Impact Summary: Experience Rating

Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment (MBIE) is responsible for the analysis and advice set out in this Regulatory Impact Statement (RIS), except as otherwise indicated. This analysis and advice has been produced for the purpose of informing final decisions for Cabinet consideration. It provides an analysis of options to change the Accident Compensation (Experience Rating) Regulations 2017 which provide for ACC to adjust a medium to large sized business' ACC Work Account levy up or down in line with their claims experience. The analysis sets out four options for changing the experience rating framework: • Status Quo – Retain current settings (MBIE's preferred approach) • Simplify the experience calculation • Simplify and improve the responsiveness of the levy • Full package – simplify, improve responsiveness and strengthen the consequences for poor performance (ACC's proposal).
Any Limitations or Constraints on Analysis
This Regulatory Impact Statement's analysis is limited in some respects by the lack of information available. MBIE considers that it has adequate information to estimate the levy impacts of the proposed changes, and drawing from international literature a basis for estimating a range of potential impacts on injury claims. There is not sufficient evidence available, however, to be certain that any potential injury claims reduction can be attributed to a reduction in injuries as opposed to claims avoidance and suppression. A literature review (Allen & Clarke, 31 May 2017) found increasing the size of financial incentives to employers is generally linked to decreased claims numbers, however there are questions around the extent to which this can be attributed to an actual reduction in injury rates as opposed to under-reporting and claims suppression. The review noted international evidence that experience rating encouraged claim suppression and under reporting as employers attempted to avoid claims costs. Two New Zealand evaluations (MBIE, 2015; and, Colmar Brunton Research, 2014) concluded, however, New Zealand's experience rating programme had not resulted in claims suppression or under-reporting because employers perceived the risks of getting caught outweighed any potential benefit. The reports did not assess whether employers would expect claims suppression to increase in New Zealand if the levy discounts or loadings were larger. MBIE's Report noted that employers' lack of understanding of experience rating and the relatively low financial incentives it offers means it may not be fully factored into decisions on lodging claims.

An analysis by ACC of the submissions for the 2019/20 and 2020/21 consultations informed this document.

Please note that the attached submissions analysis is not intended as a final document. ACC will produce a public document in early 2019.

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Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Status quo

ACC's experience rating programme aims to provide a financial incentive to employers to reduce the number and severity of workplace injuries and improve return to work outcomes.

The Accident Compensation (Experience Rating) Regulations 2017 (the Experience Rating Regulations) provide for ACC to adjust a medium to large business' ACC Work Account levy up or down in line with their injury claims experience.

Employers with very good claims experience receive levy discounts of up to 50 per cent, while those with negative claims experience receive a penalty of up to 75 per cent.

The experience rated levy is based on two key factors:

- The industry modifier (which results in a discount or loading of Up to =/- 15%) based in the employer's industry risk group
- The firm's experience rating modification which adds a further discount or loading of up to -35% to +60% relative to other firms' performance.

The formulae used to calculate these discounts and loadings are set out in the Regulations which can be found at:
http://legislation.govt.nz/regulation/public/2017/0020/10.0/DLM7105501.html

Problem

For the programme to work as intended, and drive businesses to make changes that promote injury prevention and sustainable return to work outcomes, it is important that the programme is well understood and provides a sufficient financial incentive.

Recent evaluations of the programme suggest that it is complex and not well understood by employers (Colmar Brunton, 2015; MBIE, 2015) and it has not proved to be very effective in incentivising improved employer performance.

The primary concerns raised by businesses and worker representatives during ACC's co-design process with the current programme were:

- The complexity of the experience rating calculation
- Inclusion of elements in the calculation that businesses had little control over; and,
- ACC system limitations that impact on the ability to recognise the employer's return-to-work efforts.

2.2 Who is affected and how?

The programme is compulsory, applying to medium and large businesses (and groups of businesses) who pay annual ACC levies of $10,000 or more (i.e. firms employing approximately 29 or more people on the average wage at the average levy rate).

The programme applies to approximately 15,000 businesses (3%), employing approximately 40% of the workforce.

Although the programme is focused on medium to large businesses, it is funded through a loading of 3.5 cents per $100 of liable earnings by all businesses, including small businesses not subject to the programme. This loading is on the aggregate levy, before rates are applied.

It is not proposed to expand the reach of the programme beyond the businesses that are currently subject to the programme. Rather ACC's proposed changes are intended to more clearly and strongly incentivise these businesses to make changes to promote injury prevention.

Stakeholder views

Employers and employer representatives broadly support measures that simplify the experience rating programme and make it more responsive to claims experience.

Conversely, groups representing employees – such as the New Zealand Council of Trade Unions (NZCTU) – are concerned about the continuation of the experience rating programme, considering the programme may perversely incentivise employers to suppress claims.

2.3 Are there any constraints on the scope for decision making?

It is outside the scope of this analysis to consider options for removing experience rating, as the impacts of this option have not been analysed. This is, therefore, not a feasible option for consideration at this point in time.

Section 3: Options identification

3.1 What options have been considered?

Options

The following options have been considered:

- *Option 1 - Status quo:* Retain current experience rating programme settings
- *Option 2 - Simplify the experience calculation*: This involves
  a. Removing the industry modifier and a smoothing adjustment from the current calculation; and,
  b. Applying a simple set of steps for discount or penalties to determine the final levy a business pays.
- *Option 3 - Simplify & make more responsive*: This involves
  a. Applying the changes to simplify calculations as outlined in option 1;
  b. Introduce weightings to the three years of experience used in the calculation: Year One (most recent) 100 per cent; Year Two 70 per cent; and, Year Three 40 per cent; and,
  c. Allow more of a business' claims experience to reflect in the initial levy adjustment by lowering credibility thresholds (results in more variation over time and access to larger discounts and penalties for smaller businesses).
- *Option 4 – Full Package:* This involves:
  a. Introducing the measures in options 1 & 2 to simplify the programme and make it more response; and,
  b. Strengthen consequences for poor performance by:
     i. Increasing the maximum penalty from 75 per cent to 100 per cent;
     ii. Increasing the size of the performance steps for deteriorating performance so the financial cost is greater;
     iii. Introducing a fatal claim penalty of up to 40%.

Criteria

The options are considered against the following criteria:

a. *Injury prevention & Sustainable Return to Work Outcomes:* Financial incentives influence employer behaviour which results in improved injury prevention and sustainable return to work outcomes for employees (weighed 40%);

b. *Equity:* Changes to the programme improves equity across employers by linking the levy each business pays more closely to their claims costs (weighed 20%);

c. *Administrative efficiency:* – administration is cost efficient for ACC and levy payers (weighed 20%); and,

d. *Risks:* Risk of unintended consequences and perverse outcomes is minimised (20%).

Options assessment

Criteria for Assessment	Option 1: Status Quo	Option 2: Simplify	Option 3: Simplify & make more responsive	Option 4: Full package including strengthened consequences for poor performance
Injury prevention & Sustainable Return to Work	**(0) Neutral**	**(0)Neutral** Simplification has little or no impact on employer behaviour as no change in spread of financial loadings & penalties.	**(+?) May be positive, but outcomes uncertain.** A more responsive programme is expected to send clearer price signals which may influence employer behaviour. International literature suggests experience rating results in decreased claim numbers but it's not clear that they are a result of reduced injury rates.	**May be more positive but outcomes uncertain (++?)** Increased financial consequences will provide even stronger financial incentive/penalty. International literature suggests experience rating results in decreased claim numbers but it's not clear that they are a result of reduced injury rates.
Equity	**(0) Neutral**	**(0/+)** A very small impact on the financial consequences for businesses. It removes a factor that the employer has no control over (the industry modifier).	**(+) Positive** Simplification & responsiveness changes deliver more differentiated discounts and penalties which better reflect past claims costs. It removes a factor that the employer has no control over (industry modifier).	**(++) Very Positive** Greater financial penalties for poor performance further differentiate discounts and penalties and better reflect claims costs.
Administrative efficiency	**(0) Neutral**	**(0) Neutral** Assumes no substantive implementation costs.	**(-) Neutral** Assumes some additional administrative costs associated with implementation & ongoing implementation of programme changes.	**(-) Negative** Assumes some additional administrative costs associated with implementation & ongoing implementation of programme changes.
Reduced complexity leading to improved understanding	**(0) Neutral**	**(+) Positive:** Improved employer understanding, subject to changes being communicated	**(+) Positive** Improved employer understanding, subject to changes being communicated	**(+) Positive** Improved employer understanding, subject to changes being communicated
Risks	**(0) Neutral**	**(0/-) Neutral to Low Risk** Employers have less financial incentive to address industry wide health & safety issues. But has not been an effective incentive to date	**(-) Increased Low Risk:** Option 1 Risks + increased levy volatility particularly for smaller employers (mitigated in part by broader discount/penalty steps). Increased risk of claims suppression and disputation.	**(- - -) Increased Risk** Option 1 & 2 Risks + greater financial consequences create a greater increased risk of claims suppression and disputation.
Net impact	**0 Neutral**	**(0) Neutral**	**(0/+) Neutral to positive,** but risks that would need to be mitigated	**(0/+) Neutral to positive** but greater risks, accentuated by uncertainty of impact on injury prevention & sustainable return to work outcomes

3.2 Which of these options is the proposed approach?

***MBIE's Preferred Approach is the Status Quo*:** It would be prudent to retain the status quo until the uncertainties around the likely impact on injury prevention and sustainable return to work outcomes can be addressed and an effective risk mitigation strategy is established.

Option 3 provides some benefits if the Government is prepared to accept some additional risk: If the Government is prepared to accept some additional risk then implementation of option 3 would provide clear pricing signals to employers that would deliver some further differentiation in discounts and penalties. ACC could establish risk mitigation measures, and progress policy work – in consultation with MBIE – on improved employer engagement processes and injury management tools that would help provide employers with greater ability to influence sustainable return to work outcomes and claims costs, as well as incentives for industry wide health and safety and injury management initiatives.

This approach would also allow ACC and MBIE to give further consideration to the merits of increasing penalties for poor performers once the simplification and responsiveness elements are bedded down and their behavioural impacts are better understood.

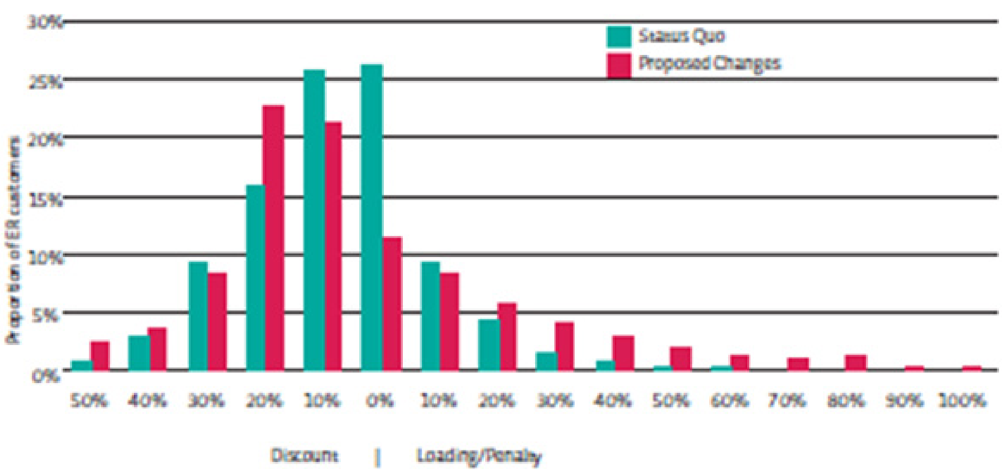
An additional average loading of 1 cent per $100 of liable earnings across all Work Account levy payers to cover the cost of the proposed changes (including small employers not covered by the programme).

ACC's modelling suggests the changes would result in:

- each firm's levies more closely reflecting the claims costs attributed to them
- a broader spread of discounts and loadings from the status quo.

As the following table shows, for Option 4, ACC estimates more businesses will receive a discount. However, 89 employers will receive experience levy increases of more than 50 per cent (often going from receiving discounts to large penalty loadings), while almost 500 employers will have increases of between 30 per cent and 50 per cent. (The broader spread of discounts and loadings for Option 3 has not been modelled as it was developed after the levy setting consultation).

Figure 1: Impact of proposed changes



Section 4: Impact Analysis (Full package)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (e.g. ongoing, one-off), evidence and assumption (e.g. compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Levy payers subject to programme	Total marginal increase in loading applied to those employers with poor claims performance: Approximately 15,000 employers and self-employed people with levies over $10,000 are subject to experience rating (i.e. firms employing approximately a minimum of 29FTE, but fewer for those businesses in higher risk industries and paying higher than average wages).	Estimated marginal additional loading: $16.5M
Employees	Affects approximately 40% of workforce, or approximately 1.1M workers. Claims costs are expected to reduce, but there is an increased risk some of this reduction is achieved through claims suppression rather than improved injury prevention and claims management. There is, however, little evidence of systemic claims suppression in New Zealand.	Low & uncertain
All levy payers (including those not subject to programme)	All Work Account levy payers subject to an additional 1 cent per $100 of liable earnings (an average 1.7% levy increase). With approximately $5.5M met by levy payers not able to benefit from this programme.	Estimate: $13M
ACC	Some administrative implications associated with implementation, ongoing operation and evaluation.	Low additional costs
Worksafe	No administrative implications.	No costs
Total Monetised Cost		$29.5M
Non-monetised costs		*Low*

Expected benefits of proposed approach, compared to taking no action		
Levy payers subject to programme	Total marginal increase in discounts or penalties depending on performance.	Estimate: $28.5M
Employees	Claims reduction through better IP & reduced claims cost by earlier sustainable return to work outcomes.	Low & uncertain
All levy payers (including those not subject to programme)	There are little or no spill-over benefits to other levy payers.	Low to none
ACC & WorkSafe	State any strategic gains: • Reduction in incidence of injury and the a reduction in the impact of injury on the community (including economic, social and personal costs) • Improved employer satisfaction.	Uncertain/Low Moderate
WorkSafe & Wider Government	State any strategic gains: • Improved compliance with Health & Safety legislative requirements.	Uncertain – Low to Moderate
Total Monetised Benefit		$28.5M
Non-monetised benefits		*Low-Moderate*

4.2 What other impacts is this approach likely to have?

There are a number of issues with the change proposals, including:

- *No outcomes assessment:* The impact on overall scheme outcomes (including injury incidence and severity, claims duration, sustainable return to work outcomes and claims costs) has not been assessed and is uncertain.
- *Removes an incentive for cooperation:* While the removal of the industry modifier simplifies the experience rating calculation and improves its responsiveness, it also removes a financial incentive for individual employers to support industry wide action to address common health and safety risks. The industry modifier is intended to encourage cooperation within an industry to improve health and safety performance. The assessment by the Independent Taskforce on Workplace Health and Safety found, however, that it is ineffective. ACC considers there are better levers to incentivise industry cooperation, including the use of grants to encourage to industry groups to development intra-industry and cross-industry programmes to improve workplace health and safety.
- *Drivers of claims reductions uncertain:* International experience suggests that increasing the size of the financial incentive associated with the experience rating is generally linked to decreased claim numbers. However, it is unclear whether this is attributable to an actual reduction in injury rates or to under-reporting and claims suppression. It is important to ensure the experience rating forms part of a wider injury management system that engages the employer and minimises the risk of perverse outcomes.
- *Risk of claims avoidance and disputation:* MBIE's research in 2015 found that the incidence of perverse behaviour is likely to be limited in the current experience rating programme, with no evidence of system claims avoidance. Increased responsiveness and financial consequences may, however, increase the risk of claims avoidance, suppression and disputation on the part of employers seeking to minimise their levies. This risk will be accentuated if employers do not consider they are able to positively influence the achievement of sustainable return to work outcomes.
- *Limited time to improve performance before increased penalties apply*: ACC is targeting a 1 April 2020 implementation date for the introduction of the experience rating changes. Those employers that are adversely affected by the proposed changes will only have 14 months to improve their health and safety performance and claims experience before the changes are implemented. Their claims experience over this period will still impact on their experience rating.
- *Fatality modifier an additional penalty:* ACC and WorkSafe New Zealand have agreed to work in partnership to achieve workplace health and safety outcomes. Through their harm reduction plan, ACC takes the lead on financial incentives. The proposed fatality modifier is a penalty rather than a claims cost matching adjustment. It begins to confuse ACC's levy setting role with the role of the health and safety regulator, and the interventions WorkSafe New Zealand can apply when they determine an employer's health and safety practices do not comply with regulatory requirements.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

The original proposals around change to Experience Rating which are contained in Option 4 were developed by ACC in consultation with industry groups and employee representatives. ACC subsequently consulted on their proposed changes from 27 September to 25 October in conjunction with its biennial levy rate consultation process.

40 submissions in response to ACC's 2018 Levy Consultation paper addressed experience rating. 93 per cent of those submissions agreed with ACC's proposed changes for simplifying the programme. Submissions from employers and employer representatives broadly support measures that simplify the experience rating programme and make it more responsive to claims experience. Conversely, groups representing employees – such as the New Zealand Council of Trade Unions (NZCTU) – are very concerned about the continuation of the experience rating programme. The NZCTU considers ACC's proposals appear to heighten the risks inherent in the programme, by providing an incentive for employers to discourage reporting of claims and encouraging workers to report injuries as having not occurred at work. They are also consider the programme does not incentivise employers to address the harm of work-related diseases have long latency periods.

While supporting simplification and responsiveness, a number of employer representatives are concerned that employers are not well placed to influence claims costs and sustainable return to work outcomes. Manage Company, which represents a number of industry associations, recommends that if levy loadings are to be increased through experience rating, there is a need to provide clearer resources and tools for employers to be able to manage this risk. The Employers and Manufacturers Association Northern notes that claims duration is often outside an employer's scope of control. They consider a more direct line of communication between employers and the parties involved in determining return to work needs to be established. They also consider ACC injury prevention programmes should be linked to discounts.

Many employer groups are also opposed to, or have significant concerns about, the introduction of a fatality modifier. Manage Company, for example, considers the introduction of the modifier clouds ACC's role in relation to that of WorkSafe New Zealand. They consider the net result would be that the employer could be penalised for the same accident twice, which would be a form of double jeopardy. The Road Transport Forum notes that a fatality can often be outside the field of control of the employer. They consider it unacceptable that an additional loading would be imposed where a party was not at fault.

MBIE subsequently consulted ACC during the development of this RIS.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

If the Minister for ACC and Cabinet approve implementation of either Options 2,3 or 4 rather than maintaining the Status Quo, then:

- the Accident Compensation (Experience Rating) Regulations 2017 will need to be updated and come into effect from 1 April 2020.
- ACC will need to develop and execute an implementation and risk management plan, that includes a communications strategy that ensures employers understand:
  - the impact of the proposed experience rating changes; and,
  - the opportunities available to them to improve their claims experience.
- ACC will need to evaluate the impact of programme's changes and, in consultation with MBIE, progress any further design work that might be required to further improve the programme.

ACC will be responsible for the ongoing delivery of the experience rating programme.

In the event that the Government decides to retain the experience rating programme in its current form (the Status Quo option), the Experience Rating Regulations will still need to be updated and ACC will need to lead a work programme as outlined in Section 7.2

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

ACC is responsible for monitoring and reporting on the experience rating programme to its Board and the Minister for ACC.

We anticipate that ACC will need to confirm key process and outcome indicators that will provide the basis for assessing the implementation of any agreed changes to the programme and the impact of the programme on scheme outcomes.

7.2 When and how will the new arrangements be reviewed?

If the status quo is retained, we anticipate ACC – in consultation with MBIE – will undertake a review that:

- addresses the risks associated with making experience rating more responsive and strengthening the consequences of poor performance
- considers additional options for engaging employers more closely along the injury and claims management value chain and interventions that enable them to support the achievement of sustainable return to work outcomes
- considers additional options for incentivising industry-wide initiatives for improving health and safety *and* injury management
- completes an assessment of the net benefit of the proposed changes on scheme outcomes
- introduces process and outcome evaluation measures to assess the impact of the experience rating.

We anticipate the review would be completed in time for the results to be reflected proposals for changes to the experience rating programme that could be consulted on during the 2020 Levy Consultation process.

If Option 2 or 3 is implemented we anticipate that ACC – in consultation with MBIE - would still establish risk mitigation measures and progress a review that would consider:

- options for improved employer engagement processes and injury management tools
- further incentives for industry wide health and safety and injury management initiatives
- the merits of increasing penalties for poor performers once the simplification and responsiveness elements are bedded down and their behavioural impacts are better understood.