Submission

By

BusinessNZ
The voice of business

to the

Accident Compensation Corporation

on the

2012/13 Levy Rate Consultation Documents

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2012/13 ACC LEVY RATE CONSULTATION DOCUMENTS
SUBMISSION BY BUSINESSNZ[1]

1.0 INTRODUCTION

1.1 BusinessNZ welcomes the opportunity to comment on the 2012/13 ACC Levy Rate Consultation Documents.

1.2 Establishing a sound financial footing for ACC along with the lower levies proposed for both the Work and Earners' Accounts for 2012/13 is good news for premium payers. Reductions of 17 percent for the Earners' Account and 22 percent for the Work Account (including residual pre-1999 claims) are proposed for the 2012/13 levy year.

1.3 The ACC Board is to be commended for taking a much more rigorous approach to the running and financing of NZ's accident insurance scheme. The Board has recently introduced a number of commercial disciplines to establish the scheme on a sound financial footing and is continuing to move towards the implementation of widely accepted insurance principles, e.g. through the introduction of experience rating and ensuring all accounts are fully funded and remain so over time. BusinessNZ has raised these issues in a number of previous levy consultation submissions and is pleased that the Board has effectively accepted most of our recommendations, at least at a conceptual level.

1.4 Despite the above, a large unfunded deficit of $7.8 billion across all ACC accounts remains (largely in respect to the Motor Vehicle Account which is only two-thirds funded) although this is significantly down on the nearly $13 billion unfunded liabilities of a couple of years ago. Such reductions have been achieved through a combination of better health and safety practices, better and more rapid rehabilitation and improved investment returns.

1.5 Notwithstanding these significant improvements, BusinessNZ continues to have concerns about a number of areas relating to levy transparency for the various accounts. This submission covers four broad areas:

- First, the overall funding policy adopted by ACC to ensure full funding across accounts; this must be achieved and subsequently maintained. Proposed funding levels appear excessive given that ACC continues to be a state monopoly with the power to tax future employers, earners and motorists.
- Second, the policy of capping changes to levy rates;
- Third, the continued funding of pre-1999 (residual) claims (including pre-1992 non-work claims) by employers; and

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

- Fourth, the significant degree of continued cross-subsidisation in the Motor Vehicle Account which has not been addressed at all in the proposed levy rate changes for the 2012/13 year.

2.0 RECOMMENDATIONS

1. BusinessNZ **recommends** that:

   Levy setting funding policy 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 **recommends** that:

   ACC re-examine whether the proposed effective funded risk margin of between 0 and 40% 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 its implications for costs on levy payers across the various ACC accounts.

3. BusinessNZ **recommends** that:

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

4. BusinessNZ **recommends** that:

   If ACC wants to retain caps on levy changes, then these should be set at a much higher level than currently proposed to ensure any areas of cross-subsidisation are dealt with reasonably quickly.

5. BusinessNZ **recommends** that:

   The significant cross-subsidisation between motorists and motorcycles be addressed as a matter of some urgency, recognising that realistically, over the next 3-5 years current cross-subsidisation will make necessary a staged process for reviewing levies to more accurately reflect risk.

6. BusinessNZ **recommends** that:

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

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

ACC, or the Department of Labour's Policy Unit undertake further research to get a better understanding of the risk factors which determine motor vehicle accident claims and costs. It is not immediately obvious that fuel use is necessarily a very accurate indicator of risk and it is important to understand where the responsibilities for costs should lie. Other factors such as vehicle type and individual driver may be more relevant to determine accident risk.

3.0 FUNDING POLICY

3.1 Proposed approaches to levy setting have improved over the last year or so with the ACC Board taking a much more rigorous and transparent approach as indicated by its levy-setting principles/goals.

3.2 Notwithstanding the above, ultimately decisions in respect to levy setting rest with the Minister of ACC and Cabinet, and 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.

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

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

3.5 Notwithstanding 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). Without such a discipline there is a danger of new policies being introduced which, while apparently cost neutral, impose costs on current and future levy payers. BusinessNZ considers the Discussion Document's proposed funding policy would minimise the risk of unfunded liabilities in future years since it is targeted at ensuring that in most cases the scheme will remain fully funded – apart from the potential for 1 in 20 year shocks.

3.6 But ACC's need for a fully funded risk margin is open to question and in BusinessNZ's view the margin (if any) should be more in the order of 5 – 15 percent than the 0 – 40 percent band proposed, for two reasons.

3.7 First, while BusinessNZ accepts that some private sector insurers may build in an additional risk margin to cover unexpected risks in insurance premium setting, it is not at all obvious why ACC should do likewise. As ACC is effectively a state-monopoly provider of accident insurance, it has (via government legislation) 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.

3.8 Second, if the accounts are effectively "over-funded" (i.e. fully funded plus a substantial margin), the temptation may be for the government of the day to expand the scheme knowing that the costs of the expanded scheme will be hidden, at least for the first few years. Given that ACC is a state-sanctioned monopoly, without the ongoing discipline that competition would provide, taking a very conservative approach to funding as envisaged in the Discussion Document is unlikely to be necessary.

3.9 None of the above should be interpreted as in any way suggesting that BusinessNZ does not support a fully funded scheme, rather that the rationale for ACC retaining reserves well beyond those required to ensure the fully-funding of claims is questionable in light of the two important factors referred to.

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

ACC re-examine whether the proposed effective funded risk margin of between 0% and 40% 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 its implications for costs on levy payers across the various ACC accounts.

4.0 PRE-1999 (RESIDUAL) CLAIMS COSTS

4.1 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 about one-quarter of the residual cost of claims is understood to relate to pre-1992 injuries incurred outside the workplace (i.e. non-work accidents) for which employers are still being required to pay.

4.2 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 their outcome – the claims have already been made and the outcome determined. Therefore funding costs should arguably be borne by general taxpayers as the most efficient and least distortionary way of dealing with these residual liabilities.

3. BusinessNZ **recommends** that:

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

5.0 CAPPING CHANGES TO LEVY RATES

5.1 The Consultation Document states that in order to smooth any financial impacts of annual levy changes, ACC has capped them for each individual classification unit in the Work Account. Current policy is to ensure levies do not change by more than 15% in addition to any increase (or decrease) in the average work levy.

5.2 For the 2012/13 levy year, ACC is proposing to apply the following capping rules:

- Increases will be capped at +10% or 2 cents (whichever is the greater)
- Decreases will be capped at -25% in addition to the change in the average rate.

5.3 As the Consultation Document correctly states, ACC must ensure that the ACC scheme continues to fund the overall expected costs, with the consequence that any shortfall caused by the cap is funded by all other work levy payers – i.e. significant cross-subsidisation continues to exist. This is essentially a direct subsidy from lower risk business groupings to higher risk business groupings.

5.4 While BusinessNZ considers there may be an occasional justification for a cap to be considered e.g. if for some reason industry classifications move around radically with significant short-term cost implications for particular levy payers, as a general rule, caps perpetuate the problems associated with cross-subsidisation between levy payers. They should therefore be removed as rapidly as possible.

4. BusinessNZ **recommends** that:

If ACC wants to retain caps on levy changes, then these should be set at a much higher level than currently proposed to ensure any areas of cross-subsidisation are dealt with reasonably quickly.

6.0 CROSS-SUBSIDISATION IN THE MOTOR VEHICLE ACCOUNT

6.1 A number of road users, principally cyclists, pay nothing towards the cost of accidents involving motor vehicles (although it is noted that if they have a car, they will contribute to ACC costs through both petrol taxes and relicensing fees). Meanwhile, motorcyclists are currently grossly subsidised by motor vehicle owners.

6.2 Given the trend towards a greater use of motor cycles and/or bicycles, it would be desirable to examine seriously whether ACC premiums should apply to those regularly using their cycles on-road and, as well, should better reflect the cost of motor cycle accidents. Motor Vehicle Account funding currently involves significant cross-subsidisation from motor vehicle owners to motor cyclists.

6.3 While there have been some moves over the past few years to reduce cross-subsidisation in the levies proposed for the Motor Vehicle Account, the moves 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.

6.4 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.

5. BusinessNZ **recommends** that:

The significant cross-subsidisation between motorists and motorcycles be addressed as a matter of some urgency, recognising that realistically, over the next 3-5 years current cross-subsidisation will make necessary a staged process for reviewing levies to more accurately reflect risk.

6. BusinessNZ **recommends** that:

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7.0 <u>OTHER ISSUES</u>

7.1 Some employers have raised concerns with ACC's projections of injury prevention costs, proposed to increase from around $15.3 million currently to $16.0 million in the 2012/13 year. While the increase is not significant by itself, these employers question whether having pulled back from a number of major injury prevention initiatives, proposed costs reflect reasonably accurately, the amount of activity which ACC is funding and/or undertaking in this area.

7.2 Along the same lines as the above, a second issue relates to funding for the Workplace Safety Management Practices (WSMP) incentives programme. Again, some employers question whether the proposed funding accurately reflects the degree of cost involved with running the programme.

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.