Submission

By

Business NZ
The voice of business

to the

Accident Compensation Corporation

on the

2011/12 Levy Rate Consultation Documents

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2011/12 ACC LEVY RATE CONSULTATION DOCUMENTS
SUBMISSION BY BUSINESSNZ[1]

1.0 INTRODUCTION

1.1 BusinessNZ welcomes the opportunity to comment on the 2011/12 ACC Levy Consultation Documents.

1.2 BusinessNZ was this year again involved in the levy setting process as a member of ACC's levy setting reference group. While acknowledging that the ACC Board is entitled to determine the extent of the levy rate consultation, BusinessNZ found the process this year useful for discussing issues targeted at improving the transparency of the scheme for levy payers. Notwithstanding this input, BusinessNZ remains concerned about a number of areas regarding the transparency of levies in relation to the various accounts. These concerns are outlined in some detail below.

1.3 BusinessNZ has made a number of submissions on the levy setting process over the years and by and large has been disappointed at the lack of take up of its recommendations. However, it is pleasing to report that a number of our key recommendations made in our submission on last year's levy round are in the process of being actioned by ACC or are being actively considered as part of a forward looking work programme. These include:

1. **ACC projections should be based on the principle that all claims post 1999 are fully-funded annually.**

2. **ACC should reinstate experience rating within the Work Account either as a stand–alone system or in conjunction with the Workplace Safety Management Practices (WSMP) scheme.**

3. **Consideration should be given to mechanisms which ensure all road users (whether car, truck, motorcycle, or cyclist) pay the relative costs associated with road use.**

4. **ACC, or the Department of Labour's Policy Unit should undertake further research to get a better understanding of the risk factors which determine Motor Vehicle accident claims and costs in order to understand better where the responsibility for costs should lie.**

5. **The various ACC Accounts, where applicable, should progressively be opened up to competition from private sector providers (starting with the Work Account).**

[1] Background information on BusinessNZ is attached as Appendix 1.

1.4 Apart from the Work Account (post 1999 work claims), which is very close to being fully-funded, the other accounts, particularly the Earners' and Motor Vehicle Accounts, are significantly underfunded. This is a consequence of a combination of cost blow-outs over previous years, limited monitoring of claims, and significant political interference in premium setting – the latest being the decision of the Government (against the advice of the ACC Board) to significantly underfund the Earners' Account last year. BusinessNZ is pleased that action has now been taken to address both and number and cost of claims across accounts, and to improve the transparency of the levy setting process.

1.5 A number of proposals outlined in the Consultation Documents are targeted at improving transparency and more closely aligning levies with the principles of a good insurance model (e.g. full-funding, experience-rating of premiums, risk (cost)-sharing, and limiting cross-subsidisation). Yet, despite these proposed improvements, significant cross-subsidisation continues to occur, particularly in respect to the Motor Vehicle Account, as starkly outlined in the Consultation Documents. Cross-subsidisation, while politically difficult to address, must be dealt with if levy payers are to be confident that the scheme is delivering value for money and is not some sort of glorified social welfare scheme with little or no accountability to levy payers.

1.6 BusinessNZ has been supportive of the current stocktake review of ACC and proposed reforms signalled by the Government and the Corporation. However, it is disappointing that the Minister of ACC has chosen not to release the report of the Stocktake group. Without full and free discussion of the issues, it is unlikely that the scheme will be improved to the extent either possible or desirable. In this respect, Business NZ urges the Minister to publicly release the report as soon as practicable so an informed debate of the issues can begin.

1.7 This submission deals with key issues in the Consultation Documents which generally fall under the broad heading of funding policy. The issues are mostly the same across the various accounts although some are unique – for example, dealing with the funding of residual (pre-1999) claims, which under current legislation are required to be fully-funded by 2019.

2.0 RECOMMENDATIONS

1. BusinessNZ **recommends** that:

The funding policy in respect to levy setting should be included in legislation to avoid the risk of annual political manipulation by either, initially, the ACC Board, or ultimately, the Minister of ACC (see p.5)

2. BusinessNZ **recommends** that:

Given that ACC is a statutory monopoly, reasons, including actuarial analysis, should be given and made public, if the Minister decides to reject or modify ACC's premium recommendations (see p.5)

3. BusinessNZ **recommends** that:

If premium smoothing is retained, then in general it should be applied consistently across accounts, with in order to avoid accusations of political bias in premium setting, the ACC Board having stated principles as to when it might be considered appropriate (or not appropriate as the case may be) (see p.6)

4. BusinessNZ **recommends** that:

ACC should re-examine whether a funded risk margin (of 5% as proposed) is justified for the Work, Earners and Motor Vehicle Accounts given the unique circumstances of New Zealand's ACC scheme (i.e. the power to tax future levy payers), and the implications for costs on levy payers across the various ACC accounts (see p.8)

5. BusinessNZ **recommends** that:

All pre-1999 residual claims (i.e. the residual claims account, residual claims within the Earners' Account and residual claims within the Motor Vehicle Account) should be funded out of general taxation as the least distortionary mechanism for funding what are in economic terms, sunk costs (see p.8)

6. BusinessNZ **recommends** that:

NOTWITHSTANDING RECOMMENDATION 5 If the Government continues with its current policy of funding the costs associated with pre-1999 motor vehicle accidents out of the Motor Vehicle Account, then this cost should be funded via a flat fee on Motor Vehicle owners (possibly as part of the licensing fee) (see p.10)

3.0 FUNDING POLICY

3.1 Business NZ believes that unless there are significant reasons why accounts should be treated differently in terms of funding regimes (as is the case with residual claims), a reasonably consistent approach should be taken across the board.

3.2 Greater control of ACC premium setting is required given that the organisation is effectively a state monopoly and that the ability for most premium payers to seek alternative insurance cover is strictly limited. Effectively, a degree of self-insurance for some large employers is the only alternative option available. Earners, motorists and most employers have no choice whatsoever and are simply required to pay levies determined, ultimately by the ACC Minister.

3.3 Proposed approaches to levy setting have improved over the last year with the ACC Board taking a much more rigorous and transparent approach as indicated by their levy setting principles/goals e.g. consistency in setting the discount rate.

3.4 Notwithstanding the above, ultimately decisions in respect to levy setting rest with the Minister of ACC and Cabinet, which as we have seen as recently as last year in respect to the Earners' Account, generally reflect the political considerations of the day, rather than sound commercial practice.

3.5 It is important, that both the ACC Board, and ultimately the Minister, are held to account in setting premium rates which reflect sound commercial practice and minimise the risk of ongoing political interference to meet political objectives.

1. BusinessNZ **recommends** that:

The funding policy in respect to levy setting should be included in legislation to avoid the risk of annual political manipulation by either, initially, the ACC Board, or ultimately, the Minister of ACC.

2. BusinessNZ **<u>recommends</u>** that:

Given that ACC is a statutory monopoly, reasons, including actuarial analysis, should be given and made public if the Minister decides to reject or modify ACC's premium recommendations.

<u>Smoothing Premiums</u>

3.6 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).

3.7 While levy stability is a desirable objective, it should not override important signals which levy payers should receive about the true costs associated with accidents (whether or not these result in a reduction or an increase in premiums over time).

3.8 Notwithstanding the factors impacting on the number and cost of claims, which make forecasting future liabilities difficult, Business NZ considers that as a general principle all claims (post-1999) should be fully-funded each year, accepting that at times, this may not be possible due to unanticipated external influences (e.g. low investment returns). The danger without such a discipline is that new policies can be introduced which while appearing to be cost neutral, mean that they are borne by current and future levy payers.

3.9 At minimum, if as it seems likely, the ACC Board continues to support a smoothing policy, then the policy should be applied consistently across accounts, to the extent possible. Currently, it appears that the 10-year smoothing policy (and previous 5-year smoothing policy) are still applied in an ad hoc manner as indicated by the different times when each account will reach a fully-funded state (e.g the Work Account compared to the Motor Vehicle Account).

3.10 Perhaps even more important than the consistent application of any smoothing policy, would be clearly stated principles from the ACC Board (and Minister) when smoothing may or may not be appropriate. For example, it would seen reasonable for smoothing to apply in isolated cases of significant "one-off" declines in investment returns which are arguably beyond the ability of ACC to reasonably control. On the other hand, if the Government makes policy changes which impact on the costs of the scheme then such costs should be independently reflected in premium rates, to the extent possible, to avoid fudging the impact of policy changes. Under current policy, smoothing policy is provided for up to 10 years. What happens next year if politics suggest it should be 25 years? The whole basis for the accident insurance scheme together with public confidence in it would likely diminish, hence the need for greater transparency in premium setting.

3. BusinessNZ **recommends** that:

If premium smoothing is retained, then in general it should be applied consistently across accounts, with in order to avoid accusations of political bias in premium setting, the ACC Board having stated principles as to when premium setting might be considered appropriate (or not appropriate as the case may be).

Funding target (risk margin) increased from 100% to 105%

3.11 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.

3.12 BusinessNZ notes that in a change to funding policy, the ACC Board has increased the funding target from 100% (full-funding) to 105% to provide an additional buffer against random variations inherent in a scheme like ACC.

3.13 Business New Zealand understands that New Zealand Financial Reporting Standards require future claims' costs liability to be assessed using a risk-free interest rate, with an additional risk margin included to allow for the inherent uncertainty of long-term claims' liabilities.

3.14 ACC considers it adequate to select a risk margin for each levy account that provides around 75% probability of the future claims' estimate. This is in line with the Australian Prudential Regulation Authority's requirement for private insurers in Australia and appears to be entirely reasonable.

3.15 While BusinessNZ accepts that some private sector insurers may build in additional risk margin to cover unexpected risks in insurance premium setting, it is not at all obvious why ACC should do likewise, or indeed why a funding target of 105% should be included when there is already effectively a risk margin put on premiums to ensure that claims costs can be met as outlined in the previous paragraph. As ACC is effectively a state-monopoly provider of accident insurance, ACC (via government legislation) has the power to tax future employers if premiums collected in any one year are insufficient to fund the ongoing costs of claims associated with accidents in that particular year.

3.16 While ACC's need for a risk margin is open to question, in BusinessNZ's view there are three reasons why a funded risk margin (of say 5% as proposed) might well be appropriate.

- If any of the ACC accounts (Work, Earners', or Motor Vehicle Account) are opened up to contestability from private sector insurers then, as previously stated, most private insurers would be required to build in a prudential margin for commercial reasons. Having a funded risk margin would therefore see ACC behaving more like a private insurer in a contestable environment.

- Because ACC has such a long smoothing policy (up to 10 years), there is a distinct risk of the ACC accounts becoming even worse over time than they are at present so a risk margin might not be totally unreasonable.

- The requirement under law for the Work, Earners and Motor Vehicle Accounts (post-1999 claims) to be fully-funded necessarily requires levy setting policies to be clearly aimed at ensuring the various accounts *are* fully-funded and remain so over time.

3.17 But all the above should take into account the wider impact of changes in levies on the economy as a whole. For example, levy rises impact directly on the Consumers Price Index (CPI) which rightly or wrongly, is taken as a benchmark for some contracts and some wage negotiations; increases in levies paid for by employers and earners also increase the overall cost of labour while reducing take home pay. Inflationary pressures are considered by the Reserve Bank and can impact on monetary conditions e.g. interest and exchange rates. All these matters need to be considered in the context of government taxation policy and other fiscal strategies that either boost or reduce disposable incomes.

4. BusinessNZ **recommends** that:

ACC should re-examine whether a funded risk margin (of 5% as proposed) is justified for the Work, Earners and Motor Vehicle Accounts given the unique circumstances of New Zealand's ACC scheme (i.e. the power to tax future levy payers), and the implications for costs on levy payers across the various ACC accounts.

Pre-1999 (Residual) Claims Levy

3.18 Business New Zealand once again expresses its concern that pre-1999 work injuries will continue to be funded by employers. More worrying however is that it is understood that about one-quarter of this cost relates to pre-1992 injuries caused outside the workplace (i.e. non-work accidents) which employers are still being required to pay for.

3.19 At a conceptual level, the costs associated with pre-1999 work accidents, pre-1999 non-work accidents and pre-1999 residual claims in the Motor Vehicle Account are, in economic terms, sunk costs. In other words, charging for previous claims cannot affect the outcome of those claims – they have already been made. For this reason the funding of those costs should arguably be borne by general taxpayers as the most efficient and least distortionary funding method.

5. Business New Zealand **recommends** that:

All pre-1999 residual claims (i.e. the residual claims account, residual claims within the Earners' Account and residual claims within the Motor Vehicle Account) should be funded out of general taxation as the least distortionary mechanism for funding what are in economic terms, sunk costs.

4.0 SPECIFIC COMMENTS ON THE MOTOR VEHICLE ACCOUNT

4.1 While there were some moves last year to reduce cross-subsidisation in the levies proposed for the Motor Vehicle Account, these were rather tentative to say the least and mainly focused on removing some of the distortions within each class of vehicle (e.g. between small and large motorcycles) rather than on addressing cross-subsidisation between motorists and motor cyclists per se. Business NZ considers a thorough investigation of the funding of the Motor Vehicle Account is justified in order to align more closely the costs associated with the scheme to scheme claimants.

Indicators of risk

4.2 Notwithstanding strong general support for risk rating the various ACC Accounts, current statistics do not appear robust enough to accurately assess what are the fundamental risk factors in on-road accidents. For example, it is not immediately obvious that petrol use is necessarily a good indicator of accident claims or severity. Many of the "safest" (lower risk) drivers are those who drive the most miles, typically in the course of their work, although it is accepted that the greater the exposure on-road, by definition the greater the likelihood of an accident, all other factors being equal.

4.3 While it is perhaps obvious that certain risk factors are likely to be common to accident claims and severity, e.g. vehicle type and owner, there are numerous other factors which may or may not be relevant in determining risk. These other factors nevertheless need thorough investigation to ensure that a risk rating of the Motor Vehicle Account is soundly based. A number of examples could be given of what **may or may not** be important risk factors:

a. Whether the driver is licensed

b. Time (exposure) on road

c. Regional differences

d. Road type

e. Age of driver

f. Sex of driver

g. Experience with various NZ weather/driving conditions

4.4 While there may be many other potential risk factors that need to be considered, the point is that it is not immediately obvious what portion of risk associated with on-road accidents can be attributed to Motor Vehicle type or the Motor Vehicle owner, or indeed petrol use. Presumably the person behind the wheel is likely to be a crucial factor in determining risk of accident not necessarily who owns the vehicle, or vehicle type, or the amount of petrol used on-road.

4.5 BusinessNZ notes that the Consultation Document (Levies for Motorists p.12) states that *"The Feedback we received on the 2010/11 levy proposals indicated that vehicle owners favoured increasing the petrol levy rather than increasing the licence fee levy."* Without a clear understanding of the nature of claims and how they arise, it is virtually impossible to provide a rational policy response as to whether more or less of the levy should be collected from petrol as opposed to the licence fee. Consequently, Business NZ would urge ACC to undertake further research in order to understand better the risks that determine accident claims and costs and thus where responsibility should lie rather than rely on crude submission responses which might reflect vested interests rather than sound economics.

4.6 Finally, BusinessNZ considers that if the Government continues with its current policy of funding the costs associated with pre-1999 motor vehicle accidents out of the Motor Vehicle Account, then this cost should be funded via a flat fee on Motor Vehicle owners (preferably as part of the registration fee) rather than out of petrol levies, given the sunk cost nature of these claims.

6. BusinessNZ **recommends** that:

NOTWITHSTANDING RECOMMENDATION 5 If the Government continues with its current policy of funding the costs associated with pre-1999 motor vehicle accidents out of the Motor Vehicle Account, then this cost should be funded via a flat fee on Motor Vehicle owners (possibly as part of the licensing fee).

APPENDIX 1

BACKGROUND INFORMATION ON BUSINESS NEW ZEALAND

Business New Zealand is New Zealand's largest business advocacy organisation.

Through its four founding member organisations – EMA Northern, EMA Central, Canterbury Employers' Chamber of Commerce and the Otago-Southland Employers' Association – and 73 affiliated trade and industry associations, Business NZ represents 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 NZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation, the International Organisation of Employers and the Business and Industry Advisory Council to the Organisation for Economic Cooperation and Development.