Submission

By

Business NZ

The voice of business

to the

Accident Compensation Corporation

on the

2008/09 Levy Rate Consultation Documents

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2008/09 ACC LEVY RATE CONSULTATION DOCUMENTS
SUBMISSION BY BUSINESS NEW ZEALAND[1]

1.0 INTRODUCTION

1.0 Business New Zealand welcomes the opportunity to comment on the 2008/09 ACC Levy Consultation Documents.

1.1 Business NZ had the opportunity to be involved in the levy setting process this year as a member of ACC's levy setting steering committee. While grateful for the invitation, Business NZ is disappointed that our concerns about the ACC levy setting process have, to date, not been accepted by the ACC Board.

1.2 For clarity, this submission is in 2 Sections. Section 1 explicitly examines issues surrounding the 2008/09 levy setting process and assumptions ACC have used, while Section 2 examines the "upcoming policy proposals" outlined in the Consultation Documents.

1.3 Given that the Work Account (previously Employers' Account) is the most important ACC account for stakeholders of Business New Zealand, this submission will focus on that account but comments made may also be applicable to other ACC accounts.

2.0 EXECUTIVE SUMMARY

2.1 Business NZ disagrees with a number of the fundamental assumptions behind how the levies are set, principally because they continue to distort the real costs associated with the ACC scheme to both businesses and their employees.

2.2 Business NZ's key concerns include:

- Over-funding of the work account by around $900 million;
- The Corporation's low discount rate, given its high investment return, with no tax payable on interest received;
- The 11.2% risk margin (for the work account) – illogical on two principal grounds. First ACC is a state monopoly insurer with the power to tax future employers, and second, given the gross overfunding of the work account, a funded risk margin is nonsensical.
- The ACC Board's decision to smooth premiums over a "five year" horizon because it sends false signals to earners and businesses as to the ACC scheme's real costs and the impact of any changed policy decisions.

2.3 These concerns are expanded upon below.

2.4 While Business NZ makes a number of recommendations in this submission, our key recommendation is the support for a truly independent assessment of the assumptions the levies are based on, taking into account the fact that

[1] Background information on Business New Zealand is attached as Appendix 1.

ACC is a state monopoly insurer and not subject to the normal commercial disciplines many other insurers face. Included within this assessment should be a review of some of the key policy decisions of the ACC Board, including the economic impacts of smoothing premiums over a five year period and whether this regime is justified on sound economic grounds.

2.5 Business NZ stands ready to assist in achieving this objective so that employers can have confidence that premiums are set on a sound basis, and not prone to political interference depending on the state of the various accounts.

2.6 Similarly, in relation to the general proposals in part 2, Business New Zealand believes that more informed discussion is required on a number of points. Business New Zealand is willing to participate fully in any and all such discussions.

3.0 RECOMMENDATIONS

Business New Zealand **recommends** that:

- **An independent assessment of the assumptions the levies are based on be undertaken, including an examination of the decisions of the ACC Board to smooth premiums over a five year period, taking into account the fact that ACC is a state monopoly insurer with the power to tax future employers and not subject to normal commercial disciplines many other insurers face. (see p.7)**

- **As part of a longer-term risk management strategy, ACC consider the potential for transferring/selling (effectively paying) private sector insurers to take on the risk of managing the liabilities and assets of the various ACC Accounts (particularly in respect to the residual claims account). (see p.7)**

- **ACC return to employers as a one-off payment, each individual employer's share of the approximate $884 million surplus in the Work Account (over and above the amount of the fully-funded claims liability which is forecast to be $1.6 billion for the year ended 30 June 2008). (see p.9)**

- **ACC make public the reasons why premiums are not adjusted to bring reserves to a fully-funded state if it projects that the proportion of claims liability funded will fall below 100%, to minimise the risk (either intended or unintended) of accusations of political bias in premium setting. Conversely, should projected premiums be significantly higher than that required to maintain a fully-funded account (say 110%), then again ACC should be required to provide reasons for retaining such funds rather than giving it back to premium payers. (see p.10)**

- **ACC seek independent economic advice on their assumptions in the Work Discussion Document, in particular, the assumptions surrounding an interest rate of 6.61%. (see p.10)**

- **ACC examine whether a funded risk margin of 11.2% is justified for the Work Account given the unique circumstances of New Zealand's ACC scheme (i.e. the power to tax future employers) and that currently the work account is grossly overfunded and projected to be so for some years. (see p.11)**

- **Any element of "premium smoothing", if ACC wishes to retain this, should be over a much shorter period, say 2-3 years at maximum, rather than the current ACC Board's policy approach of 5 years. (see p.12)**

- **Given that ACC is a statutory monopoly, if the Minister decides to reject or modify its premium recommendation(s), the reasons for doing so, including actuarial analysis, be made public to allow both premium payers and ACC to scrutinise the Minister's decisions and reduce any potential for political bias in the setting of levies. (see p.13)**

- **Levies for on-hire employees be based on a small number of general classifications based on broad groupings of existing classifications. (see p.14)**

- **Consideration of the extension of the ACC scheme to those who suffer mental harm from experiencing traumatic workplace events be deferred until a more detailed consideration of the impact of such an extension on employer levies can be undertaken. (see p.15)**

- **Further detail be provided in relation to these proposals for changes to weekly compensation, and time be given to employers to analyse and comment upon them at that time. (see p.15)**

- **Further investigation and analysis be undertaken of the need to soften the onus on employees to prove workplace exposure as the cause of gradual process diseases or conditions. (see p.16)**

SECTION ONE: 2008/09 DRAFT LEVIES

4.0 COMMENT ON THE WORK ACCOUNT

4.1 The ACC Work Account is made up of funds paid by all New Zealand employers and self-employed to cover the costs (with the exception of pre-1992 non-work injuries) of work-related personal injury. The amount that employers and self-employed will pay to the account is estimated at $582 million for the year ending 30 June 2008.

4.2 ACC proposes to set the 2008/09 average composite employer rate at $1.25 per $100.00 of payroll.

4.3 The $1.25 levy is constituted by the Work Account levy ($0.78) plus the pre-1999 residual claims levy ($0.47).

4.4 Business New Zealand considers that the proposed average premium rate of $1.25 is full of distortions and reflects a "smoke and mirrors" approach to levy setting. The Work Account had a "Proportion of Claims Liability funded" sitting at 166.8% as at 30 June 2007 with the reserves only projected to drop relatively slowly to around 154.7% by 30 June 2008 and 140.4% for the year ended June 2009. Such reserves in excess of 100% full funding are employers' money which is being used to effectively "subsidise" future premiums, given the expectations of future growth in the cost and number of claims. It is noted that ACC policy is to target funding at 100% (plus an additional 11.2% in the claims cost estimate as an effective risk margin).

4.5 The funds accumulated in the Employers Account reserves do not belong to ACC but are held in trust for New Zealand employers who have essentially been overtaxed. By determining that the money will be kept in the interim to off-set (probable) future levy rises, ACC is refusing a legitimate rebate to employers. Employers value current cash-flow higher than levy stability. The opportunity cost of ACC keeping around close to $900 million (see ACC Financial Performance Forecasts for the Work Account, projected for the year ended 30 June 2008) is that employers will be unable to use their own funds for additional investment in the economy.

4.6 Given the inherent risks associated with determining reasonably accurately the costs (and revenue streams) associated with long-term claims, Business NZ considers that ACC should investigate appropriate risk minimisation strategies to reduce the potential for largely "unforeseen" risks to impact adversely on ACC, and more particularly, its premium payers. While ACC have achieved excellent investment returns over the past few years, managing potential risks would appear increasingly necessary given the size of the various accounts both in terms assets held and liabilities involved. Business NZ considers the possibility of transferring/selling (effectively paying) the private sector to take on the risks associated with some accounts (e.g. the residual claims account) might be worth investigating further.

Business New Zealand **recommends** that:

An independent assessment of the assumptions the levies are based on be undertaken, including an examination of the decisions of the ACC Board to smooth premiums over a five year period, taking into account the fact that ACC is a state monopoly insurer with the power to tax future employers and not subject to normal commercial disciplines many other issuers face.

Business New Zealand **recommends** that:

As part of a longer-term risk management strategy, ACC consider the potential for transferring/selling (effectively paying) private sector insurers to take on the risk of managing the liabilities and assets of the various ACC Accounts (particularly in respect to the residual claims account).

Overfunding of the work account by around $900 million

4.7 The ACC financial performance forecasts show that the work account will be overfunded to the tune of $884 million for the year ended 30 June 2008. This equates to overfunding of 54.7% over and above that required to fully fund the account.

4.8 ACC has argued that they are progressively giving back this money over time in the form of lower premiums than might otherwise be the case. Notwithstanding this point, Business NZ has serious concerns with the extent of reserves having been built up given that they are grossly beyond what is needed to fully fund the scheme.

4.9 Business NZ has a number of concerns with ACC's ongoing retention of these funds.

- The funds retained distort the true costs of accident claims which premium payers (in the case of the work account – employers) pay. In the absence of any discounts for low claims costs at the individual enterprise level (i.e. experience rating claims) there is effectively a transfer of wealth from current employers to future employers which reduces the pricing signals facing employers.

- The potential exists for the build up of reserves (effectively a 'war chest') to fund new policy initiatives by government or ACC, with the costs of same appearing to be revenue neutral to employers as they are met through the build up of existing funds. This contravenes the whole principle of a fully-funded model where changes to policies which impact on premiums (either positive or negative) are almost immediately felt by premium payers.

- The excess reserves are effectively employers' money which they would value as a means of either reinvesting in their businesses or reducing debt levels, or possibly both. To put the $884 million in context. It equates to $200 million more than the total estimate of ACC levy income forecast for the year to June 2008 i.e. more than the entire year's levy expected to be paid from employers.

4.10 Given ACC's power to tax future employers, the need to build in such a high premium buffer would appear to be necessary only if ACC faced competition from private sector insurers and couldn't recoup any losses.

4.11 While Business New Zealand would not advocate lowering reserves to under 100 percent of liabilities (believing that having reserves less than estimated liabilities is as dangerous, if not more so, than retaining reserves well above estimated liabilities), retaining projected reserves of 54.7% above the fully-funded rate (and including a risk margin of 11.2%) for what is in effect a Crown run monopoly, is nonsensical.

4.12 While the concentration above has been largely on the pitfalls of "over funding" the accounts, there is as well a potential danger of "under funding" which also needs to be recognised.

4.13 While the Work Account can be seen to be in a very healthy position with significant reserves over and above those required to fund existing claims, this is not necessarily the case with the other accounts. Obviously reserves are being progressively built up in both the residual claims and motor vehicle accounts (with both needing to be fully-funded by 2014). However the earners account is only marginally overfunded at the moment and is projected to fall short of being 100% funded by 2010. Nevertheless it is accepted that the earners account includes a 10.6% risk margin. Therefore given that ACC has the power to recoup such funds should they fall significantly below 100% full funding, then the projections for the earners account are likely to be reasonable.

4.14 Notwithstanding the above points, Business NZ believes that unless there are significant reasons why accounts should be treated differently in terms of funding regimes (as with the residual claims account), a reasonably consistent approach should be taken across the board. For example, if it is agreed that ACC will attempt to ensure that assets equal liabilities five years out and adjust premiums accordingly, then one would expect that the Proportion of Claims liabilities funded should be estimated at very close to 100% at the end of the five year period. Clearly in the case of the earners account this is not the case – the estimate being 90.4% by 2012 – or a projected deficit of $400 million.

4.15 Running projected deficits represents a cost which must be funded by future earners and Business NZ would be concerned if such funding policy became widespread. Again this calls into question whether a consistent approach is in fact being taken across accounts as there is no explanation given in the Discussion Documents as to why this is projected to occur. It leaves the potential for premium payers to conclude that wider political considerations are at work when setting premiums rather than sound commercial practice. A consistent approach to accounts would prevent this accusation from gathering momentum.

Business New Zealand **recommends** that:

ACC return to employers as a one-off payment, each individual employer's share of the approximate $884 million surplus in the Work Account (over and above the amount of the fully-funded claims liability which is forecast to be $1.6 billion for the year ended 30 June 2008).

Business New Zealand **recommends** that:

ACC make public the reasons why premiums are not adjusted to bring reserves to a fully-funded state if it projects that the proportion of claims liability funded will fall below 100%, to minimise the risk (either intended or unintended) of accusations of political bias in premium setting. Conversely, should projected premiums be significantly higher than that required to maintain a fully-funded account (say 110%), then again ACC should be required to provide reasons for retaining such funds rather than giving it back to premium payers.

Interest (Discount) Rate Assumptions

4.16 The average employers' composite levy is based on an anticipated interest rate of 6.61% by ACC which is equivalent to long-term Government Bonds (and is effectively a "risk-free" rate of return).[2] This would appear to be a very conservative expected rate of return and clearly out of step with returns achieved over the last few years. While Business New Zealand does not have the particular expertise to determine where the expected rate should be set, advice should be sought from international and domestic agencies that could provide independent assistance to ACC on such matters. The situation is further complicated by the fact that ACC does not pay tax on it investment income.

4.17 Using a low discount rate and funding an unnecessarily large risk margin can only result in excessive reserves and increasingly over funded accounts.

Business New Zealand **recommends** that:

ACC seek independent economic advice on their assumptions in the Work Discussion Document, in particular, the assumptions surrounding an interest rate of 6.61%.

11.2% Risk Margin

4.18 One of the greatest benefits of a fully-funded model is that the cost of the scheme is transparent and any changes (for example additional benefits) are immediately captured within premium settings.

4.19 While Business New Zealand accepts that private sector insurers will almost always build in a margin for "risk" in insurance premium setting, it is not at all obvious why ACC would or should do likewise. As the accident insurance market has now been returned to ACC as a state-monopoly, ACC (via government legislation) has the power to tax future employers should

[2] Business NZ accepts that ACC proposes in its funding policy to have an investment return higher than the risk-free interest rate over the first five years, then returning to the risk–free rate from 2013. These rates being 7.7% for 2007/08, 7.3% for 2008/09, 6.75 for 2009/10 to 2012/13 and 6.61% thereafter. In Business NZ's view, these expected returns are extremely conservative and don't reflect ACC's investment performance in the past.

premiums collected in any one year fail to be sufficient to fund the ongoing costs of claims associated with accidents in that particular year.

4.20 ACC is still proposing building in a 11.2% risk margin on top of the estimated claims liability for further claims (and retaining a 5% prudential margin on top for pre-1999 work and pre-1992 non-work claims (the "residual claims"). While Business New Zealand accepts that the risk margin and prudential margin for the residual claims account are probably justified (given that it must be fully-funded by 2014) Business NZ sees no justification for funding a risk margin of 11.2% for the work account given (a) that ACC is a monopoly insurer and has the power to tax future employers should claims costs be significantly higher than expectations and (b) perhaps more fundamentally, that the ACC work account is grossly over funded to the tune of around $900 million. It is for these reasons that there is no justification for any risk margin at this stage. If any risk margin for the work account is justified at the moment, then it should be at a much lower rate (say 5%).

Business New Zealand **recommends** that:

ACC examine whether a funded risk margin of 11.2% is justified for the Work Account given the unique circumstances of New Zealand's ACC scheme (i.e. the power to tax future employers) and that currently the work account is grossly overfunded and projected to be so for some years.

Smoothing Premiums

4.21 ACC makes two important points in respect to funding policy. The first is that they must ensure that all ACC Accounts have enough funds to provide for future costs (i.e are fully funded). The second point *"….is we [ACC] also have to ensure that the levies we charge to cover these costs are fair and predicable."* On both these points Business NZ would strongly agree. However, ACC's objective of managing levy stability over time is not reflected in actual premiums faced by individual employers.

4.22 While ACC is correct to say that at the aggregate level premiums have remained stable (in fact the compositional levy is projected to stay constant at around $1.25 over a number of years), this is not reflected at the individual enterprise level.

4.23 Business NZ is strongly of the view that premiums should reflect changes in behaviour (at the level of the individual enterprises that make up the various risk groups).

4.24 While levy stability should be a desirable objective, it should not override important signals which should be sent to levy payers about the true costs associated with accidents (whether or not this results in reducing or increasing premiums over time).

4.25 Business NZ is very concerned that ACC's near obsession with retaining aggregate premiums at a constant level may send employers unrealistic signals as to the costs associated with work accidents. Because a significant proportion (over 20% of the average work levy excluding residual claims) is being funded via a build-up of reserves, premiums are very distorted for current employers and likely to be so for some time.

4.26 As mentioned earlier, the way to overcome this ongoing problem is to give back the extensive overfunded reserves to employers as a "one-off" payment, unrelated to the premium setting round.

4.27 Business NZ considers that if ACC wishes to retain any element of "premium smoothing" it should be over a much shorter period, say 2-3 years at maximum, rather than the current ACC Board's policy approach of 5 years.

Business New Zealand **recommends** that:

Any element of "premium smoothing", if ACC wishes to retain this, should be over a much shorter period, say 2-3 years at maximum, rather than the current ACC Board's policy approach of 5 years.

Premium Setting ultimately determined by Minister of ACC

4.28 Business New Zealand notes that ACC levy recommendations are not binding on the Minister (of ACC) who can "accept, reject, or modify the Corporation's recommendations". While it is useful for the Minister to be able to change the ACC's recommendations in respect to premium rates if new information comes to hand which suggests that ACC's actuarial advise was flawed, there has been a tendency for ACC Ministers over the years to tinker with ACC's recommendations, and make their own recommendations.

4.29 While it is possible that these changes are soundly based on actuarial analysis, there is a danger that changed recommendations from the Minister may reflect wider "political" judgements as to what ACC premiums should be.

4.30 Business New Zealand considers that if the Minister decides to reject or modify ACC's recommendation(s), then the Minister must clearly outline to the public and premium payers, why ACC's recommendations have not been accepted, and the actuarial advice on which the changed recommendations have been made. It is not acceptable for the Minister to change ACC's recommendations without full and comprehensive advice on the basis of which the decision has been made.

4.31 In the absence of such transparency, there is a risk that premiums will be considered to have been set, rightly or wrongly, to take account of political realities rather than sound commercial practice. Business New Zealand would suggest that the premium levies struck for 2007/08 for the Work Account (previously the Employers' Account) reflected a degree of political decision-making rather than being set on the basis of sound commercial disciplines.

Business New Zealand **recommends** that:

Given that ACC is a statutory monopoly, if the Minister decides to reject or modify its premium recommendation(s), the reasons for doing so, including actuarial analysis, be made public to allow both premium payers and ACC to scrutinise the Minister's decisions and reduce any potential for political bias in the setting of levies.

SECTION 2: PROPOSED NEW POLICY PROPOSALS BY ACC

5.0 PROPOSALS TO AMEND ON HIRE CLASSIFICATIONS

5.1 Business New Zealand believes it is appropriate that levies applied to employees of on-hire companies should reflect at least the broad nature of the industry in which their skills are deployed. This is based on the premise that ACC levies should reflect the relative risks and costs associated with the potential for harm in a given occupation. Creating a separate set of risk categories for on-hire employees would effectively break with this key premise in favour of a relatively arbitrary classification process driven mainly by a need for administrative simplicity and cost effectiveness.

5.2 It is recognised, however, that the administrative complexities that would arise if on-hire employees were classified across the full spectrum of existing classifications are overly onerous. It therefore makes sense to adopt a smaller, broader, range of classifications based on homogeneous groupings of existing classifications, which will enable a reasonable reflection of costs associated with the risk profile of the work undertaken, while being relatively straightforward and inexpensive to administer.

Business New Zealand **recommends** that:

Levies for on-hire employees be based on a small number of general classifications based on broad groupings of existing classifications.

6.0 PROPOSAL TO PROVIDE COVER FOR MENTAL INJURY CAUSED BY WITNESSING A WORK RELATED TRAUMATIC EVENT

6.1 ACC proposes to extend the ACC scheme to cover mental injury caused wholly or substantially by direct experience of a sudden traumatic event during the course of employment.

6.2 Business New Zealand is concerned that insufficient thought has gone into this proposal. Even though the proposals explicitly exclude mental injuries caused by non-work or gradual process exposure they do not appear to take sufficient account of the wide variety of occupational situations, which by their nature expose employees to traumatic events. Obvious examples include police, fire and ambulance officers. Others include forestry workers who witness the death of colleagues from falling trees, construction workers who witness accidents on worksites, farm workers who witness tractor accidents and so on.

6.3 Business New Zealand is concerned that the proposals may expose ACC to claims from a far wider range of employment situations than those envisaged in the examples currently provided; those of a bank teller witnessing the murder of a colleague during a robbery and a truck driver who killed a person who jumped in front of his vehicle.

6.4 It is therefore concerned that the impact of a wider catchment of examples from which claims may be drawn will impact in unforeseen ways on employer levies.

Business New Zealand **recommends** that:

Consideration of the extension of the ACC scheme to those who suffer mental harm from experiencing traumatic workplace events be deferred until a more detailed consideration of the impact of such an extension on employer levies can be undertaken.

7.0 WEEKLY COMPENSATION PROPOSALS

Business New Zealand has no specific comments on relations to the proposals listed under this section of the discussion document; viz,

- Improving access to weekly compensation for workers who are injured while between jobs or on unpaid leave
- Providing more reasonable compensation for seasonal and casual workers that is easier to understand
- Making the abatement of weekly compensation easier for people to understand and increasing incentives for people to return to work
- Allowing eligible claimants to increase their weekly compensation to the minimum full time rate earlier
- Increasing the rate paid for loss of potential earnings compensation

Obviously there may be issues arising from these proposals, but the form in which they are presented in the discussion document does not permit an in depth analysis.

Business New Zealand **recommends** that:

Further detail be provided in relation to these proposals, and time be given to employers to analyse and comment upon them at that time.

8.0 PROVISIONS TO IMPROVE ACCESS TO VOCATIONAL REHABILITIATION

<u>Discretionary extension of the three year limit on vocational rehabilitation</u>

8.1 Business New Zealand supports the proposal to permit ACC the discretion to allow vocational rehabilitation for longer than the current period of three years.

<u>Removal of the upper age limit for vocational rehabilitation</u>

8.2 Business New Zealand supports the removal of the upper age limit for eligibility for vocational rehabilitation, removing the present limits based on weekly compensation.

<u>Requirement for occupational assessors to take into account pre injury earnings</u>

8.3 Business New Zealand supports the proposal to require occupational assessors to consider claimant's pre-injury earnings rates when identifying suitable work types in occupational assessments.

9.0 PROPOSALS TO IMPROVE ACCESS TO CLAIMS FOR GRADUAL PROCESS, DISEASE OR INFECTION

<u>Changes to cover provisions for work related gradual process, disease or infection</u>

9.1 Business New Zealand believes that more discussion is required on the specific impacts of the proposals to adjust the criteria governing application of the present 3-part test. In our view, the fact that the burden of proof presently rests with claimants and *"could be hard to meet"* is not of itself sufficient justification to change the approach. As presented in the consultation document on 2008/9 levies for employers and self employed people, the proposals for change appear to be predicated on the possibility that employees may face difficulties, rather than some objective assessment of this being a significant issue. The question that needs to be asked and answered is whether or not the present approach is unreasonable in the circumstances in which it is normally applied. To date there has been little if any discussion to this end. That said, we agree that there is a need to clarify that the responsibility for and cost of investigating a claim rests with ACC.

Business New Zealand **<u>recommends</u>** that:

Further investigation and analysis be undertaken of the need to soften the onus on employees to prove workplace exposure as the cause of gradual process diseases or conditions.

APPENDIX 1

BACKGROUND INFORMATION ON BUSINESS NEW ZEALAND

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 67 member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). An increase in GDP of at least 4% per capita per year is required to achieve this goal in the medium term.

The health of the economy also determines the ability of a nation to deliver on the social and environmental outcomes desired by all. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.