Submission

By

Business NZ

to the

Accident Compensation Corporation

on the

2007/08 Levy Rate Consultation Documents

October 2006

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2007/08 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 2007/08 ACC Levy Consultation Documents.

1.1 The ACC scheme and ACC levies loom large in the consciousness of New Zealand businesses both large and small, in low and high-risk occupations. On the proposed figures New Zealand businesses will pay around $446.5 million in levies to the Employers Account for the year ended 30 June 2007, a significant figure in itself. Complying with the Injury Prevention, Rehabilitation and Compensation Act and associated regulations also represents a significant compliance cost.[2]

1.2 Given that the 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.

1.3 The overarching concern of Business New Zealand's submission is the lack of transparency in premium setting and the apparent continuation of ad hoc decision-making in respect to premium changes. Greater transparency in premium setting and the rationale for changes to premiums need further explanation in order for stakeholders to have confidence in the ACC scheme. The fact that ACC is effectively a state monopoly provider demands no less.

[1] Background information on Business New Zealand is attached as Appendix 2.
[2] See Business NZ-KPMG Compliance Cost Survey Results (September 2006).

2.0 RECOMMENDATIONS

Business New Zealand **recommends** that:

- **ACC return to employers as a one-off payment, each individual employer's share of the approximate $500 million surplus in the Employers' Account (over and above the amount of the fully-funded claims liability which is forecast to be $1.5 billion for the year ended 30 June 2008).**

- **In order to improve transparency, ACC should provide a forecast Statement of Financial Performance for the next five years to allow levy funders to analyse current premium setting performance against projected outcomes.**

- **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).**

- **ACC seek independent actuarial and economic advice on their assumptions in the Employers' consultation paper, in particular, the assumptions surrounding an interest rate of 6.75% (p.5) and the significant increase expected in the national payroll (p.10).**

- **ACC proposed premiums and the rationale for such premiums be audited by independent third party actuaries (and the results made public) to ensure transparency in the premium setting process.**

- **Given that ACC is a statutory monopoly, if the Minister decides to reject or modify the premium recommendation(s) of ACC, the reasons for doing so, including actuarial analysis, should be made public to allow both premium payers and ACC to scrutinise the decisions of the Minister.**

- **The Self-Employed Work Account and the Employers' Account be retained as separate Accounts.[3] Notwithstanding this recommendation, if the Government decides to pursue its stated objective of merging the two accounts, then employers should receive a one-off rebate to take account of the different financial positions of the employers' and self-employed accounts. This rebate should be clearly separated from normal levy payment requirements to ensure transparency.**

[3] See Appendix 1: Letter to the Minister of ACC from Business NZ dated 28 August 2006 outlining the reasons why the Employers' and Self-employed Work Accounts should remain separate.

3.0 COMMENT ON EMPLOYERS ACCOUNT

3.1 The ACC Employers Account is made up of funds paid by all New Zealand employers to cover the costs (with the exception of pre-1992 non-work injuries) of work-related personal injury. The amount that employers will pay to the account is estimated at $446.5 million for the year ending 30 June 2007.

3.2 ACC proposes to maintain the 2007/08 average composite employer rate at the current average rate of $1.21 per $100.00 of payroll.

3.3 The $1.21 levy (based on an interest rate return of 6.75%) is constituted by the Employers Account levy ($0.67, which is $0.19 less than the current average) plus the pre-1999 claims levy ($0.54, which is $0.19 more than the current average).[4]

3.4 Business New Zealand considers that the proposed average premium rate of $1.21 is full of distortions and reflects a “smoke and mirrors” approach to levy setting. The Employers’ Account had “Reserves Proportion of Claims Liability (excluding Reserves Adjustment)” sitting at 176.6% as at 30 June 2006 with the reserves only projected to drop slightly to around 163.8% by 30 June 2007 and 146.4% for the year ended June 2008. 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% in the claims cost estimate as an effective prudential margin).

3.5 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 $500 million (see ACC Account Surplus p.45 of 2007/08 Levies for Employers Consultation Document) is that employers will be unable to use their own funds for additional investment in the economy.

[4] ACC states in the Employer Consultation Document that a significant reason for the decrease in the average levy for 2007/08 and the increase in the pre-1999 (residual) claims costs is that legislative changes have moved the liability for a number of existing gradual process claims from the Employers Account to the Residual Claims Account. Note: the Consultation Document explains these issues in greater detail. It should be noted that the average rate of $1.21 tends to mask the impact of these changes on particular groupings of employers, particularly accredited employers.

3.6 It is noted that ACC states (p.13 of the Employers Consultation Document) that *"As the current level of assets held in the Employers' Account is significantly above the 101% target, the excess reserves can be returned to levy payers. The reserves adjustment in the current 2006/07 levy rate is -14.2 cents and is increased to -28.5 cents in the proposed 2007/08 rate."* Similar changes have been made in respect to over funding of the Self-employed Account as well. While employers and self-employed will welcome these announcements, the reduction or rebate proposed in the case of the Employers' Account is extremely timid given the vast reserves which are forecast to continue into the future. As stated above, the Employers Account is still projected to be grossly overfunded to the tune of about 50% by 2008, down from the 76.6% overfunding in the year to June 2006.

3.7 One of the advantages of a fully-funded model, amongst other things, is that changes in policy decisions or issues which affect costs (either positively or negatively), are immediately reflected in premium rates. The ad hoc process adopted by ACC masks potential cost drivers and makes monitoring ACC performance all the more difficult.

3.8 The danger with significant levels of reserves (over and above those required to fully-fund the cost of existing claims) is that there is the potential for significant "creative accounting" in respect to premium setting which creates distortions. More cynically, they can be seen as a mechanism for ACC (and the Government) to fudge increased costs associated with the ACC scheme.

3.9 Greater transparency in premium setting is required, including ACC providing a forecast Statement of Financial Performance to allow premium papers and analysts to determine whether in fact ACC premiums are being set to reach ACC's goal of achieving 111% full-funding (100% full fund plus 11% "prudential margin") over a 5 year period as is the stated policy position of ACC.

3.10 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:

ACC return to employers as a one-off payment, the approximate $500 million surplus in the Employers' Account (over and above the amount of the fully-funded claims liability which is forecast to be $1.5 billion for the year ended 30 June 2008).

Business New Zealand **recommends** that:

In order to improve transparency, ACC should provide a forecast Statement of Financial Performance for the next five years to allow levy funders to analyse current premium setting performance against projected outcomes.

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).

Impact of policy changes on particular employers

3.11 Business NZ wishes to raise important concerns in regard to recent and proposed policy changes which will impact on particular groupings of employers.

3.12 ACC considers that levy stability is an objective of the scheme. While employers would not dispute the importance of trying to ensure relative stability, this should not result in the sending mixed signals to employers, including accredited employers, about the cost of the scheme.

3.13 While "average" premiums for employers will remain at $1.21 per $100 of liable earnings, policy decisions have significant impacts on particular groupings.

3.14 Take for example the Accredited Employer (Partnership) Programme, which allows employers to partially self-insure. "Artificially" lowering the average levy for work claims in 2007/08 (because of the significant reserve built up in the Employers' Account beyond that needed to fully fund claims) means that compared to other employers, Accredited Employers no longer receive the significant benefits of self-insurance.

3.15 At the same time, the increase in the Residual Claims Account (for pre-1999 claims), for which all employers (including accredited employers and self-employed) have to pay, means some accredited employers will face significant levy hikes for 2007/08.

3.16 ACC, and more particularly the Government, must be mindful of the potentially adverse impacts of significant policy changes on the scheme, and more particularly, on the incentives for companies to take greater responsibility for their own accident costs and claims through the accredited employer programme. In this respect, Business NZ considers the effect of policy changes on the economic feasibility of the accredited employer programme needs to be addressed. The danger is that current accredited employers will simply leave the scheme if short-term ad hoc changes are made which reduce the viability of being an accredited employer.

Proposal to add further occupational diseases to Schedule 2 of the Injury Prevention, Rehabilitation, and Compensation Act 2001

3.17 While this issue was not covered explicitly in the 2007/08 ACC Levy Consultation Papers, the pontential exists for significant and unquantifiable costs to be added to the scheme. The issue is as much about the unquantifiable nature of these costs as the total costs themselves.

3.18 For example, ACC has acknowledged that it really does not have an accurate idea of the impact of potential "hearing loss" claims which are yet to be filed in respect to the Residual Claims Account, let alone those costs which potentially will flow back to the Employers Account.

3.19 Any expansion of entry into the scheme must be done very carefully and be based on proper evidence and good funding and costs models. To move ahead without such information would not be responsible and would reduce employer confidence in the ACC scheme.

Interest Rate and Cost of Claims assumptions

3.20 The average employers' composite levy is based on an anticipated interest rate of 6.75% by ACC (p.5) which is only 0.92% higher than long-term Government Bonds (which is effectively a "risk-free" rate of return). 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 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.

3.21 Business New Zealand notes that ACC is projecting that the expected national payroll (p.10) is forecast to increase from $48.3 billion to $53.6 billion from 2006/07 to 2007/08 – representing a 10.9% increase. Business New Zealand would question what assumptions were used to forecast this significant increase given that employment growth is projected to slow substantially over the next year.

Business New Zealand **recommends** that:

ACC seek independent actuarial and economic advice on their assumptions in the Employers' consultation paper, in particular, the assumptions surrounding an interest rate of 6.75% (p.5) and the significant increase expected in the national payroll (p.10).

Transparency in Premium Setting

3.22 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 recommendations of ACC 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 to make their own recommendations.

3.23 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.

3.24 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.

3.25 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. In this respect, there is also a risk that ACC, in its initial premium setting proposals, will try and "second guess" what premium rates are politically acceptable to the Minister.

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

ACC proposed premiums and the rationale for such premiums be audited by independent third party actuaries (and the results made public) to ensure transparency in the premium setting process.

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

Given that ACC is a statutory monopoly, if the Minister decides to reject or modify the premium recommendation(s) of ACC, the reasons for doing so, including actuarial analysis, should be made public to allow both premium payers and ACC to scrutinise the decisions of the Minister.

<u>Proposed merger between the Self–Employed Work Account and the Employers' Account</u>

3.26 Business New Zealand notes that ACC has released an "information paper" on the proposed merger of the above accounts. Business New Zealand strongly opposes the merger as outlined in a letter to the Minister of ACC (see Appendix 1).

3.27 The information paper provides updated information on the financial status of both the Employers' and Self-employed accounts.

3.28 While the Self-employed Account is now adequately funded, there is still a major difference between the funding positions of the two accounts with the Employers' Account forecast to be funded at 163.8% compared to 126.5% for the Self-employed account (for the year ended June 2007).[5] ACC considers that if it is decided to proceed with merging the two accounts then the funding imbalance should be corrected via employers getting a rebate on their levies to be spread over two years - 2007/08 and 2008/09.

[5] ACC state in their "Information Paper" on the proposed merger (31 August 2006) that *"On the basis of initial projections, if the Accounts were combined in the simplest way under the current funding situation, there would be a redistribution of levy reserves from the Employers' Account to the Self-employed Account of up to $96 million as at 1 April 2007….[and] it is proposed that this $96 million funding imbalance be corrected via rebates to employers on their levy rates in both the 2007/08 and 2008/09 levy years, should a merged Account be in place by 1 April 2007"*

3.29 Notwithstanding Business NZ's opposition to merging the two accounts, providing for rebates for employers to address the imbalance in funding is appropriate if the two accounts are to be merged. However, Business NZ would make two points. Firstly, making the payment a "one-off" payment is probably more appropriate than spreading the benefits over two years. Secondly, and more importantly, the proposed rebate to employers must be seen as being independent from premiums facing employers for the 2007/08 and 2008/09 years i.e. the "rebate" should be clearly separated from premiums paid to ensure transparency in premium setting and to avoid any confusion from premium payers. In this respect, Business NZ recommends that the rebate be issued separately from normal ACC levy payment requests.

Business New Zealand **recommends** that:

The Self-Employed Work Account and the Employers' Account be retained as separate Accounts.[6] Notwithstanding this recommendation, if the Government decides to pursue its stated objective of merging the two accounts, then employers should receive a one-off rebate to take account of the different financial positions of the employers' and self-employed accounts. This rebate should be clearly separated from normal levy payment requirements to ensure transparency.

[6] See Appendix 1: Letter to the Minister of ACC from Business NZ dated 28 August 2006 outlining the reasons why the Employers' and Self-employed Work Accounts should remain separate.

<u>APPENDIX 1:</u> **Letter from Business New Zealand to the Minister of ACC**

28 August 2006

Hon. Ruth Dyson
Minister of ACC
Parliament Buildings
WELLINGTON

Dear Ruth

Proposal to Merge the ACC Self-Employed Work Account and ACC Employers' Account

Thank you for providing me with a copy of the proposed merger paper for comment. I have read the paper with interest and have the following comments to make.

I note that you have made an in principle decision to merge the two accounts but are open to determining how best to manage any risks associated with the merger. Business New Zealand would welcome the opportunity to have further input into this process.

At the outset I must say that there is nothing in this latest merger paper to change what we recommended in our 26 January memo on the possible merger of the Employers' and Self-Employed Accounts, namely:

1. That the Self-Employed Work Account and the Employers' Account be retained as separate Accounts.

2. Without prejudice to the above recommendation, if the accounts are merged, both the Employers' and Self-Employed Work Accounts be on a comparatively sound financial footing to minimise the risk of cross-subsidisation as a result of the merger.

3. That experience rating be reinstated, either as a stand-alone system or in conjunction with the Workplace Safety Management Practices (WSMP) scheme.

Notwithstanding the above, I note in your paper that a number of reasons are given for the proposed merger – improving levy stability for small businesses, providing for a greater focus on industry/occupational risk and improving administrative efficiencies for ACC. It is also argued in the paper that the separation of self-employed from other businesses is no longer logical given that the accounts are now administered by ACC as effectively a sole insurer. Finally it is stated that self-employed claims to earnings experience tends to be similar to that of small and medium businesses.

Levy Stability

The paper is correct in pointing out some of the difficulties (e.g. levy instability etc) associated with relatively small risk pools which reflect the relatively small size of the NZ market. However, concerns over levy instability are not, by themselves, justification for combining the employers' and self-employed accounts. The factors driving levy instability must also be considered.

The ACC scheme is by nature insurance-based. As with any insurance market, individuals and companies ought to face costs associated with their behaviour, acknowledging that the purpose of insurance is to pool risks within similar risk profiles.

The paper states the positive flow-on effects of the proposed merger as including greater levy stability for the self-employed and employers because the cost of all self-employed and employee injuries would be spread over a larger and more stable earnings base.

In reality, a merger would see the self-employed subsidised by the larger employer pool with lower premiums likely as a consequence and employers bearing a proportion of the burden. But since it is also argued that for a number of reasons, the self-employed account is unstable, it is hard to see how combining the Employers' and Self-employed accounts would result in increased stability for employers; only the self-employed would benefit.

Greater focus on industry/occupational risk

The paper states that one of the major advantages of merging the work accounts includes the removal of levy differentials between self-employed and employers and a greater focus on industry and occupational risk.

This justification for a merger of the Employers' and Self-employed Accounts fails to accept the role of individual enterprises in achieving desirable outcomes at the enterprise level. Industry-wide initiatives are unlikely to meet the unique needs of each enterprise to achieve positive outcomes in terms of health and safety management systems, and hopefully a reduction in the number and severity of accident claims. Moving towards centralised approaches (as a merger implies) would mean less ownership of health and safety outcomes at the enterprise level and of the benefits and costs of taking appropriate steps to reduce liabilities; initiatives taken at the enterprise level would, to some extent, be captured by the rest of the industry. In other words such a merger would result in the socialisation of the costs and benefits of the ACC scheme and would represent a radical move away from the insurance-based approach.

Administrative efficiencies for ACC

While there would likely be some administrative efficiency from merging the accounts as outlined in the paper, administrative efficiency by itself is not a particularly useful indicator of the overall efficiency of the ACC scheme.

To take two extreme examples. It would be possible to have very low administrative costs by simply minimising any monitoring or follow-up on claims. While in the short-term this may well reduce costs to employers and others, over time the incentives for individuals to misreport claims and potentially rort the system would be greatly enhanced. In this respect, there will be an optimal amount of money spent on administrative/monitoring costs to ensure that individuals and employers have strong incentives to minimise the risk of accidents, but ensuring that those who are injured are appropriately dealt with both in terms of rehabilitation and earnings-related compensation where applicable. A second radical example which Business New Zealand would strongly oppose, would be to simply have a flat levy for all accidents irrespective of the risk involved. While this would likely increase administrative efficiencies, it would defeat the whole concept of insurance principles which is to pool risks within similar risk profiles. The point here is that the overall impact on the ACC scheme and incentive structures needs to be considered when recommending changes.

While the paper states that there is no longer any logic for continuing with the separation of the two accounts given that original rationale for the separate accounts (i.e. privatisation of the Employers' Account) is now redundant, it is important to also look forward to the future in respect to the changing nature of work and employment and whether this might influence the number of self-employed people and or size of the self-employed earnings pool. If self-employment is likely to become a larger share of the market then it may be considered premature to merge the two accounts.

Only fleeting mention is made in the paper of the "under" and "over" funding positions of the Self-employed and Employers' Accounts although I note in the paper that you consider that the *"timing for the policy change is right on the basis that current predictions are that both accounts are (more than) adequately funded, which will, to some extent, minimise any resulting levy impacts and make transition to a single account easier. Current predictions show overfunding in the Employers' Account and, to a lesser extent, the self employed account."*

The data from ACC's 2006/07 levy consultation papers show that while the Employers' Account was significantly overfunded, the Self-employed account was projected to only be funded to around 90% by June 2007. Maybe update figures available to ACC show different results. Needless to say I would be very surprised if in the space of a year that both accounts are now funded to similar levels given the significant disparities evident over the last couple of years. If they were then it would show gross forecasting errors were made by ACC in last year's levy consultation documents.[7]

As Business NZ outlined in its paper to you on 26 January 2006, if the accounts are merged then *"…both the Employers' and Self-employed Work Accounts must be on a comparatively sound financial footing to minimise the risk of cross-subsidisation between the two accounts as a result of the merger".*

Claims to earnings experience similar

The paper states that ACC data, when broken down by Levy Risk Group (LRG), shows that self-employed claims to earnings experience tends to be similar to that of small and medium businesses.

While Business New Zealand is not in a position to query the validity of this statement, it would be useful to know how self-employed claims to earnings experience relates to larger industries or whether there are significant differences. It would appear from your paper that it is an issue, at least in some industry groupings.

If business form (or size) is a risk factor then, like any other risk factors, it should be considered when determining appropriate risk pools. That business activity (outputs) may be similar does not necessarily justify lumping such businesses together in the same pool.

[7] The ACC Consultation Documents on 2006/07 levies (ACC, October 2005) show that the Employers Account was forecast to be over funded by $341 million as at 30 June 2007 (which represents overfunding of around 27.2%). In contrast the Self-employed Account (a small account by comparison) was forecast to be in deficit by $33.5 million which represents underfunding of around 11.1%.

One mechanism for overcoming this problem without socialising costs amongst all employers (as the merger proposal would do) would be to create larger pools but reintroduce a form of experience-rating, clearly rewarding/penalising claims' behaviour at the individual enterprise level. Experience rating takes account of the fact that enterprises within the same industry grouping often have consistently different claims costs through time based on a range of factors. It encourages an internalising of the costs and benefits of workplace accidents.

Business New Zealand considers that any benefit of combining the Employers' and Self-employed Accounts (e.g. for potential administrative savings) would appear to conceal potential costs (greater risks of cross-subsidisation and the socialisation of costs undermining incentives for employers and employees to improve their own health and safety outcomes) as outlined in Business New Zealand's 26 January memo to you. At a minimum, effective experience-rating would need to be introduced to counteract the negative effects of larger risk pools and to take into consideration individual enterprise risk which may or may not differ substantially over time from the industry average. Workplace Safety Discount schemes for smaller enterprises, while supported, do not reward employers who reduce accidents and accident costs - only those who comply with the paperwork. The two do not necessarily follow, although we accept that better systems generally reduce the likelihood of injury. The reintroduction of experience-rating would be fundamental if serious consideration is to be given to merging the two accounts, quite apart from sorting out the respective under and over funding of the Self-employed and Employers Accounts.

Given the above issues it may be desirable to at least delay proposals to merge to two accounts until some of the above issues can be analysed in more detail by your officials.

Yours sincerely

Phil O'Reilly
Chief Executive

APPENDIX 2:

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 57 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.