Submission

By

BusinessNZ
The voice of business

to the

Accident Compensation Corporation

on the

Levy Consultation 2015/16 Proposed Rates

June 2014

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ACC LEVY CONSULTATION 2015/16 PROPOSED RATES
SUBMISSION BY BUSINESSNZ[1]

1.0 INTRODUCTION

1.1 BusinessNZ welcomes the opportunity to comment on the proposed levy rate changes set out in the ACC Levy Consultation Document 2015/16.

1.2 Employers, employees and motorists will welcome the levy cuts proposed for the 2015/16 year; they are in aggregate significant and will provide a slight boost in take-home pay while reducing employers' non-wage labour costs.

1.3 A 21% reduction is proposed for the average Work levy (from $0.95 to $0.75 excluding GST for every $100 of liable earnings), a decrease of 6% for the Earners Account (from $1.26 to $1.20), with the Motor Vehicle account levy projected to drop by a massive 40% (from $330.68 to $200) based on reductions in both licensing fees and the petrol levy.

1.4 Notwithstanding the significant levy reductions outlined above, BusinessNZ has major and continuing concerns about levy transparency over the various accounts. This submission focuses on three broad areas:

- First, ACC's overall funding policy.
- Second, the need for the reasoning behind the proposed levy reductions to be subject to greater transparency.
- Three, the significant degree of continued cross-subsidisation in the Motor Vehicle Account.

1.5 BusinessNZ would welcome the opportunity to discuss our recommendations with ACC officials and/or the ACC Board.

RECOMMENDATIONS

BusinessNZ **recommends** that:

1. ACC re-examine whether the proposed effective funded risk margin of between 0 and 40% for the Work, Earners' and Motor Vehicle Accounts is justified given the unique circumstances of New Zealand's ACC scheme (i.e. the power to tax future levy payers) and the cost implications for levy payers across those accounts.

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

BusinessNZ **recommends** that:

2. **To ensure premium setting transparency and minimise the sending of distorted signals to future levy payers, ACC return to employers, earners, and motorists (as a one-off payment), their respective shares of the surplus in the Work, Earners' and Motorist Accounts over and above the amount required to fully-fund the claims liability.**

BusinessNZ **recommends** that:

3. **ACC premiums be set by the ACC Board based on sound insurance principles rather than political decision-making (e.g. as evident in respect to cross-subsidisation in the Motor Vehicle Account).**

BusinessNZ **recommends** that:

4. **ACC premiums be audited by independent third party actuaries - with the results made public and their rationale explained - to ensure transparency in the premium-setting process.**

BusinessNZ **recommends** that:

5. **The Minister's reasons for rejecting or modifying the ACC Board's recommendations, including any actuarial analysis, be made public - with opportunity for further public input - allowing both premium payers and ACC to scrutinise the decision-making and limiting the potential for political opportunism.**

BusinessNZ **recommends** that:

6. **All references to the residual claims levy component in levy setting for 2015/16 be deleted given that the Work, Earners and Motor Vehicle Accounts are now all fully-funded, making the continued use of the term "residual levy" redundant.**

BusinessNZ **recommends** that:

7. **Proposals outlined in the Consultation Document to risk rate light passenger vehicles within four levy bands be implemented.**

BusinessNZ **recommends** that:

8. Consideration be given to introducing mechanisms to ensure all road users (whether motorists, truck drivers, motorcyclists, or cyclists) pay the real costs associated with road use.

BusinessNZ **recommends** that:

9. The significant cross-subsidisation of motor cyclists by motorists be urgently addressed, recognising that over the next 3-5 years, current cross-subsidisation will make necessary a staged levy review process to reflect risk more accurately.

BusinessNZ **recommends** that:

10. If, in the opinion of the ACC Board and the Government, there is a sound public policy reason for the continued cross-subsidisation of motorcyclists (although no obvious reason occurs to BusinessNZ), the nature of this subsidisation be made transparent and the funding come from general taxation instead. The funding will then clearly show in the government accounts, allowing the quality of the expenditure to be judged alongside all other areas of Government expenditure.

2.0 OVERALL ACC FUNDING POLICY

2.1 It is important for the ACC Board, and ultimately the Minister, to be held to account for setting premium rates which reflect sound commercial practice and minimise the risk of on-going interference to meet political objectives.

2.2 While levy stability is a desirable objective, it should not take precedence over 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).

2.3 Notwithstanding factors that affect the number and cost of claims and make forecasting future liabilities difficult, BusinessNZ considers ACC's need for a fully-funded risk margin is open to question. In BusinessNZ's view, the margin (if any) should be more in the order of 5 – 15 per cent than the 0 – 40 per cent band proposed, for four reasons.

2.4 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 on-going costs of accident claims for that year.

2.5 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 the costs of expansion will be hidden, at least for the first few years. This contravenes the whole principle of a fully-funded model where changes to policies impacting either positively or negatively on premiums are almost immediately felt by premium payers.

2.6 Given that ACC is a state-sanctioned monopoly, without the on-going discipline that competition would provide, the Consultation Document's very conservative approach to funding is unlikely to be required.

2.7 Third, tying up unnecessary funding from employers (and earners) effectively means depriving the economy of money. On the margin at least, this will reduce employer investment in plant and equipment thereby limiting economic and employment growth.

2.8 Fourth, retaining such significant funding reserves (well beyond the 100% full-funding outlined in the consultation document) makes the calculation of future premium payer costs across the various accounts grossly misleading. Future premium payers are being funded by the significant build-up in resources as a result of earlier decisions not to lower premiums.

2.9 The funds retained distort the true costs of accident claims which premium payers (employers in the case of the work account) pay. There is effectively a transfer of wealth from current to future employers which reduces the pricing signals facing future employers.

2.10 Having fewer reserves than estimated liabilities is probably even more dangerous than retaining reserves well above estimated liabilities and BusinessNZ would not advocate reserves lower than 100% of liabilities. However, retaining projected reserves of 0-40% above the fully-funded rate for what is in effect a Crown run monopoly is nonsensical.

BusinessNZ **recommends** that:

1. **ACC re-examine whether the proposed effective funded risk margin of between 0 and 40% for the Work, Earners' and Motor Vehicle Accounts is justified given the unique circumstances of New Zealand's ACC scheme (i.e. the power to tax future levy payers) and the cost implications for levy payers across those accounts.**

3.0 TRANSPARENCY IN PREMIUM SETTING

3.1 BusinessNZ notes that ACC levy recommendations are not binding on the Minister (of ACC) who can "accept, reject, or modify the Corporation's recommendations". While the Minister should be able to change ACC's premium rate recommendations if new information comes to hand suggesting ACC's actuarial advice was flawed, there has been a tendency over the years for ACC Ministers to tinker with ACC's recommendations and to make recommendations of their own.

3.2 It is possible that ministerial changes will be soundly based on actuarial analysis but there is a danger they may reflect wider political judgements as to what ACC premiums should be. For example, the 2012 decision by the Government to retain ACC levies at the then existing levels (i.e. unchanged), despite recommendations by the ACC Board for significant reductions, reeked of political interference and made public consultation on the proposed levies something of a farce. However, since its inception in the early 1970s, and spanning a wide range of governments, the scheme has always been subject to political manipulation when it comes to premium setting.

3.3 BusinessNZ believes that if the Minister decides to reject or modify ACC's recommendation(s), the reasons for non-acceptance should be outlined to the public and premium payers and the actuarial advice on which the changes have been made provided. It is not acceptable for the Minister to change ACC's recommendations without making clear why different decisions have been made.

3.4 Similarly, there needs to be greater transparency over levy reductions. We seriously question the justification given for levy decreases in the 2015/16 ACC Levy Consultation Document – i.e. that greater rehabilitation and control of claims costs are the key ingredients driving levies lower.

3.5 In reality, if one looks at the table on page 23 of the consultation document (see over page), the costs associated with new claims are relatively static ($0.57 for 2015/16) while administration costs (as a percentage of liable earnings remain constant at $0.17. The main driver of reduced levies appears to be the Funding Adjustment (from -$0.10 to -$0.30). Therefore, in the absence of more detailed data, it can be concluded that this impressive result is either the consequence of (a) gross overcharging of levy payers in the past and/or (b) impressive financial investment returns. But the latter should be considered a "one-off" and not part of an ongoing structural change in claims and/or costs.

The table below shows a comparison between the current portion of the average Work levy and the 2015/16 proposed average Work levy.

	Current 2014/15 levy rate	Proposed 2015/16 levy rate	% change
To fund the cost of new claims during the levy year	$0.56	$0.57	2%
To fund Scheme costs	$0.17	$0.17	-2%
Funding adjustment	-$0.10	-$0.30	-200%
Incentive programme funding	$0.06	$0.04	-31%
Current year levy	$0.64	$0.44	-31.2%
Residual portion	**$0.31**	**$0.31**	**0%**
Work levy for claims	**$0.95**	**$0.75**	**-21%**

3.6 It is essential not to base levy reductions on improved investment income as this will always fluctuate. Indeed, one of the highest risks the Corporation identifies is that long-term investment performance could decline, requiring a significant increase in levy rates to achieve the same income level. It is important to note that under a competitive model premiums/levies would be priced to reflect risk and investment returns appropriately reserved to meet long-tail claims, not to reduce premiums artificially.

3.7 In a competitive insurance market such impressive investment returns would either be retained as a potential "buffer" or given back to shareholders in the form of dividends and the like.

3.8 In the absence of a competitive market, ACC has in effect two choices. First, reduce premiums (as proposed) or (b) adopt a more transparent process giving back to current premium payers as a 'one-off' payment the entire amount of money beyond 100% full-funding of the various accounts.

3.9 The danger of smoothing premiums over such a long period, as ACC is proposing, means future premium payers are in effect being subsidised by previous levy payers. This, in the future, will see the ACC scheme significantly distorted as regards real (fully-funded) cost of new claims.

3.10 Premium smoothing also seriously jeopardises the ability to introduce competition into the Work Account as ACC would have a competitive advantage over the private sector in subsidising future premiums.

3.11 While some might consider premium smoothing does not greatly matter, it defeats one of the key levy-setting goals and principles outlined on page 18 of the Consultation Document: each levy payer contributes their fair share to scheme costs.

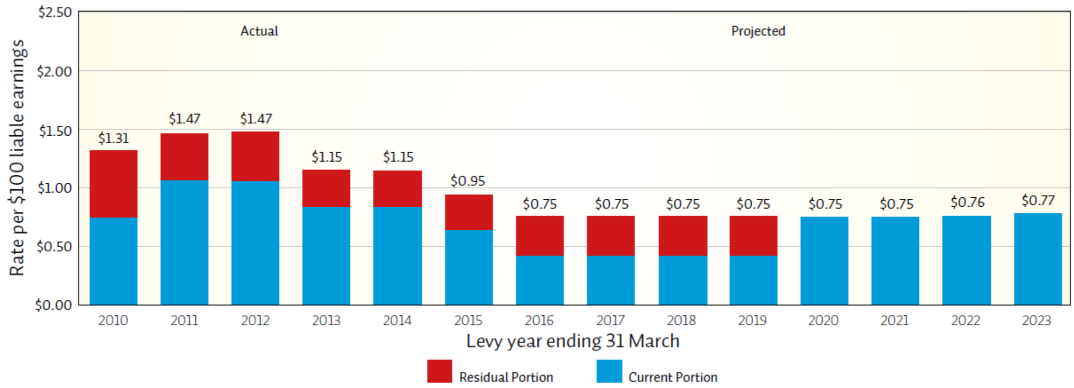
3.12 With the use of premium smoothing and in the absence of transparency, there is a risk that it will be thought, rightly or wrongly, that premiums have been set to take account of political realities rather than reflecting sound commercial practice. Clearly the ACC Board is the most appropriate mechanism for setting levy rates, given its responsibility for the efficient running of the current scheme.

3.13 Finally, there is no longer any good reason for ACC continuing to collect the residual levy at $0.31 per $100 of liable earnings given that the ACC scheme is now fully funded across the 3 major accounts –Work, Earners and Motor Vehicle. There is no need to collect a residual work or residual earner's levy as all levy rates are now solely reflective of the claims liability for each ongoing cover period.

3.14 The graph below (p.23) is very misleading. The so-called residual portion for the years 2016 through to 2019 is not in fact a residual levy at all, but is part of the levy to pay for future claims.

Average Work levy rate for employers and self-employed people

The graph below shows the proposed 2015/16 average levy rate and the projected average levy rates to 2022/23.



3.15 While the true risk rate is estimated at around $0.75 (see previous table), this will be made up of both the current levy portion ($0.44) + $0.31 (the theoretical residual portion which no longer exists). While BusinessNZ understands and accepts that $0.44 will not fund the costs associated with 2015/16 expected claims, it would be better for the residual levy to be dropped completely and the proposed levy for 2015/16 be $0.75 making ACC transparent in its levy setting.

3.16 Retaining the "smoke and mirrors" approach proposed by ACC to levy setting means seriously compromising the benefits of experience-rating. This is because the $0.31 (residual component) will not be subject to experience rating but instead is being collected to fund the costs associated with ***future*** claims since ***all current claims*** are fully-funded. This serious oversight needs to be rectified before the 2015/16 levies are set as it will adversely impact on the costs of NZ's best performing employers benefiting lower performing employers at their expense.[2]

3.17 A key way to improve work-place safety is to ensure that as much of the premium as possible is subject to experience rating. This is one, amongst

[2] Appendix 2 contains examples of the implications for better performing employers of retaining the residual claims levy at $0.31.

many, reasons, why a fully funded model is vastly superior to the pay-as-you-go model used by ACC until the late 1990s.

3.18 Removing all references to residual levies and removing that component from all the graphs outlined in the Consultation Paper would be the simplest and most transparent way of dealing with this issue.

BusinessNZ **recommends** that:

2. To ensure premium setting transparency and minimise the sending of distorted signals to future levy payers, ACC return to employers, earners, and motorists (as a one-off payment), their respective shares of the surplus in the Work, Earners' and Motorist Accounts over and above the amount required to fully-fund the claims liability.

BusinessNZ **recommends** that:

3. ACC premiums be set by the ACC Board based on sound insurance principles rather than political decision-making (e.g. as evident in respect to cross-subsidisation in the Motor Vehicle Account).

BusinessNZ **recommends** that:

4. ACC premiums be audited by independent third party actuaries - with the results made public and their rationale explained - to ensure transparency in the premium-setting process.

BusinessNZ **recommends** that:

5. The Minister's reasons for rejecting or modifying the ACC Board's recommendations, including any actuarial analysis, be made public - with opportunity for further public input - allowing both premium payers and ACC to scrutinise the decision-making and limiting the potential for political opportunism.

BusinessNZ **recommends** that:

6. All references to the residual claims levy component in levy setting for 2015/16 be deleted given that the Work, Earners and Motor Vehicle Accounts are now all fully-funded, making the continued use of the term "residual levy" redundant.

4.0 CROSS-SUBSIDISATION IN THE MOTOR VEHICLE ACCOUNT

4.1 One of the key levy-setting goals and principles of the ACC Board is that each levy payer contributes their fair share to the scheme costs. Unfortunately, when it comes to the Motor Vehicle account, politics appears to gain the upper hand and this important principle is effectively ignored.

4.2 While the ACC Board is to be congratulated for moving towards a framework for “risk based” rating cars based on crash data (based on four bands of risk), it is disappointing that ACC continues to refuse to grasp the nettle of cross-subsidisation between Motor Vehicles and Motorcyclists.

4.3 A number of road users, principally cyclists, pay nothing towards the cost of accidents involving motor vehicles while motorcyclists continue to be grossly subsidised by motor vehicle owners.

4.4 There have been moves over the past few years to reduce Motor Vehicle Account cross-subsidisation but these have been tentative to say the least, mainly focusing on removing some of the distortions within each vehicle class (e.g. between small and large motorcycles) rather than addressing motorists’ cross-subsidisation of motor cyclists per se. BusinessNZ considers a thorough investigation of Motor Vehicle Account funding is justified to enable the costs associated with the scheme to be more closely aligned to scheme claimants.

4.5 The Consultation Document shows cross-subsidisation between transport modes to be both significant and unjustified. The nature of insurance is to pool similar risks within similar risk categories (and as a result some cross-subsidisation is inevitable) but the Consultation Document shows that little progress has been made to address the issue of unjustified cross-subsidisation.

4.6 The nature of the subsidisation is well explained in the Consultation Document but in short, just over $100 million will need to be collected to pay for expected motor cyclist claims in the year to June 2016. Under the proposed levy rates motor cyclists will contribute just $27 million and owners of other vehicles will contribute about $77 million i.e. motor cyclists will pay about 25% of the actual cost of accident claims.

4.7 The ACC Consultation Document tries to justify this cross-subsidisation by stating (on p.96) that if the true cost of motorcycle injuries was reflected in motorcycle levies then owning a motorcycle could become prohibitively expensive. BusinessNZ considers this a cop-out.

4.8 There will be motor cycle owners who can readily afford to pay the risk-rated premium associated with their behaviour while there will be some car owners who struggle to pay for ACC licensing fees.

4.9 It is not clear from research that motorcyclists, on average, have any more or less ability to pay than do other motorists.

4.10 ACC, correctly in the view of BusinessNZ risk rates activities in the Work Account based on actual risk. This means that a professional rugby player pays $4.79 per $100 of liable earnings for ACC related claims given the relatively higher risk of injury to professional rugby players compared with those working in less risky environments e.g. office workers. So a professional rugby player earning $105,000 per annum will pay around $5,000 in ACC Work levies per annum.

4.11 The table on p.96 (see below), shows that the average motorcyclist will pay $331 for the 2015/16 premium year (the same as last year) but if the correct levy applied (i.e. based on insurance risk) the cost would be $1,267 per annum (licence fee) plus ACC petrol levy.

	Proposed licence fee (unchanged from the 2014/15 year)	Licence fee based on past claims experience	Licence fee if only considering motorcycle claims that did not involve other vehicles
Average motorcycle (including moped)	$331	$1267	$534
Motorcycles (600cc or less)	$328	$1025	$464
Motorcycles (over 600cc)	$427	$1881	$837

4.12 While high, relative to current rates, BusinessNZ considers that rates should be more progressively based on risk, noting that it may take a number of years to achieve true risk-based levies for motorcycle owners.

4.13 BusinessNZ is not aware of any other New Zealand insurance market where a wide group of individuals is explicitly subsidised (beyond normal insurance principles which pool risk within similar risk categories). Where individuals are considered to be in need of taxpayer assistance (generally income-related), targeted individuals receive assistance via various tax measures and income support to enable them to purchase essential goods and services.

4.14 If the Government decides that for some rigorously determined public policy reason motorcyclists should continue to be subsidised (although BusinessNZ cannot think of any) then such subsidies should be transparent and funded out of general taxation, with the subsidy explicitly recognised in the Government's accounts as is currently the case with government (taxpayer-funded) assistance to low income earners, the elderly (via NZ Superannuation payments) etc.

4.15 Continuing to cross-subsidise motorcylists through increased levies on other motorists is both unjustified and defeats many of the principles that the ACC Board states are upheld when setting levies.

4.16 Continuing cross-subsidisation also makes a mockery of ACC’s efforts to improve the quality of levy setting in other areas (e.g. in respect to the use of “risk rating” light passenger vehicles) when a big area relating to motorcyclists is essentially ignored.

BusinessNZ **recommends** that:

7. **Proposals outlined in the Consultation Document to risk rate light passenger vehicles within four levy bands be implemented.**

BusinessNZ **recommends** that:

8. **Consideration be given to introducing mechanisms to ensure all road users (whether motorists, truck drivers, motorcyclists, or cyclists) pay the real costs associated with road use.**

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9. **The significant cross-subsidisation of motor cyclists by motorists be urgently addressed, recognising that over the next 3-5 years, current cross-subsidisation will make necessary a staged levy review process to reflect risk more accurately.**

BusinessNZ **recommends** that:

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APPENDIX 1

BACKGROUND INFORMATION ON BUSINESSNZ

BusinessNZ is New Zealand's largest business advocacy organisation.

Through its four founding member organisations – EMA Northern, Employers' Chamber of Commerce Central (ECCC), Canterbury Employers' Chamber of Commerce (CECC), and the Otago-Southland Employers' Association (OSEA) – and 74 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, BusinessNZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development.

APPENDIX 2

IMPLICATIONS FOR EMPLOYERS OF RETAINING THE RESIDUAL CLAIMS LEVY AT $0.31

The impact on employers who have put in systems and have good claims records is negative. Some analysis at pricing outcomes for Small and Medium employers getting a 10% Experience Rating Discount and a 10% either WSMP/WSD Discount is outlined below.

For Large and Very Large Employers we have used a 30% ER Discount and 20% WSMP Discount.

Also the examples below are on NZ's worst performing large employers getting a 50% ER Loading.

For ease we have simply used a $50k annual salary with no LCI adjustment.

	2015/16 Proposed $0.44 and $0.31	**2015/16 excl Residual Levy $0.75**	**Difference in $**
Small Employer 9 Staff $450k Liable Earnings	$2,999	$2,734	$265
Medium Employer 40 Staff $2million liable earnings	$13,328	$12,150	$1,178
Large Employer 200 staff 30% ER Discount 20% WSMP	$55,640	$42,000	$13,640
Large Employer 200 staff 50% ER Loading	$97,000	$112,500	$15,500 reduced costs
Very Large Employer 2000 Staff 30%ER Discount 20% WSMP	$556,400	$420,000	$136,400
Very Large Employer 2000 Staff 50% ER Loading	$970,000	$1,125,000	$155,000 reduced costs

What this highlights very clearly is that on average rates effectively NZ's worst performing employers are going to receive the most benefit by maintaining the residual levy at $0.31 and NZ's best performing large employers are going to effectively be paying more than required.