishers.

Source: Regulators' websites and written regulations

The UK, together with most of the rest of Europe, share a single PEGI system for the classification of video games. This means that once a video game has a PEGI rating, that rating can be used right across Europe. Similarly, the US and much of Canada uses ESRB ratings, and ESRB ratings have also been accepted in other parts of Central and South America. While they are not published, we understand that the PEGI and ESRB systems use flexible charging models comprising scaled fees. While in some instance the nominal cost of receiving PEGI and ESRB ratings may potentially be greater than getting a classification from the FVLB/OFLC, the cost of receiving an OFLC classification on a market size-adjusted basis is many orders of multitude higher. Furthermore, all of the jurisdictions that have implemented the IARC system enable games to be classified via the IARC tool at no cost to developers and publishers, while in New Zealand the full fee is payable should a publisher wish to have an online game voluntarily classified.

In addition to the cost of classification by the OFLC, video game applicants must also pay fees to the FVLB, including a fee of \$20 (plus GST) just to have a video game cross-rated. This fee is payable even where there is no physical product to attach a label to. This system of dual administration is unique to New Zealand and we are not aware of a similar model existing anywhere else in the world.

Responses to the discussion questions

To assist the Department's review, we have provided direct responses to each of the discussion questions that are relevant to our industry.

QUESTION 1:

What are the implications for your business or activity arising from additional costs? For example: would you conduct your business or activity differently, would it affect the content your business offers, or would additional costs be transferred to consumers?

As we have highlighted in our commentary so far, the cost of classifying video games in New Zealand is:

- much higher than the cost of classifying film and DVD/online content
- higher than the cost of classifying video games in Australia and most or not all other countries with a government-run ratings authority, and
- on a market size-adjust basis, potentially the most expensive in the world.

Based on our industry analysis and discussion with publishers and distributors, any increase in the cost of submitting video games for classification, especially the significant increases canvassed in some of the options, will have the following impacts:

- **Video game publishers will reduce the number of physical products that they seek to introduce into the New Zealand market.** Distributing video games in physical format is already a highly expensive and risky activity, especially given the ease with which consumers may access games on the grey market (eg. purchasing directly via Amazon). The importance of the physical game market is already a diminishing proportion of the overall games market and is highly vulnerable to increased costs. The impact of higher fees will not only be on physical products. Higher classification fees will also reduce the incentive of online-only game publishers to voluntarily have their games classified.
- **Increased costs to publishers and distributors cannot easily be transferred to consumers** as video game consumers have highly rigid expectations about what games should cost. Over the past two decades, the price of physical video games to consumers has largely stayed the same, meaning that the inflation-adjusted cost of physical games has fallen year after year. The cost of creating video games, however, has risen significantly.
- **Additional classification costs will therefore be borne by publishers, distributors and retailers, who may be unable to absorb them.** Physical games that are too expensive to bring to market in New Zealand will simply not be sold here – at least legally. The real cost of any increase in classification fees will impact the distributors who serve the New Zealand market and the bricks-and-mortars retailers all around the country who will have fewer physical games to sell. These are businesses that collectively employ thousands of New Zealanders. The businesses that may flourish, on the other hand, would be unscrupulous distributors and retailers who see an opportunity to seize the market vacated by responsible businesses, flooding

the market with non-compliant products without appropriate warnings for consumers.

- **Consumers will suffer as their access to boxed video games will be reduced and/or they seek out non-compliant products.** This will disproportionately affect those without access to, or are unable to afford, high speed uncapped internet access and who rely on purchasing boxed games for their enjoyment. These consumers will likely still play the game, but will simply import them directly from overseas or purchase them from non-compliant businesses. Not only will this not support legitimate local distributors and retailers, but it also means that they may purchase games without any labels, or labels from jurisdictions with unfamiliar ratings systems.
- **Higher classification costs will both directly and indirectly impact on the local game development industry.** There are already only a small number of video game distributors left in New Zealand, given the small size of our market. These distributors will be impacted by any increase in classification fees and their sustainability will be threatened. Should distributors reduce their activities or exit the market entirely, it will reduce or remove the already limited ability of local New Zealand game developers - which the New Zealand Government regards as one of the highest priority industry to develop - to distribute home-grown games in physical format to serve the local market.
- **Increasing classification fees may very likely, and perhaps counter-intuitively, lead to lower overall revenue to the OFLC as publishers and distributors exit the physical retail market.** This will exacerbate the very challenge that this review is seeking to address and this is perhaps the most critical point of this submission. Unlike the theatrical film industry, where the supply and demand for cinematic films is relatively inelastic, many of the video games currently being classified by the OFLC (excluding a core number of highly consumer-friendly 'AAA' titles) have razor thin margins when it come to a justification for a physical release and these will be the first to exit the market should classification fees rise. Any potential higher classification fee will not compensate for the resulting drop in submissions, leading the OFLC and the New Zealand Government towards an even more challenging fiscal environment than it is currently facing.

QUESTION 2:

Are there other objectives or principles that the Department should take into account when deciding which option and the level of any charges to progress?

Overall, we support the 5 principles for assessing options outlined in the discussion paper and raise key issues that must be considered.

Table 6: Proposed principles for assessing options

Principle	Comment
Effectiveness	How well does the funding option achieve the Review’s objective? Does it produce any unwanted consequences?
Efficiency	The services provided by OFLC are produced to the required standard at the least cost. Transparency means operating in such a way that it is easy for others to see what and how many activities OFLC is carrying out, why, and at what cost. It implies openness, communication, and accountability.
Equity and fairness	This criterion asks whether stakeholders will be treated fairly and reasonably under the options being tested.
Simplicity	Is the cost-recovery option easy to understand and work with for stakeholders? Is it administratively simple and cost effective to administer?
Stakeholder engagement	Have stakeholders been involved in the process of informing the Government’s decision?

Source: discussion paper

We have set out our views against each principle below:

Effectiveness

- As discussed above, we are concerned that any option that increases the fees for submission will lead to lower overall revenue to the OFLC as video game publishers and distributors exit the physical retail market. This will surely be an unwanted consequence.

Efficiency

- It is not clear from the discussion paper, nor the OFLC’s annual reports, how the OFLC’s budget is spent - for example the proportion of the budget that is spent on operational classification activities, and the proportion spent on ancillary activities such as research and public affairs. It is also not clear what proportion of the budget is spent on different media types, like video games, films and adult content. We have discussed in this submission our concern that the revenue raised from video game submissions may be helping to subsidise the OFLC’s expenses unrelated to our sector, such as the significant volume of waivers given to film and DVD/online applicants.
- Furthermore, we are not sure whether some of the OFLC research activities like the ‘Youth and Porn - How and Why Young New Zealanders are Viewing Online Pornography’ project conducted in 2018-9, while very important from a public policy perspective, are being funded (at least partly) from industry classification fees, despite being of limited relevance to the majority of fee-payers.

- The discussion paper does briefly turn to this point on efficiency, noting that “*the degree of distributor influence on our system’s cost-efficiency will be enhanced by making the operations of OFLC as transparent as possible, through continued, regular review and setting of charges*”. The practical implementation of increased transparency of the OFLC’s operations is something we would strongly support.

Equity and fairness

- In looking at this principle, we encourage the Department to more strongly consider the objective ‘reasonableness’ of fee levels, as well as the nexus between the fees that are charged and how those fees are spent. While we consider the discussion paper to be of overall very high quality, we contest some of the broader sweeping statements that suggest that classification costs in New Zealand are relatively low and not a significant burden on industry. This may be true for some media types, but not our sector. As we have covered, the cost of having a video game classified in New Zealand is far greater than the costs for film and DVDs/online applicants, and in most instances greater than the cost in Australia and other jurisdictions.
- We also question the fairness of reviewing classification fees in the absence of any review (that we know of) of the scale and the cost of the OFLC’s operations. While jurisdictions like North America and Europe have ratings systems that are entirely industry-funded with no contribution by taxpayers, the critical difference there is that industry also has responsibility over the efficiency of the system itself and focus on keeping costs as low as possible.

Simplicity

- We discuss this later on the submission, but all other things being equal, we do not support a levy model. A charging ‘user-pays’ model is far simpler, as well as being far fairer for the businesses who use, and just as importantly – do not use, classification.
- On the other hand, we do not agree with approach taken in option 3 that seeks to simplistically determine a rigid proportional split between government and industry funding. The process of setting fees should be a far more nuanced process involving wider considerations.

Stakeholder engagement

- While we appreciate the opportunity for early engagement, we note that this consultation process only relates to high level principles and approaches and does not, for example, present any specific models or nominate any specific revised fees. We would expect the Department to engage in further industry consultation as these details become clearer. We would also appreciate any information on any efficiency-related proposals the Department is considering helping mitigate the upwards pressure on fees.

QUESTION 3:

What is your preferred cost-recovery option for OFLC's existing classification activities and why?

Option 1: Full cost-recovery from submitters

Option 2: No cost-recovery from users. The Government meets all costs arising from OFLC's classification activities covered by existing Regulations

Option 3: Partial cost-recovery from user-charges and Government funding

QUESTION 4:

If option 3 is your preferred option, do you agree with a 50/50 split between the Government and the sector? If not, what proportion of costs should Government and the sector pay?

QUESTION 5:

What impact would the cost implications in the scenarios under each option have on your business or activity?

We have responded to questions 3,4 and 5 together in our commentary below which have been addressed one option at a time.

Option 1: Full cost-recovery from submitters for costs arising from classification activities covered by the existing regulations

This is by far the most unreasonable and least fair of the three options. It should be no surprise that it is an option that we do not support. The discussion paper states that this option would increase the cost to applicants by 117 per cent. This would likely lead to a submission fee of \$3,105.49 for video games at the very least, which is over 7 times the cost of the cheapest submission in Australia (NZD \$440), while providing a rating covering a market that is around 5 times smaller in size.

The cost of an urgent submission would be an almost absurd sum of \$4,658, compared to the equivalent cost in Australia of NZD \$874. As we have covered at length in this submission already, this would lead to an immediate and significant collapse of video game submissions which should be gravely taken into account in any modelling of this option. It would potentially also lead to the demise - immediately or over time - of many existing video game publishers, distributors and retailers with a significant resulting loss of jobs. Not only would this lead to a greater fiscal burden on the New Zealand Government to fund the classification system, exacerbating current pressures, it may also lead to a need to increase spending on monitoring and enforcement costs to address the significant rise in non-compliance from opportunistic distributors and overseas retailers that would occur.

We are not aware of any government-run ratings system in the world that is entirely, mostly, or even half industry-funded. The discussion paper asserts that the "the federal Australian equivalent to our classification system is largely funded by the sector through classification fees". We respectfully dispute this, as it is our understanding that the Australian Government's federal classification function, comprising the operation of the Classification Board, the Classification Review Board and the Classification Branch of the Department of Communications of the Arts, is actually mostly budget-funded.

The discussion paper also makes the point that the “British equivalent is 100 percent sector-funded”. As we have previously discussed, with respect to video games the UK has adopted the PEGI system and while its implementation in the UK is industry-funded, it is also industry run – meaning that it has control over and is accountable for how the system is run. Furthermore, as the PEGI system is separate from film and other media, all of the costs paid by industry go only towards the administration of video game ratings, as opposed to the system in New Zealand where video game submission fees may go towards funding the operations, research and other activities of non-game functions (and theoretically, to be fair, vice versa).

Option 2: No cost-recovery from users. The Government meets all the costs arising from classification activities covered by existing Regulations

The discussion paper notes that it is likely that a shift to full Crown funding would not be opposed by the sector, and we certainly have no reason to oppose this option. Option 2 would likely lead to a greater range of video games being published, distributed and sold in New Zealand in physical format, supporting local publishers, distributors and retailers. It would also increase the number of online video games being voluntarily classified as they would be highly incentivised to do so.

While Option 2 would obviously have a cost impact for the Government, this cost would dwindle to close to nothing under a regulatory framework that in future extends the current limited exemption of games from labelling requirements to also cover restricted games. We do not think this is an unrealistic reform direction, noting that:

- The current exemption for non-restricted games has functioned effectively and responsibly since the Act came into force with little if any community concerns raised.
- We believe there has been a narrowing of community standards between Australia and New Zealand, particularly since Australia’s implementation of an R18+ category for games as well as (arguably) less conservative attitudes towards sexual content and nudity in Australia in recent years. That means that Australia’s MA15+ and R18+ ratings may be increasingly compatible with New Zealand community standards.
- The PEGI and ESRB systems show that multi-jurisdictional rating systems can be effective, even where there are small variances in community standards between participating jurisdictions. Any risks can be further mitigated through retained Crown review and call-in powers, such is the model that exists in Ireland where video games are exempt from classification (as it adopts the PEGI system), but the Director of Film Classification may prohibit a video game in some circumstances.

While we appreciate that this broader reform may be beyond the scope of this review consultation, we encourage inclusion in the OFLC’s research program of a project to consider the extent to which the greater acceptance of Australian and British labels for higher impact games is (or is not) consistent with current community standards.

Option 3: Partial cost-recovery from user-charges and Government funding

As outlined in the discussion paper, there is broad industry acceptance of a mixed cost-recovery as both industry and the community receive benefits from classification. However, we do not support any option that raises fees for the submission of video games above current rates. This includes the funding model comprising a 50/50 split between the Government and the sector raised in the discussion paper, which the paper advises would increase the fee for submitting video games by around 9 per cent (we question whether the increase would not be even higher).

Our rationale is not based on some rigid obstinance against fees rising, which we accept is a normal part of operating in a regulated environment, but based on what the industry is able to absorb. Video game businesses already pay much more to have their titles classified in New Zealand than film and DVD/online distributors, and the cost of classification in New Zealand is already among the very highest of government-run classification systems around the world. On a market size-adjust basis, we are not aware of any jurisdiction in the world with a higher cost of classification than New Zealand.

As we have already outlined in this submission, higher classification fees will put significant pressure on publishers and distributors at a time where the commercial viability of physical boxed products is already under strain, and this will impact on both retailers and consumers too. Fewer games being released in physical format will also mean reduced revenue to the OFLC. While the impact of a mixed model will not be as dire as the situation described under Option 1, the impact will be real and it will have significant repercussions.

Turning our mind to the issue that the discussion paper poses about what proportion of costs Government and the sector should pay, we respectfully question whether it is the right policy approach or even helpful to try to focus on the quantum of split first. We also note that even if a split is used, the highly variable nature of the OFLC's revenue and expenses from year-to-year will mean that the *actual* split will rapidly stray from the agreed proportion soon after implementation. We believe that a fairer and more sustainable approach to fee-setting would be to focus on policy considerations rather than using an arbitrary split, particularly the impact on industry and the community of increasing or decreasing fees, together of course with practical considerations such as the cost of carrying out classification. The Government proportion of revenue could then be provided on a 'no-win, no-loss' basis to ensure the OFLC has guaranteed funding.

For the purposes of responding to discussion question 4, if an explicit split is used to calculate future classification fees, we would support any split that maintains fees at no more than the current rate, which may be the 2018-9 rate of 75 per cent Government-funded and 24 per cent industry-funded. Should the Government not consider that maintaining fees at their current level are fiscally sustainable, we would urge consideration of reforms to make classification processes more efficient and cost-effective, such as by implementing a system similar to the authorised assessment application process currently available in Australia to help ease the

workload of the OFLC, or to question whether the current level of fee waivers are sustainable.

QUESTION 14:

Do you have a preference for user-charges or a levy for OFLC's current classification activities? Please comment on the reasons for your preferred choice.

QUESTION 15:

Do you have a preference for how fees or a levy may be set? If so, please explain your preference.

We believe that a user-charge fee is overall a fairer mechanism for funding classification activities as it better ensures that the businesses that most use the classification system are the ones appropriately paying for it. The disadvantages of a levy system are numerous and have already been well articulated in the discussion paper. It is also a significant policy departure from how classification has been charged in New Zealand since the Act commenced, and how it is charged in all other regions in the world.

The greatest disadvantage of a levy system that we see is the fact that it is manifestly unfair on businesses that seldom use classification, including the publishers that may only release one or two games in a year. This will lead to businesses exiting the industry or ceasing the physical release of games, increasing the burden on a shrinking number of existing players and reducing the OFLC's income. It will also create a high impediment to entrepreneurs seeking to find niches by distributing new games, including locally-made games. While there may be fewer direct handing costs involved in collecting levies, we would argue there are potentially other indirect administrative costs given the complexities involved in identifying, calculating, disputing and enforcing the levy.

We therefore support the existing user-charge system. In determining the quantum of a user-charge, we again repeat our call that the proportion of the costs of classifying video games that is recovered from industry is equitable in comparison to the proportion of the costs of classifying films and DVD/online that is recovered. This will ensure greater fairness and avoid situations where income raised from one sector is helping to subsidise other unrelated sectors.

Our sector is currently responsible for less than 8 per cent of total submissions, but the revenue raised from video game businesses accounted for almost a quarter of the OFLC's total revenues from industry in 2018-9. We again note the contrast between the high fees that are charged for submitting video games and the lower fees currently being charged to the film and DVD/online sectors, as well as the high proportion of fee waivers that reduce the cost-recovery from those sectors even more.

We also disagree with the higher urgent fee that is charged for video game submissions compared to film and DVD/online, owing to the use of a fixed proportional cost (50 per cent), rather than a flat media-agnostic fee such as is used in Australia. As the standard charge for a computer game submission is higher than the charge for film and DVD/online, it means that the cost of escalating the urgency of an application will always cost our sector more than other sectors, despite the fact that it does not cost the OFLC more to prioritise a video game than other media.

QUESTION 20:

Are there any other comments, or suggestions relevant to this consultation you would like to make?

A number of matters have not been included in the scope of this review, even though they are highly relevant to the question of how New Zealand's classification system can be sustainably paid for.

Chiefly, the discussion paper has not questioned the basis for why the fees that are charged for classifying video games remains greater than the cost of classifying films and DVD/online. Rather, the paper seems to accept this assumption without questioning whether it is representative of the actual time and cost incurred by the OFLC in classifying different media. The discussion paper also does not question whether the current level of fee waivers given to film and DVD/online submissions, which were almost half of film/DVD/online submissions in 2018-9, can be maintained and whether they are eroding the principle of cost-recovery.

We therefore recommend that the Department undertake a process similar to the 'cost recovery implementation statement – classification fees'⁵ conducted by the Australian Government in 2017-8 that traces revenue and expenses against discrete classification functions to ensure fees are being fairly and equitably charged across content types. This process in Australia found, for example, that the costs and revenue attributable to the classification of video games were largely equal, while for films and DVD/online the costs to government were significantly higher than the equivalent revenue raised from industry.

This review must consider not only the revenue side of classification (fees and government funding) but also the expense side of classification. Noting that this process may already be occurring internally within government, the process of setting fees must ask critical questions about whether New Zealand's classification system, including both the legislative framework and the OFLC's operational framework, is sustainable. Two major questions include:

- Is the OFLC's current expenditure levels appropriate and are there any ways to reduce the cost to government of classification while ensuring that the community continues to be served by classification? We note that the OFLC's 2018-9 expenditure levels are similar to those in the years 2014-7, despite an approximately one third drop in the volume of classification activity (see table below).
- Given the age of New Zealand's classification system, are there any reforms, substantial or minor, that should be considered to make it more efficient? Examples already discussed in this paper include the introduction of an authorised assessment scheme to encourage a more co-regulatory approach, and the expansion of the video game labelling exemption to also

⁵ Department of Communications and the Arts, 'Cost recovery implementation statement – classification fees', March 2018, <https://www.classification.gov.au/sites/default/files/2019-08/cost-recovery-implementation-statement-classification-fees.pdf>

include restricted games so that well-recognised overseas ratings may be used responsibly.

Table 7: OFLC's total expenses vs classification activity

Year	OFLC total expenses	Decisions made
2018-9	\$2,900,000	1,468
2017-8	\$3,501,000	1,825
2016-7	\$3,120,000	2,293
2015-6	\$3,063,000	2,395
2014-5	\$3,053,000	2,361

Source: OFLC annual reports