Submission

By

to the

Accident Compensation Corporation

on the

2010/11 Levy Rate Consultation Documents

November 2009

PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

2010/11 ACC LEVY RATE CONSULTATION DOCUMENTS
SUBMISSION BY BUSINESS NEW ZEALAND[1]

1.0 INTRODUCTION

1.1 Business New Zealand welcomes the opportunity to comment on the 2010/11 ACC Levy Consultation Documents.

1.2 Business NZ has been involved in the levy setting process in previous years as a member of ACC's levy setting steering committee. This year's ACC levy setting steering committee process provided little opportunity for early input. This lack of real engagement is partly why it is now proposed that ACC levies should rise by significant amounts to pay for increased claims and associated inflating claims' costs. In simple terms, premiums to date have been driven largely by short-term political considerations with no serious thought given either to the longer term implications of expanding the scheme or to promoting incentives to minimise accidents and encourage an early return to activity as individuals recover from their accidents.

1.3 Business NZ takes no pleasure from the present state of the ACC accounts – which by any analysis show an organisation in considerable trouble. Excluding the Work Account, which is very close to being fully-funded, the other accounts, particularly the Earners' and Motor Vehicle Accounts, are significantly underfunded, despite clear legislative requirements for post-1999 claims to be fully-funded (on an ongoing basis). Pre-1999 claims must be fully-funded by 2014 (proposed to be extended out to 2019).

1.4 While ACC is correct in stating in the consultation papers that lower investment returns have significantly impacted on proposed levy rates, in our opinion some accounts have been deliberately underfunded, calling into question the standard of ACC's previous funding policy decisions and ultimately decisions made by successive ACC Ministers in respect to setting levy rates.

1.5 A major concern for Business NZ is the projected blow-out in levy costs across all accounts. While it is accepted that elements of smoothing make it difficult to compare levies over time, the general trend towards substantial increases in levies across accounts is something policy makers need to address with some urgency.

1.6 ACC proposes to increase the average combined work levy from $1.31 currently to $1.89 for the 2010/11 year. This represents a huge increase in costs for employers, averaging around 44 percent. Requiring employers to fund such rises in the current recessionary environment is simply going to make them less competitive. This will have flow-on implications for employment intentions and will, as well, raise wage bargaining issues since (at least partially) employees are likely to seek to recover the significant increases in earner premiums.

---

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

1.7 Such rises call into question the ability of ACC to control costs and efforts to encourage rapid rehabilitation for those injured. This not only impacts on the potential costs facing the work account but also the other major accounts, mainly the Earners, Motor Vehicle and Residual Claims Accounts.

1.8 Business NZ is therefore supportive of the current stocktake review of ACC and proposed reforms signalled by the Government and the Corporation. We look forward to providing assistance to ensure that the scheme is truly sustainable over time.

1.9 The primary focus of an accident insurance scheme should be on providing an appropriate framework whereby the number of accidents and their severity are reduced.

1.10 Reducing the overall costs associated with an accident insurance scheme requires that "stakeholders" (funders, claimants, health professionals and insurers) all face strong incentives to minimise the number of accidents and costs associated with them. In this respect, incentives for employers, employees, health professionals and insurers do matter.

1.11 Business NZ considers that the current ACC Board has done a good job in a relatively short period of time trying to assess more realistically the liabilities and assets associated with the scheme when setting levy rates going forward. This should assist with the scheme's future transparency. Even so, a number of significant policy changes underpin the draft levy proposals, and these, in our view reduce the scheme's transparency for premium payers – effectively fudging costs (for example, excessive smoothing of premiums). Much greater transparency in premium setting is required going forward for employers, earners and motorists to have a degree of comfort that the scheme is delivering value for money.

1.12 Business NZ stands ready to assist in achieving this objective so that employers can have confidence that premiums are set on a economically sound and principled basis.

1.13 This submission is in two parts. Part one 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 issues are unique – for example, dealing with the funding of residual (pre-1999) claims, which under current legislation are required to be fully-funded by 2014. Such issues will be touched on as well.

1.14 Part two of the submission deals with issues surrounding the benefits of contestability in the provision of ACC services, while debunking some of the myths put up by the opponents of contestability. This has nothing to do with ideology but ensuring that premium payers obtain value for money while those who suffer accidents receive appropriate treatment in a timely manner. Business NZ considers these contestability issues are crucial to ensuring services are provided in a cost-effective manner; they are also particularly relevant given the amount of misinformation attracting media attention since the consultation papers were released.

1.15 It should be noted that this submission does not comment specifically on the Injury Prevention, Rehabilitation and Compensation Amendment Bill which has been introduced and has been referred to the Environment and Industrial Relations Select Committee. Business NZ will be making separate submissions on that Bill as and when submissions are required.

2.0 RECOMMENDATIONS

Business New Zealand **recommends** that:

1. **an independent assessment of the principles the levies are based on should be undertaken (see p.9)**

Business New Zealand **recommends** that:

2. **the funding policy in respect to levy setting should be included within legislation to avoid the risk of annual political manipulation of levy setting (see p.9)**

Business New Zealand **recommends** that

3. **the rationale for any changed policy approaches in respect to levy setting by the ACC Board (e.g. smoothing policy and changes in same) should be made public (with the opportunity for the public to be heard) to assist in transparency of premium setting to avoid accusations of political bias (see p.9)**

Business New Zealand **recommends** that:

4. **ACC should examine whether a similar funded risk margin of around 12% 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 employers) and the fact that the Work Account is very close to being fully-funded while the earners' and Motor Vehicle Accounts (post-1999 claims) are grossly underfunded (see p.11)**

Business New Zealand **recommends** that:

5. **ACC projections are based on the principle that all claims post-1999 should be fully-funded annually unless there are extraordinary reasons for not doing so (see p.13)**

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

6. **Any element of premium smoothing, if ACC wishes to retain this, should be over a much shorter period, say 2-3 years maximum, rather than the current ACC Board's policy approach of smoothing for up to 10 years (up from 5 years last year) (see p.13)**

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

7. **If premium smoothing is retained, then it should be applied consistently across accounts, unless there are extraordinary reasons why it should not be (see p.13)**

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

8. **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.14)**

Without prejudice to recommendation (8),

9. **if recommendation (8) is not acceptable then consideration should be given to extending the timeframe by which the residual claims across accounts must be funded to 2019 (as proposed by Government) or even beyond, given the sunk cost nature of these claims. Given the nature of these <u>residual claims</u>, Business NZ would not be averse to considering funding the <u>residual claims only</u> on a Pay-as-you-go (PAYG) basis if this would spread the costs more efficiently. Alternatively a low flat tax on employers, earners and motorists could be a viable option. Nothwithstanding the above, under any proposed regime, employers should not continue to be required to fund residual clams associated with pre-1992 non-work accidents to earners. (see p.14)**

Business New Zealand **recommends** that:

10. 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. Consideration should be given to introducing experience-rating in the Earners' and Motor Vehicle Accounts as well (see p.17)

Business New Zealand **recommends** that:

11. Consideration be given to mechanisms which ensure all road users (whether car, truck, motorcycle, or cyclist) pay the relative costs associated with road use (see p.18)

Business New Zealand **recommends** that:

12. 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 responsibility for costs should lie; it is not immediately obvious that fuel use is necessarily a very accurate indicator of risk. Other factors such as the vehicle type and individual driver may be more relevant in respect to accident risk (see p.19)

Business New Zealand **recommends** that:

13. The various ACC Accounts, where applicable, should progressively be opened up to competition from private sector providers (starting with the Work Account), with ultimately the Government's role restricted to ensuring minimum service and delivery standards within a risk-based, 24-hour universal no-fault system (see p.24)

PART ONE:

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 with the residual claims account), a reasonably consistent approach should be taken across the board.

3.2 Legislation clearly requires the Work, Earners' and Motor Vehicle Accounts to be fully-funded for claims post-1999. However, this requirement appears not to have been robust enough to avoid concerns about political manipulation of premiums e.g. in respect to a smoothing policy which has resulted in some accounts (e.g. the Earners' Account and the Motor Vehicle Account) being grossly underfunded (i.e. total projected liabilities significantly exceeding total projected assets). While the Work Account is currently 99% fully-funded (forecast to drop to 90% in 2010 before recovering again), the Earners' Account (post-1999 claims) is projected to be less than 50% fully-funded by 2010, with the Motor Vehicle Account in a very similar situation.

3.3 ACC is correct in asserting that reductions in investment returns have been a significant factor in the deterioration in funding. However, this is only one reason. Others include the number, cost and length of claims ***and*** in the view of Business NZ, the deliberate underfunding of these accounts in previous years due to political considerations. 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.

3.4 Current and proposed approaches to levy setting are ad hoc with little consideration outlined in the consultation documents for the decisions that have been, or are projected to be made in respect to levy setting. While the issues surrounding residual claims will be dealt with later in this paper, issues such as decisions to "smooth" premiums over a maximum period of up to 10 years simply appear to be driven by political considerations rather than by any sound economic rationale, further distorting the accident costs faced by levy payers.

3.5 If indeed a smoothing policy is considered desirable, then why different approaches across the Work and Earners' Accounts (Work currently 5 years, Earners' 10 years)? While the funding policy adopted for 2010/11 is laid out well in the consultation documents, what confidence can levy payers have that the policy will not be changed on an ad hoc basis next year as has occurred in previous years, to take account of political or fiscal concerns?

Business New Zealand **recommends** that:

1. an independent assessment of the principles the levies are based on should be undertaken.

Business New Zealand **recommends** that:

2. the funding policy in respect to levy setting should be included within legislation to avoid the risk of annual political manipulation of levy setting.

Business New Zealand **recommends** that

3. the rationale for any changed policy approaches in respect to levy setting by the ACC Board (e.g. smoothing policy and changes in same) should be made public (with the opportunity for the public to be heard) to assist in transparency of premium setting to avoid accusations of political bias.

Risk Margin

3.6 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.

3.7 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.

3.8 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.

3.9 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 should do likewise. 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.

3.10 ACC is still proposing building in a funded risk margin across the various accounts (around 12% on average it is understood) 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 fully accepts that a 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 for the Work Account since:

- ACC is a monopoly insurer and has the power to tax future employers should claims' costs be significantly higher than expectations.

- The ACC Work Account continues to be more or less fully-funded.

3.11 It is for these reasons that there is little justification for any (funded) risk margin at this stage. If any funded risk margin for the Work Account is currently justified, then it should be at a much lower rate (say 5%).

3.12 Notwithstanding the above, in Business NZ's view, there are three reasons why a funded risk margin might well be appropriate, irrespective of any NZ Financial Reporting Standards' requirements:

- 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. It could therefore be argued that by having a funded risk margin, ACC is trying to mimic what would occur in a contestable environment.

- Because ACC has such a long smoothing policy (up to 10 years), the risk of the ACC accounts becoming even worse over time is a distinct possibility so a significant risk margin within the Earners' and Motor Vehicle Accounts could be considered justified.

- 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.

3.13 The above issues should all 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 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 issues need to be considered in the context of government taxation policy and other fiscal strategies that either boost or reduce disposable incomes.

Business New Zealand **recommends** that:

4. ACC should examine whether a similar funded risk margin of around 12% 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 employers) and the fact that the Work Account is very close to being fully-funded while the earners and Motor Vehicle Accounts (post-1999 claims) are grossly underfunded.

Smoothing Premiums

3.14 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).

3.15 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).

3.16 While it could be argued that smoothing is perhaps warranted when an account has excess funds beyond those required to fully fund it, Business NZ is concerned that the smoothing policy currently advocated to bring reserves up to 100% of claims' liabilities is far too long if reserves have fallen below 100%.

3.17 Business NZ pointed out in its submission on the 2009/10 levy consultation round (October 2008) that in the case of the Earners' Account the Discussion Document contained a graph which showed "…the funding for new non-work *claims is projected to fall to around 75% of the full-funding required to fund claims within that account (2011), although it is accepted that ACC projects that with premium increases over time, the account will be restored to full-funding by 2014. Business NZ considers that this policy shows a reckless disregard for the potential risk for this account to fall even further into the red."*

3.18 Unfortunately, Business NZ's concern last year was vindicated when the latest consultation documents were released with both the Earners' and Motor Vehicle Accounts slipping further into the red (i.e. they are both now only approximately 50% fully-funded (for post-1999 claims). The longer the smoothing period the greater the potential for the accounts to get into a very difficult situation.

3.19 While there will always be the potential for one-offs to affect the liabilities and assets of each account, such a long smoothing policy sends distorted signals to current and future levy payers as to the true costs associated with accidents. It also leaves a significant potential burden for future levy payers in the form of unfunded liabilities across accounts. If a smoothing policy is to be retained, it should arguably be applied over a much shorter time frame and consistently across accounts, unless there is a strong justification for a separate policy response for a particular account.

3.20 Notwithstanding the number of factors impacting on the number and cost of claims, which makes 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 appear to be cost neutral, while current and future levy payers are sent distorted signals as to the scheme's real costs.

3.21 Smoothing to take account of one-offs may sometimes be appropriate. However, it is certainly not appropriate to smooth premiums in the case of surpluses or deficits of a structural nature. Business NZ considers that there are structural deficits within both the Earners' Account and the Motor Vehicle Account which need to be addressed. Smoothing is simply a mechanism to delay an inevitable increase in premiums down the track. Failure to take early action to increase premiums (while politically unpalatable) simply results in subsequent reduced flexibility should unforeseen risks arise within any of the accounts.

3.22 Business NZ considers that if ACC wishes to retain any element of premium smoothing this should be over a much shorter period, say 2-3 years at maximum, rather than the current ACC Board's policy approach of 10 years (up from 5 last year). This would minimise the risk of any new policy decisions being implemented which impact significantly on the costs of the scheme (either positively or negatively) but yet are hidden for the first 2-3 years in terms of the "average" composite premium.

3.23 As mentioned earlier, one of our key recommendations concerns support for a truly independent assessment of the principles the levies are based on. 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 10-year period and whether this regime is justified on sound economic grounds. At a minimum, if a 10-year smoothing policy is indeed supported by the ACC Board, then it 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) continues to be applied in an ad hoc manner.

Business New Zealand **recommends** that:

5. **ACC projections are based on the principle that all claims post-1999 should be fully-funded annually unless there are extraordinary reasons for not doing so.**

Business New Zealand **recommends** that:

6. **Any element of premium smoothing, if ACC wishes to retain this, should be over a much shorter period, say 2-3 years maximum, rather than the current ACC Board's policy approach of smoothing for up to 10 years (up from 5 years last year).**

Business New Zealand **recommends** that:

7. **If premium smoothing is retained, then it should be applied consistently across accounts, unless there are extraordinary reasons why it should not be.**

Pre-1999 (Residual) Claims Levy

3.24 Business New Zealand notes that ACC proposes to increase the average residual claims' levy to $0.71 per $100 of payroll/liable earnings (up from $0.56 currently). However, it is also noted that if ACC extends out the period for fully-funding residual claims to 2019, then the residual claims levy will likely fall to around $0.36 for the forecast period out to that year.

3.25 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-third of this cost relates to pre-1992 injuries caused outside of the workplace (i.e. non-work accidents) which employers are still being required to pay for.

3.26 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. In this respect the funding of those costs should arguably be borne by general taxpayers as the most efficient and least distortionary funding method.

3.27 While Business NZ's recommendation is that residual claims (across all the relevant accounts) should be funded out of general taxation, if this is not economically practical, then the costs of residual claims should be spread amongst as many people as possible and over as long a period as possible. This will ensure that the costs associated with what is effectively a "tax", are the least distortionary possible. In this respect, Business NZ considers that ACC should look at further options relevant to the funding and timescale of fully-funding pre-1999 claims (across the various accounts).

3.28 Business NZ considers a number of options could be investigated in this context such as reverting back to a PAYG system of funding *pre-1999* claims (i.e. fund simply the anticipated cost of exiting claims in the year they fall or impose a low flat levy (tax) on employers, earners and motor vehicle owners to pay for the ongoing costs of pre-1999 claims over time. Both these proposals would spread the costs of pre-1999 accidents (which are sunk costs) over a much longer time frame thus lessening the impact on current and future premium payers. Further investigation of the merits of these proposals is required.

Business New Zealand **recommends** that:

8. 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.

Without prejudice to recommendation (8),

Business New Zealand **recommends** that:

9. if recommendation (8) is not acceptable then consideration should be given to extending the timeframe by which the residual claims across accounts must be funded to 2019 (as proposed by Government) or even beyond given the sunk cost nature of these claims. Given the nature of these residual claims, Business NZ would not be averse to considering funding the residual claims only on a Pay-as-you-go (PAYG) basis if this would spread the costs more efficiently. Alternatively a low flat tax on employers, earners and motorists could be a viable option. Nothwithstanding the above, under any proposed regime, employers should not continue to be required to fund residual clams associated with pre-1992 non-work accidents to earners.

Workplace Safety Management Practices (WSMP) and Experience Rating

3.29 Business New Zealand submits that WSMP on its own is an ineffective injury prevention tool because there is no link to actual injury incidence, only to the implementation of systems which may or may not be effective. Conversely, notwithstanding a large increase in injuries, an employer enjoying the rewards of participation may not be penalised simply because there was an audited system in place.

3.30 Extending the WSMP is not appropriate for small businesses as the compliance costs of meeting audit requirements mean that only a small proportion of enterprises (mainly medium to large-sized) are in a position where the level of discount available is greater than audit requirement costs.

3.31 Currently, there is little ability for small and medium sized enterprises to reduce their premium levels irrespective of their claims' record. This is particularly significant given that over 95% of all enterprises in New Zealand employ fewer than 20 persons.

3.32 Business New Zealand therefore continues to support the reintroduction of experience rating, either as a stand-alone system or in conjunction with a modified WSMP scheme. Such an initiative was, for a considerable time, the discount scheme of choice and provided positive incentives for employers of all sizes (and the self-employed) to strive to improve their workplace safety practices and to minimise risks. Experience rating is beneficial also to small businesses that cannot enter the Partnership Programme or for whom the WSMP scheme is too cumbersome.

3.33 While Business New Zealand supports WSMP, the scheme is systems-based rather than output based, meaning there is an assumption that if employers have received a satisfactory audit from ACC, the risk of accidents in the workplace is lower.

3.34 Business New Zealand considers it much better to have an outcomes-based approach where the rate of injury is the relevant factor in setting premiums.

3.35 Business New Zealand considers that experience rating is essential in ensuring strong incentives are available to employers so that those with consistently lower than average accident rates (within their risk class) are rewarded. On the other hand, those with poorer than average accident rates will experience higher premiums.

3.36 Within similar industry and risk classes there are often substantial and consistently different accident rates attributable to a range of factors. Often similar businesses within the same industry have significant ongoing differences in accident claims and associated claims' costs, reinforcing the need to focus on individual enterprise risk. Experience rating is therefore crucial to ensuring employers benefit from better than average outcomes within their risk category.

3.37 Business NZ notes that the PriceWaterhouseCoopers (PWC) Report on the ACC Scheme Review (March 2008), commissioned by ACC, stated, in respect to experience-rating: "…*in our view, experience-rating which makes appropriate use of statistical credibility offers substantial fairness and economic resource allocation efficiencies, which if properly regulated, could outweigh the residual adverse incentive risk which may remain…" (p. xxxiii).*

3.38 Four arguments by critics of experience rating are worth mentioning briefly:

- The first is that accidents are unfortunate random occurrences and as such a system of experience rating cannot affect their outcome. Many accidents (and health states) are purely random with little that can be done to minimise them (other, possibly, than at great cost). On the other hand, a number of so-called "accidents" can be avoided through appropriate health and safety management.

- The second criticism of experience rating is that it provides limited incentives for employers to reduce the number of workplace accidents because they can pass on costs to consumers or employees, presumably through higher cost of product and/or lower wages than might otherwise be the case. In an insulated and protected environment where employers are not subject to competition, the above might be true. However, in reality, the ability to pass on costs is strictly limited. Most businesses are subject both to international and domestic competition; therefore the ability to sustain cost increases (even on the margin) is likely to be low.

- The third criticism of experience-rating is that in some cases an employer may be experience-rated on an alleged "work-related" accident which they believe was completely beyond their control. While there will no doubt be some cases where employers feel unduly punished by experience-rating, the benefits of experience-rating need to be clearly understood.

- Finally, the argument is sometimes put forward that introducing experience-rating will encourage employers to put pressure on their employees either not to report work-related claims or alternatively to report (work) claims as non-work related. Claims will then be funded out of the Earners' Account with reduced impact on the employer's experience rating. As mentioned in response to the previous criticism, there may theoretically be cases on the margin where such behaviour may occur, but these should not be used to diminish the positive impacts of experience rating. Moreover, effective claims' monitoring should ensure this kind of employer or employee behaviour is minimised.

3.39 It should also be noted that (irrespective of the existence of experience-rating), in some cases there may be incentives for employees to report "non-work" related accidents as having occurred at work. Again this misreporting of accidents can be minimised through the effective monitoring of claims and by having appropriate systems in place to minimise and detect fraud.

Business New Zealand **recommends** that:

10. 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. Consideration should be given to introducing experience-rating in the Earners' and Motor Vehicle Accounts as well.

4.0 SPECIFIC COMMENTS ON THE MOTOR VEHICLE ACCOUNT

4.1 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.

4.2 Given the trend towards a greater use of motor cycles and/or bicycles (on road), 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. The current system of funding the Motor Vehicle Account involves significant cross-subsidisation from motor vehicle owners to motor cyclists as the Consultation Documents indicate.

4.3 While there are some moves to reduce cross-subsidisation in the levies proposed for the Motor Vehicle Account, these are rather tentative to say the least and are 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. 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. This should result in the introduction of experience-rating premiums for the Motor Vehicle Account as well as for the Earners' and Work Accounts.

4.4 Finally, in respect to the Motor Vehicle Account, Business NZ notes that the Discussion Documents ask respondents for feedback on the appropriate balance between funding claims from petrol purchases and from registration. Without a clear understanding of the nature of claims and how they arise, it is virtually impossible to provide an answer to this question. 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. For example, it is not immediately obvious that petrol use is necessarily a good indicator of accident claims or severity.

Business New Zealand **recommends** that:

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

Business New Zealand **recommends** that:

12. 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 responsibility for costs should lie as it is not immediately obvious that fuel use is necessarily a very accurate indicator of risk. Other factors such as the vehicle type and individual driver may be more relevant in respect to accident risk.

PART TWO:

5.0 CONTESTABILITY I N THE ACC ACCOUNTS

5.1 Central government does not have to be a monopoly service provider of accident insurance to meet its social and economic objectives. Contestability would provide for an improved service to both funders and claimants as providers would be required to focus much more clearly on the provision of an efficient cost-effective service than currently happens in respect to ACC.

5.2 There has been a great deal of misinformation in the media since the recent release of the ACC Consultation Papers and government proposals that have yet to be fleshed out in detail. Some opponents of making the current ACC monopoly model contestable have raised a number of red herrings in respect to contestability which deserve a considered response.

5.3 There is a wide range of models which could introduce rehabilitation and levy competition to ACC. Business NZ is pleased that the stock-take will be examining and considering all possible arrangements is this respect.

5.4 Although there might be some perceived benefits in ACC retaining its current monopoly position in respect to accident insurance provision, these are likely to be minor compared with the benefits of competition. The latter clearly outweigh any negative effects as perceived by contestability's opponents.

5.5 Two perceived benefits of ACC retaining its monopoly status are briefly outlined below:

- **A single organisation:** Because ACC covers all accident insurance with respect to work and non-work accidents (including motor vehicle accidents), individuals are effectively dealing with one organisation in respect to their claims. Some people may view this as positive from an administrative point of view.

- **Perceived stability and certainty:** Some may consider that ACC as a state-sanctioned monopoly with the power to tax (levy) future employers, earners and motorists, gives current and future claimants a high degree of certainty that their entitlements will be met. However, mechanisms can be put in place to ensure that the risk of failure from private insurers is extremely low, or if failure does occur, that individual claimants are covered.

5.6 On the other side of the coin, there are significant problems associated with the ACC run currently as a state-sanctioned monopoly. These are briefly outlined below, not necessarily in any order of importance.

- **One-size-fits-all does not encourage improved outcomes:** Premiums often do not reflect the costs associated with the individual workplace, recognising that to an extent, the nature of accident insurance is to pool risks within similar risk categories. Current policy revolves around the principle of a one size fits all approach which may not reflect the needs and wants of individual enterprises. The absence of any effective form of experience rating is problematic while the only real form of "choice" is the ability to partially self-insure through the ACC Partnership Programme (over 150 employers are in this programme which it is understood covers about 25 per cent of the workforce). However for most employers – who are small and medium sized enterprises – the Partnership Programme is not a realistic option.

- **Monitoring of Claims:** The incentives on ACC to rigorously monitor and possibly contest claims are likely to be driven by political considerations rather than sound commercial practice. While unlikely to have a major short-term impact, the lack of effective work capacity assessment testing, with the subsequent removal of claimants from the scheme once they are fit and able to work, is likely to add significant costs to the scheme over time – costs which ACC and the Government may not necessarily wish to address.

- **Potential for ministerial interference:** ACC premiums are ultimately determined by the Minister of ACC who can accept, reject, or modify the corporation's recommendations. The Minister's ability to change recommendations in respect to premium rates if new information comes to hand can be useful. However, there has been a tendency in recent years for ACC Ministers to tinker with ACC's recommendations and instead make recommendations of their own. When such decisions are not based on competent and comprehensive advice, there is, rightly or wrongly, a risk that premiums will be seen as being set for political reasons, rather than on the basis of sound commercial practice. Furthermore, ACC could become the vehicle for government to achieve objectives apart from the organisation's principal function as an accident insurer. This is much more likely to happen if ACC retains its monopoly position with no contestability from the private sector.

- **Distorted premium setting processes:** A fully-funded model should see policy changes that impact on costs immediately reflected in employers', employees' and motorists' premiums. But in reality ACC premiums too often reflect political considerations (combined with ad hoc policy introduction such as smoothing premiums) and so send employers, earners and motorists distorted signals as to the real cost of accidents.

- **Cross subsidisation:** Significant cross-subsidisation occurs within some accounts (principally the Motor Vehicle Account) because of political considerations e.g. the levies paid for motor cycles are significantly less than justified by the number of accidents, and perhaps more importantly, accident claim costs. Failure to realign these rates is almost solely due to opposition from the motor cycle fraternity. Other road users, e.g. cyclists, pay no levies whatsoever in respect to road accidents.

5.7 Contestability in the provision of ACC services and delivery would provide a number of benefits while having little downside risk. The following positive outcomes are much more likely to occur under a competitive model.

- **Monitoring of claims and management of risk would likely be more pronounced** in respect to employers, earners and motorists, with premiums more accurately reflecting actual risk and claims' history than at present.

- **Under a competitive model, any attempt to pass on an insurer's inefficiencies would result in levy payers shifting their business to another insurer.** Insurers trying to increase premiums beyond the level justified by the market would be penalised through reduced market share. Allowing new insurers to enter the market at any time would keep premiums at actuarially fair levels. Ultimately employers would have the right to switch insurers if they experienced a significant and unwarranted increase on the amount currently paid.

- **Premium "options" would be more likely to meet the unique needs of enterprises rather than a "one-size" fits all approach.** Greater use of risk sharing arrangements would likely be common under a competitive regime.

- **Private insurers would be likely to invest significant resources into the monitoring of claims** in order to ensure these were dealt with quickly, appropriate treatment was given, and claimants were encouraged back into the workforce as promptly as possible. This would be likely to reduce costs over time.

5.8 While opponents of contestability in the accident insurance market have often stated that it is only larger companies that would benefit from a move to contestability, evidence from the 1999 "reforms" (which opened up work-related accidents to competition would suggest otherwise. The then NZ Employers Federation submission on the *"Accident Insurance (Transitional Provisions) Bill" (January 2000)* stated that around three-quarters of companies reported lower costs of accident insurance under a competitive model, with some companies of fewer than 10 employees reporting savings of more than 40 per cent on their accident insurance premiums.

5.9 A letter by the Department of Labour's Labour Market Policy Group (LMPG) to the Minister of Accident Insurance (29 August 1999) stated that: *"while initial data from the [Accident Insurance Market] Regulator has indicated a reduction in premiums, the data are not reliable enough to reach firm conclusions at this stage. However, anecdotal feedback from insurers and brokers indicates savings, particularly for large employers."*

5.10 For businesses where current premiums do not reasonably reflect risk in the workplace accurately, premiums would likely increase. But as a corollary, those firms that had been effectively cross-subsiding such businesses would see lower premiums. The then NZ Employers Federation in its submission on the *"Accident Insurance (Transitional Provisions) Bill" (January 2000)* stated: *"All the research in New Zealand shows that premiums have declined substantially under a competitive regime, with surveys of employers demonstrating that around 75% of employers have had significant reductions under the competitive regime. While some premiums have increased, rates now much more closely reflect the real costs of accidents in the workplace, Cross-subsidisation, an undesirable feature of the old monopoly ACC structure, has been largely removed."*

5.11 A common misconception is that premiums under a competitive market would be unrealistically low at the start of a competitive regime (loss leading) in order to capture market share but increase rapidly once an insurer had established a significant share of the market. In respect to allegations of insurers loss leading, an independent actuarial assessment of the accident insurance market in New Zealand post 1 July 1999 (during the competitive market phase) revealed that there was a 14 per cent reduction in premiums with the comparison showing employers were paying around $82 million per annum less than they were under the old ACC monopoly model. An assessment by actuary Mark Weaver (Melville Jessup and Weaver) considered that up to 7 per cent of the $82 million savings (i.e. about $6 million) could be due to loss leading behaviour. However, in the context of the scheme, this amount was negligible. Weaver stated that any potential for loss leading to impact on future premium payments could be mitigated by ensuring private insurers got people back to work as appropriate. *"If the loss leading can be covered by greater efficiencies then the premiums can remain low. If not then they will have to go up. Those getting it wrong will lose custom, especially if any more new players enter the market."*

5.12 While significant issues need to be worked through before some accounts can be effectively opened up to competition, there are few obstacles to introducing greater competition into the Work Account. In this respect Business NZ is supportive of the agreement between the Government and ACT to investigate opening up the Work Account to competition, and working through any potential issues, for this to occur in a timely manner.

5.13 Concurrently, it is important that ACC improves its premium-setting processes and revises the assumptions it has made in respect to premium setting across all accounts, so that levies more closely resemble those likely under a competitive regime. Such changes, combined with improved service delivery, would make any transition to a competitive regime easier to manage.

Business New Zealand **recommends** that:

13. The various ACC Accounts, where applicable, should progressively be opened up to competition from private sector providers (starting with the Work Account), with ultimately the Government's role restricted to ensuring minimum service and delivery standards within a risk-based, 24-hour universal no-fault system.

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.