Regulatory Impact Statement

ACC levies for 2016/17

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the Ministry of Business, Innovation and Employment (MBIE) and provides analysis of options for setting ACC levy rates for 2016/17.

ACC levies are based on actuarial forecasting of injury rates, rehabilitation performance, healthcare costs, wage inflation, discount rates and investment returns. The robust actuarial process that levies go through each year aims to provide the best estimate of ACC's funding requirements from the information available. However, changes to these factors from year to year change the level of funding that ACC requires.

MBIE has commissioned Finity Consulting Limited to undertake an independent quality assurance review of ACC's actuarial analysis and levy proposals. The review is a test for reasonableness and is not intended to be an independent estimate of levy rates. The review found the overall average levy rates and the assumptions used to be reasonable.

The *Accident Compensation Act 2001* (the AC Act) requires the collection of levies to fund the cost of all claims under each levied Account on a full funding basis. The AC Act also sets out principles of financial responsibility the Minister for ACC must consider before recommending regulations to set levy rates. In addition to these, the AC Act requires the Minister for ACC to have regard to the public interest.

The Minister for ACC must receive and consider levy recommendations from ACC prior to making regulations to set levies. It is MBIE's role to advise the Minister on these recommendations.

This RIS is limited to providing analysis of options for setting average levy rates for the Work, Earners' and Motor Vehicle Accounts. Other levy-related proposals including enhancements to the Vehicle Risk Rating programme, the petrol levy rate and technical changes to levy regulations have not been considered.

The financial information provided, including projected funding positions and levy paths, reflects actuarial analysis using data and information through to 31 December 2014 and economic assumptions as at 31 March 2015. This is consistent with the modelling undertaken for ACC's levy consultation. The options analysis provides estimated impacts on the Crown's Operating Balance Excluding Gains and Losses (OBEGAL) relative to ACC's preliminary December 2015 Half Year Economic and Fiscal Update (HYEFU) submission.

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Summary

Under the full funding model, ACC must collect sufficient funds to meet the lifetime cost of injuries by offsetting the outstanding claims liability with a sufficient level of assets. Due to the inherent volatility in a long-tail liability scheme such as ACC, small changes in claims performance and economic factors can lead to large changes in ACC's funding requirements. This presents challenges when setting levies.

This year ACC has adopted the Government's funding policy for the levied Accounts. Applying this funding policy, ACC has recommended levy reductions in 2016/17 which would see the Work and Earners' Accounts move towards the funding target and maintain the Motor Vehicle Account at the funding target.

In our assessment of ACC's recommendation, we consider alternative options for setting 2016/17 levies which include taking the Accounts to the funding target in three years, and maintaining levies at 2015/16 rates. We assess these options against criteria based on the principles of financial responsibility in the *Accident Compensation Act 2001* (AC Act) and factors that we have identified to be in the public interest.

After considering the factors outlined above we support ACC's recommended levy rates.

Background

What is ACC?

1. ACC is the Crown agent responsible for providing comprehensive, no-fault personal injury cover to all New Zealand residents and visitors to New Zealand. ACC coverage is managed under five separate Accounts outlined below:

Table 1: Summary of the ACC Accounts

Account		How it is funded	Entitlements it pays for
	Earners' Account	Levies on earners through PAYE (or invoiced directly by ACC for self-employed people)	Earners' non-work injuries (not including motor vehicle and treatment injuries)
Levied Accounts	Work Account	Levies on employers and self-employed	Work-related personal injuries
	Motor Vehicle Account	Levies on motor vehicle owners (registration and through petrol)	Motor vehicle injuries
	Treatment Injury Account	Contributions from the Earners' and Non-Earners' Accounts	Treatment injuries
Non-Levied Accounts	Non-Earners' Account	Government appropriation	Non-earners' personal injuries

2. This Regulatory Impact Statement considers options for setting 2016/17 levy rates for the Work, Earners' and Motor Vehicle Accounts. The appropriation for the Non-

Earners' Account and portion of the Treatment Injury Account is considered during the government Budget process each year.

Process for setting 2016/17 levies

3. Each year ACC undertakes public consultation on levy rate proposals before making recommendations to the Minister for ACC.

4. Following ACC's public consultation, the Ministry of Business, Innovation and Employment (MBIE) provides the Minister for ACC with advice on ACC's levy recommendations, drawing on Finity's independent quality assurance review.

5. The Minister for ACC considers ACC's recommended levy rates for the levied Accounts. Before recommending regulations to set levies, the Minister must have regard to the principles of financial responsibility outlined in section 166A of the AC Act[1]:

   - the levies derived for each Account should meet the lifetime cost of claims each year
   - levies should correct for any deficits or surpluses in the Accounts by setting levies at an appropriate rate for a subsequent year or years
   - large changes in levies should be avoided.

6. In addition to these principles, section 300 of the AC Act requires the Minister to also have regard to the public interest when carrying out the functions and powers under the AC Act, in particular, the interests of tax payers, levy payers, claimants, and potential claimants.

ACC's 2016/17 levy proposals align with the Government's funding policy

7. This year ACC has adopted the Government's funding policy, which Cabinet agreed to in May 2014, to inform its 2016/17 levy proposals.[2] The parameters of this funding policy are:

   - targeting a funding band of between 100% and 110% of reported liabilities
   - basing levies on new year injury costs with an adjustment that would take the funding position to the midpoint of the target funding band over a 10 year horizon
   - setting a cap on the annual levy increases for any one Account at 15% (not including levy increases due to inflation for the Motor Vehicle Account).

8. The Government's funding policy indicates the Government's preference to take a long-term view and to place greater emphasis on levy stability.

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[1] The principles were introduced into the AC Act by the *Accident Compensation (Financial Responsibility and Transparency) Amendment Act 2015* in September 2015.

[2] ACC consulted on the Government's funding policy to inform the Government funding policy statement on behalf on the Minister for ACC as part of its wider consultation on 2016/17 levies. The Minister will consider submissions and advice from officials before seeking Cabinet agreement to issue the funding policy statement as required by section 166B of the AC Act. ACC will be required to give effect to the funding policy statement when consulting on and recommending levies for future levy rounds (2017/18 onwards).

2015/16 levy rates

9. The current average levy rates for the 2015/16 levy year are set out below:

Table 2: 2015/16 levy rates

Work Account (per $100 liable earnings excluding GST)	Earners' Account (per $100 liable earnings excluding GST)	Motor Vehicle Account (per vehicle excluding GST)
$0.90	$1.26	$194.25

Problem definition

10. The AC Act requires the cost of all claims under each levied Account to be fully funded by offsetting the future cost of outstanding claims with an adequate level of assets.

11. This presents challenges when forecasting the lifetime costs of past claims and claims expected in the new year. Movements in economic factors and claims experience lead to movements in the asset to liability ratios (the funding position) of the Accounts and expectations of new year injury costs.

12. Given the objective of achieving target solvency and the notion that levies shall, in the first instance, reflect new year injury costs, levy rates need to be updated each year to reflect best estimates of claims experience and economic factors.

The levied Accounts are at or above their target solvency

13. This year ACC has adopted the Government's funding target of 105% for the levied Accounts (the midpoint of the target funding band of 100% to 110% of reported liabilities). Since the Work and Earners' Accounts hold funds in excess of this target, we must now consider how to set levy rates for 2016/17 and future periods to return surplus funds.

14. The funding position for the Motor Vehicle Account is projected to be at 105% at the beginning of the 2016/17 levy year. Nonetheless, current levy rates in this Account are above projected new year injury costs. As such, maintaining the average Motor Vehicle levy at the 2015/16 rate would take solvency of the Account above 105%.

Table 3: Summary of the funding positions of ACC's levied Accounts

Levied Account	Projected funding position (assets relative to reported liabilities)	
	31 March 2015 (end of 2014/15 levy year)	**31 March 2016** (end of 2015/16 levy year)
Work	113%	115%
Earners'	125%	123%
Motor Vehicle	102%	105%

Updated claims experience and economic assumptions have changed ACC's estimates of future costs

15. Underlying claims costs are generally higher than ACC previously forecast, and changes in economic assumptions have overall placed upwards pressure on levy rates. ACC's hindsight estimate of new year claim costs for 2015/16 has shown cost increases of 11% for the Work Account, 4% in the Earners' Account, and 7% for the Motor Vehicle Account.

16. These changes in expected 2015/16 claims costs arise from both changes in economic factors and ACC's underlying claims experience. Excluding the impact of changes in economic assumptions, costs are:

    - higher than forecast for weekly compensation due to increased claims volumes and deteriorating rehabilitation rates

    - lower than expected for social rehabilitation, as the number of new claims is less than expected.

17. Changes in economic assumptions, including lower discount rates, lower than expected investment returns and lower claims inflation have increased estimated 2015/16 claim costs for each Account.

18. The estimated new year costs expected in 2016/17 are slightly higher than ACC's revised estimate of 2015/16 costs. This reflects ACC's updated assumptions of claims frequency and the average cost of each claim in the coming year.

Table 4: Changes in new year costs[3]

	Work Account	**Earners' Account**	**Motor Vehicle Account**
2015/16 (last year's assessment)	$0.83	$1.24	$139.39
2015/16 (current estimate)	$0.90	$1.30	$145.03
2016/17 (current estimate)	$0.91	$1.33	$149.95

19. Work and Earners' levies are expressed relative to income so the increase in costs from 2015/16 to 2016/17 (current estimates) represents a 2-3% increase in real terms. The Motor Vehicle levy is expressed in per vehicle terms, so the change in costs from 2015/16 to 2016/17 (current estimates) represents a 3% increase in nominal terms.

Framework for analysis of levy proposals

20. A range of levy rates would be consistent with the requirements in the AC Act to set levies to fully fund the Accounts. However, different rates will see ACC's funding position change more quickly or slowly depending on the size of the funding adjustment applied to the levy rate required to meet new year costs.

[3] These are the rates required to meet both the cost of new year claims and scheme costs.

Levy rates must balance competing objectives

21. In our analysis of options for setting 2016/17 levies, we have used the principles of financial responsibility in section 166A of the AC Act to form our assessment criteria.

Table 5: Principles of financial responsibility

Principle	Comment
Levies should be set to meet the lifetime cost of claims each year	Levies should reflect the true cost of injuries so that ACC, the Government, and levy payers can make informed decisions. Linking the contributions made by levy payers each year to the expected lifetime costs of claims in that year helps to: • reduce intergenerational transfers • improve price signals • provide the right incentives to avoid injuries and invest in rehabilitation.
Levies should correct for any surplus or deficit over an appropriate number of years	Levies should include a funding adjustment to return the Account to the funding target. Where there is a deficit of funds, moving towards the funding target provides ACC clients with certainty that funds will be available to meet their ongoing treatment and rehabilitation costs. Where there are surplus funds, these should be returned to levy payers so that ACC does not hold more funds than required to offset the outstanding claims liability.
Large changes in levies should be avoided	Reasonably stable and predictable levy rates over time are important for levy payers because fluctuations in levies translate directly to fluctuations in businesses' and households' incomes, compromising their ability to plan.

22. Trade-offs between these principles must be made when setting levies. If levies are set each year to fully offset any surpluses or deficits that have emerged in the Accounts, levies would likely see large year-on-year volatility and departure from underlying costs; a reasonable one standard deviation assumption about annual solvency movements is in the order of $1.5 billion to $2 billion.

23. Responding more slowly to solvency changes over a number of years reduces levy rate volatility and restores the ACC Accounts to the funding target in the medium to long term (all else equal). On the other hand, if levies take too long to respond to

changes in solvency, ACC's Accounts may experience persistent long-term departure from the funding target. This trade-off is summarised below.

Table 6: Trade-off between shorter and longer funding horizons

	Shorter funding horizon	Longer funding horizon
Solvency target	More often at or near target solvency	May see long-term departures from funding target
Levy stability	Greater volatility in year on year levies	Greater levy stability
Alignment with new year injury costs	Greater departure from new year injury costs	Greater alignment between levies and new year injury costs

The AC Act requires the Minister to consider the public interest

24. In addition to the requirement for the Minister to consider the principles of financial responsibility, the Minister must also have regard to the public interest and, in particular, the interests of taxpayers, levy payers, claimants, and potential claimants, as required under section 300 of the AC Act. MBIE has identified the following matters of public interest to include in our assessment of options for 2016/17 levies:

- impact on Crown accounts
- impact of levies on the economy
- distributional impacts to Work Account levy payers due to the removal of residual levies.

Removal of residual levies will have a distributional impact on Work levies

25. This year the Government removed the requirement for ACC to collect residual levies, meaning levy rates for 2016/17 will no longer include a residual component.[4] This has been accounted for in both ACC's consultation rates and levy recommendations to the Minister for ACC.

26. The removal of residual levies does not change the funding needs of the levied Accounts, however there will be a distributional effect on the Work levy rate that individual businesses and the self-employed pay. Options that provide for reductions to the average Work Account levy rate would reduce this distributional impact.

The Government's funding policy places greater emphasis on levy stability

27. As the Work and Earners' Accounts are currently above the new solvency target of 105%, levy rates for 2016/17 must be set below new year costs in order to return surplus funds. However, the funding horizon determines the size of the funding adjustments applied to the levy rates and therefore how quickly funds are returned.

[4] The *Accident Compensation (Financial Responsibility and Transparency) Amendment Act 2015* (Amendment Act) provided for the removal of residual levies by gazette notice and this was done following the Amendment Act's commencement in September 2015.

28. The Government's funding policy prescribes a 10-year funding horizon, meaning each year levy rates are adjusted to return or fund one tenth of any surplus or deficit in the Accounts.

29. This illustrates the Government's preference to take a long-term view when setting levies. It is expected that a 10 year funding horizon will result in more stable levies over time, with gradual funding adjustments over subsequent levy periods moving the Accounts towards their funding target.

30. MBIE has considered the Government's funding policy (which ACC has adopted for its 2016/17 levy proposals) as an indicator of the Government's preferences in balancing the trade-off between being at target solvency of the Accounts and maintaining stability in levy rates now and in the future.

Options for setting 2016/17 levies

31. The length of time taken to reach target solvency levels changes when setting 2016/17 levy rates that deviate from the funding policy. To illustrate the implications of reducing levies more or less quickly in the 2016/17 levy year, we have included an analysis of the following three options:

   - Option 1: ACC's recommended levy rates, applying the Government's funding policy
   - Option 2: Return to funding target in three years
   - Option 3: Maintaining 2015/16 levy rates then applying the Government's funding policy in future years.

32. We have assessed options for setting 2016/17 levy rates against criteria formed using the principles of financial responsibility and public interest considerations outlined previously. The expected impacts on ACC's funding positon have been provided along with the implications for levy payers and the wider economy.

33. All rates for the Work and Earners' Accounts are per $100 of liable earnings and exclude GST. All rates for the Motor Vehicle Account are per vehicle and exclude GST.

Option 1: ACC recommendation

34. ACC has recommended the following average levy rates for 2016/17:

Table 7: ACC's recommended levy rates

	Work	Earners'	Motor Vehicle
2015/16 rate	$0.90	$1.26	$194.25
Proposed 2016/17 rate	$0.80	$1.21	$130.26
Change (%)	-11.1%	-4.0%	-32.9%

35. ACC's proposed rates have been determined using the Government's funding policy (paragraph 7 refers). Because the funding policy places a relatively high weighting on stable levies, only 10 per cent of any surplus or deficit will flow through to a funding adjustment in levy rates in any given year. Applying a longer funding horizon means levies will be more closely aligned with the expected new year injury costs in the forthcoming year.

36. Due to the application of the funding horizon, funding adjustments become smaller when Accounts approach the funding target and levy rates would see small increases as the Accounts approach target solvency (holding all else equal). This is because in order to return excess funds to levy payers and move towards the funding position, levies must be set below expected new year injury costs. As the target funding position is approached, levies must gradually rise to align with new year injury costs.

37. The table below shows a breakdown of the components that make up ACC's proposed rates for 2016/17.

Table 8: Breakdown of 2016/17 levy components for ACC's proposed levy rates

	Work Account	**Earners' Account**	**Motor Vehicle Account**
Expected cost of claims for 2016/17	$0.91	$1.33	$149.95
2016/17 funding adjustment	-$0.11	-$0.12	-$19.69
Proposed 2016/17 levy	$0.80	$1.21	$130.26
Expected funding position at 2015/16 levy year end	115%	123%	105%
Expected funding position at 2016/17 levy year end	115%	121%	105%
Change from 2015/16 funding position[5]	No change	-2%	No change

38. Key drivers of change in this year's levy rates are:

- levy rates have been updated to reflect best estimates of new year claims costs for 2016/17 (paragraph 18 refers)
- ACC has adopted a new funding target that is below the current solvency ratios of the Work and Earners' Accounts
- 2016/17 rates include funding adjustments designed to return one tenth of excess fund in the Work and Earners' Accounts

[5] Note that although proposed rates for the Work and Motor Vehicle Accounts are below the expected cost of claims for 2016/17, solvency position (to the nearest per cent) is unchanged due to other factors such as forecast investment returns.

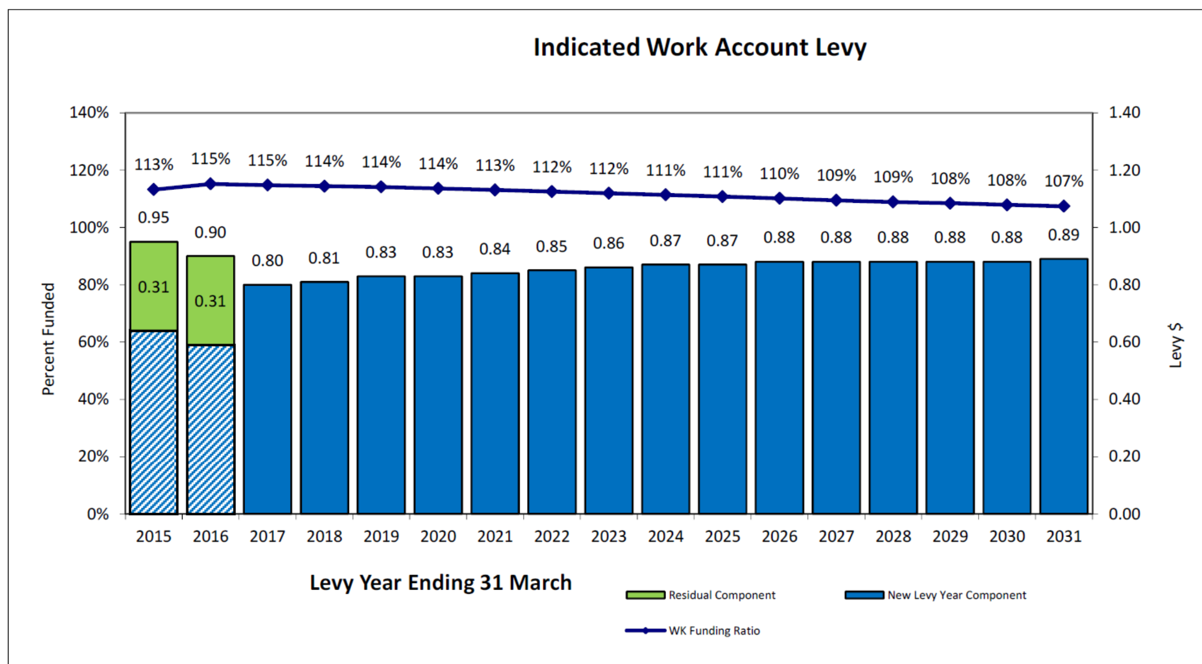
- the removal of the residual levy means that there will be fewer businesses contributing to Work Account levies.[6] As the funding requirements of the Work Account will not change, the average levy rate must increase (all else equal) to cover the shortfall.

Work and Earners' Accounts

39. Because the new funding target of 105% is below the current solvency of the Work and Earners' Accounts, ACC's proposed rates would collect fewer funds than required to meet the lifetime costs of claims in the 2016/17 year. This would return 10 per cent of the excess funds and therefore move the solvency of these Accounts towards the funding target.

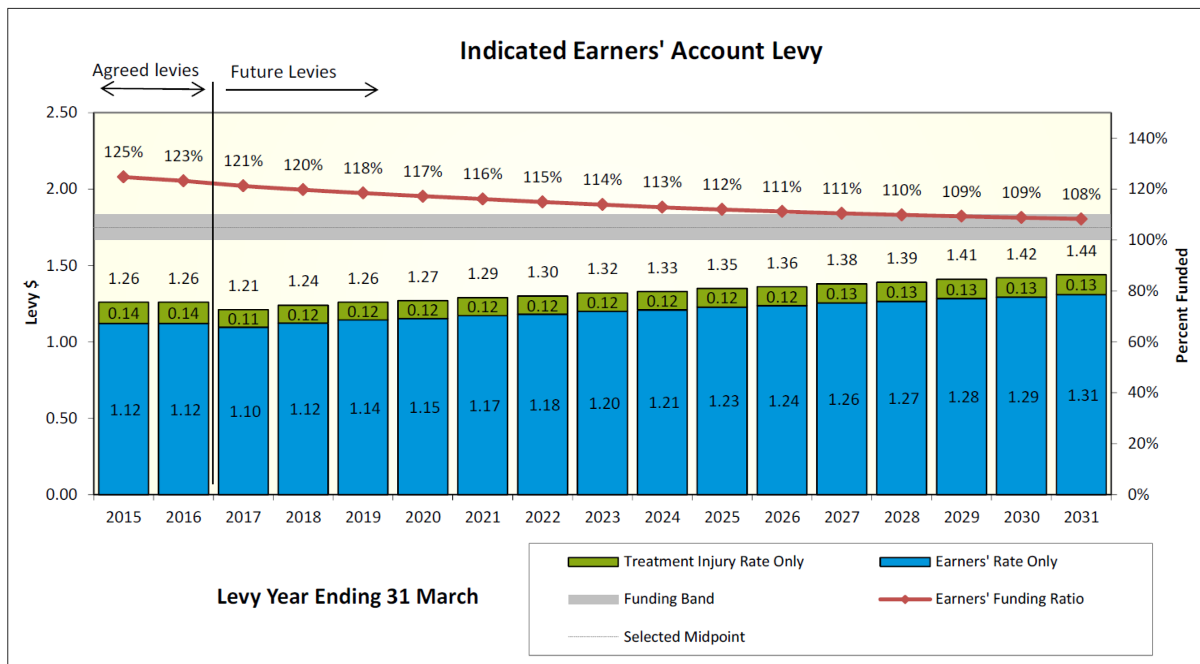
40. Figures 1 and 2 show the projected solvency positions of the Work and Earners' Accounts over the next 10 years under the Government's funding policy. Over time, small increases to levy rates are projected to be required as the Accounts approach target solvency to gradually move towards the cost of new year claims. Once the Accounts are at target solvency, small increases to the rates are expected to be required in-line with inflationary pressures affecting the scheme (eg health cost inflation has historically increased faster than the growth in the levy base, typically 1-2% per annum). Note that although these funding projections reflect current best estimates, it is likely that future levies will differ due to fluctuations in factors affecting funding positions and new year costs.

Figure 1: Projected Work Account funding position under Option 1



[6] This occurs because while all employers (Accredited and non-accredited) currently pay the residual levy, only non-accredited employers pay the current portion of the levy. That is, while non-accredited employers will continue to pay the same total levy, Accredited employers will see a reduction in the levy they are invoiced because they will no longer pay the 'residual portion'.

Figure 2: Projected Earners' Account funding position under Option 1

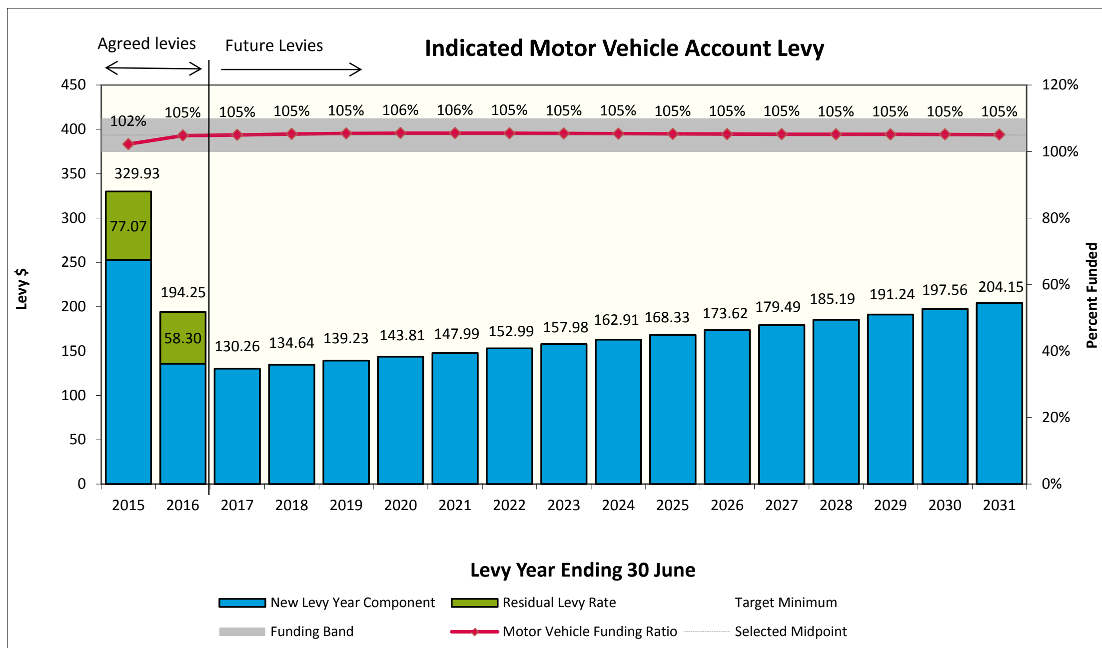


Motor Vehicle Account

41. The funding position for the Motor Vehicle Account is projected to reach ACC's target solvency of 105% at the beginning of the 2016/17 levy year. This means the average levy rate must fall (relative to last year's rate) to reflect the expected lifetime costs of claims in 2016/17.[7] This is shown in Figure 3.

[7] Although ACC's proposed levy rate intends to maintain the Motor Vehicle Account at current solvency, a downwards funding adjustment is required to account for other factors (eg ACC's investment returns) which would otherwise move the Account above funding target of 105%.

Figure 3: Projected Motor Vehicle Account funding position under Option 1



Option 2: Return to funding target in three years

42. While Option 1 places greater emphasis on stable levies in future years, 2016/17 levy rates could be set to return the Work and Earners' Accounts to the Government's funding target of 105% more quickly.

43. Option 2 reduces Work and Earners' levies and keeps these at a flat rate in order to return the Accounts to 105% in three years. This requires significant funding adjustments and therefore lower 2016/17 levy rates for the Work and Earners' Accounts.

44. The Motor Vehicle levy under Option 2 is the same as ACC's proposed rate as the Account is already at its target solvency of 105%.

Table 9: Proposed levy rates under Option 2

	Work	Earners'	Motor Vehicle
2015/16 rate	$0.90	$1.26	$194.25
Option 2 2016/17 rate	$0.56	$0.98	$130.26
Change (%)	-37.8%	-22.2%	-32.9%

45. Option 2 would bring the Work and Earners' Account to target solvency considerably faster compared to Option 1. This means that large increases to the Work and Earners' levy rates would be required in 2019/20 as levy rates return to align with the cost of new year claims. Funding paths for the Work and Earners' Accounts under Option 2 are provided in Figures 4 and 5.

Figure 4: Projected Work Account funding position under Option 2

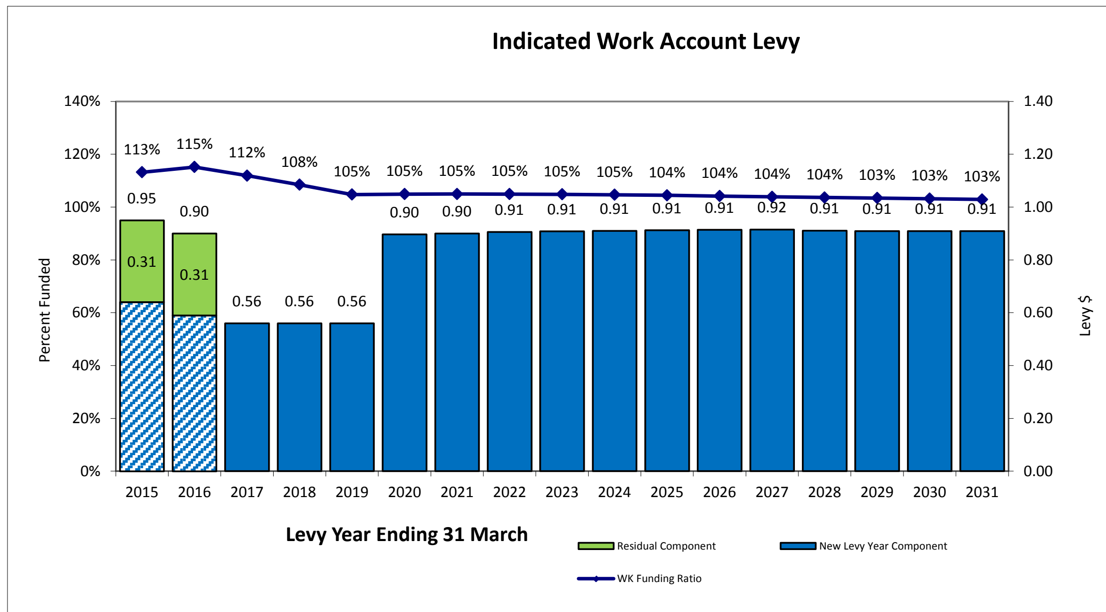
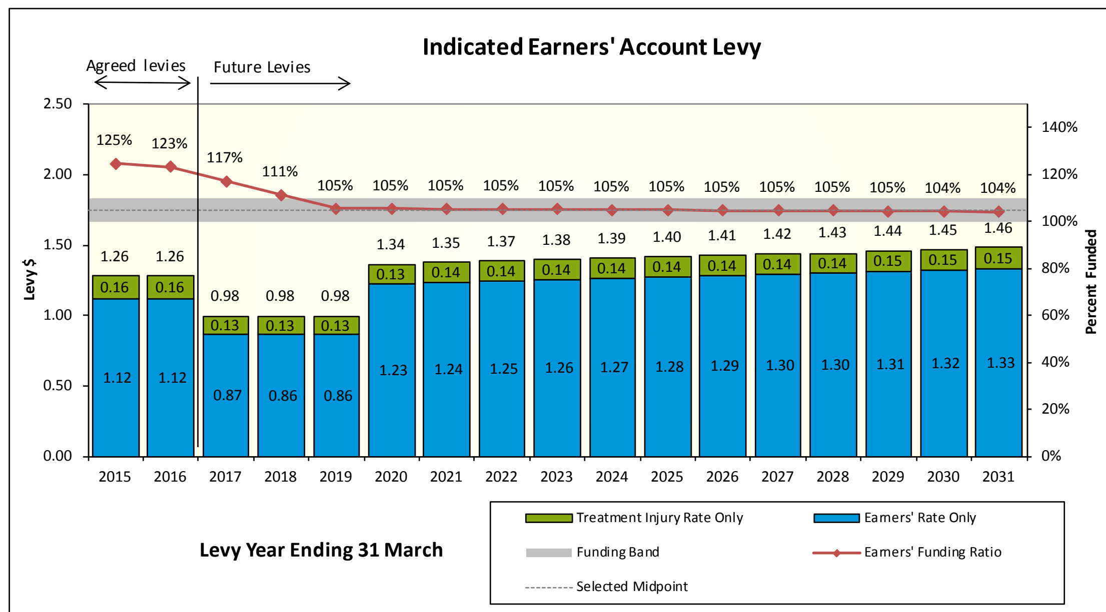


Figure 5: Projected Earners' Account funding position under Option 2



46. Under Option 2, the 2016/17 Motor Vehicle levy rate and projected funding path is the same as under Option 1 (Figure 3 refers) because the Motor Vehicle Account is already at target solvency. Regardless of the funding horizon applied, the Motor Vehicle levy will be set to align with new year costs, with a small funding adjustment applied to maintain the Account at target solvency.

Table 10: Breakdown of 2016/17 levy rates under Option 2

	Work Account	Earners' Account	Motor Vehicle Account
Expected cost of claims for 2016/17	$0.91	$1.33	$149.95
2016/17 adjustment	-$0.35	-$0.35	-$19.69
Proposed 2016/17 levy	$0.56	$0.98	$130.26
Expected funding position at 2015/16 levy year end	115%	123%	105%
Expected funding position at 2016/17 levy year end	112%	117%	105%
Change from 2015/16 funding position	-3%	-6%	No change

Option 3: Maintain 2015/16 rates

47. Option 3 shows the effect on solvencies and projected levy paths of the levied Accounts if 2015/16 rates were maintained for the 2016/17 levy period. These rates would see ACC collect more funds than necessary to meet the funding needs of the levied Accounts.

48. The breakdown of the 2015/16 levy rates in each Account in Table 11 show that the Earner's and Work levy rates would be slightly below the expected cost of claims in 2016/17. Maintaining the current Motor Vehicle levy rate would see the 2016/17 levy rate collect on average $44.30 per vehicle above the expected cost of claims.

Table 11: Breakdown of 2016/17 levy rates under Option 3

	Work Account	Earners' Account	Motor Vehicle Account
Expected cost of claims for 2016/17	$0.91	$1.33	$149.95
2016/17 adjustment	-$0.01	-$0.07	+$44.30
Proposed 2016/17 levy	$0.90	$1.26	$194.25
Expected funding position at 2015/16 levy year end	115%	123%	105%
Expected funding position at 2016/17 levy year end	116%	122%	107%
Change from 2015/16 funding position	+1%	-1%	+2%

49. Keeping levies at 2015/16 rates would see the solvency of the Work and Motor Vehicle Accounts increase above the funding target, and would see the solvency of the Earners' Account fall slightly. This means that greater adjustments to levies would be required in future years in order to return the levied Accounts to their funding targets. Funding paths for the each Account under Option 3 are shown in Figures 6, 7 and 8.

Figure 6: Projected Work Account funding position under Option 3

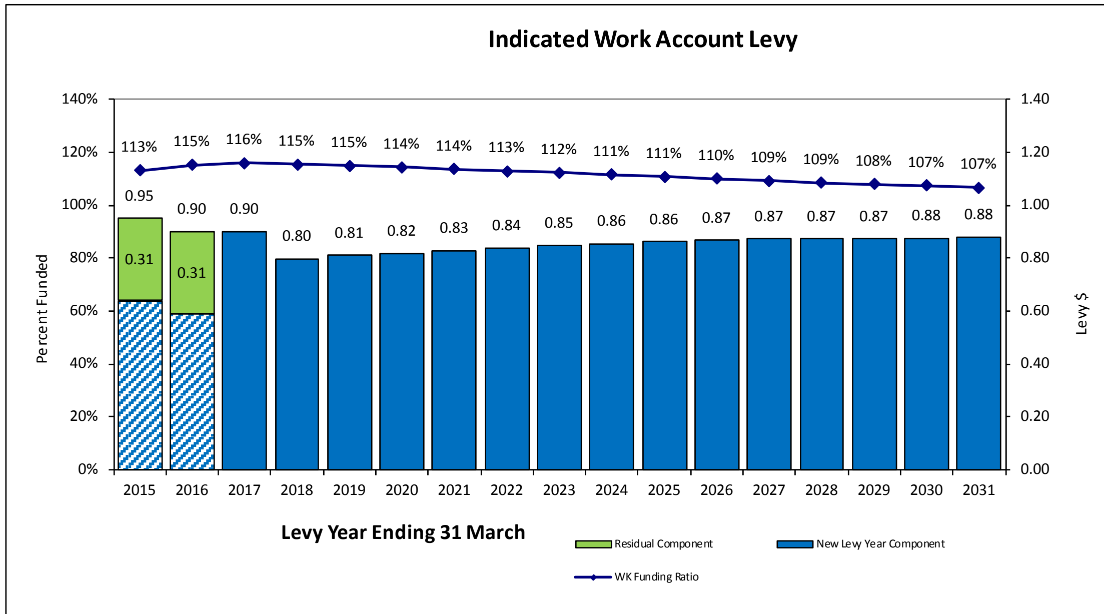


Figure 7: Projected Earners' Account funding position under Option 3

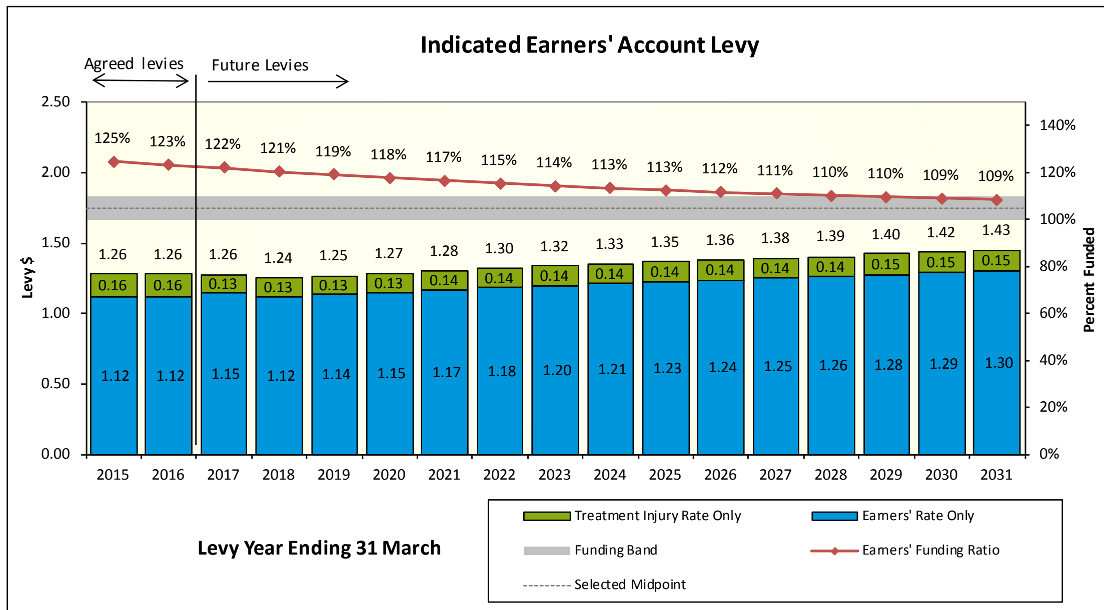
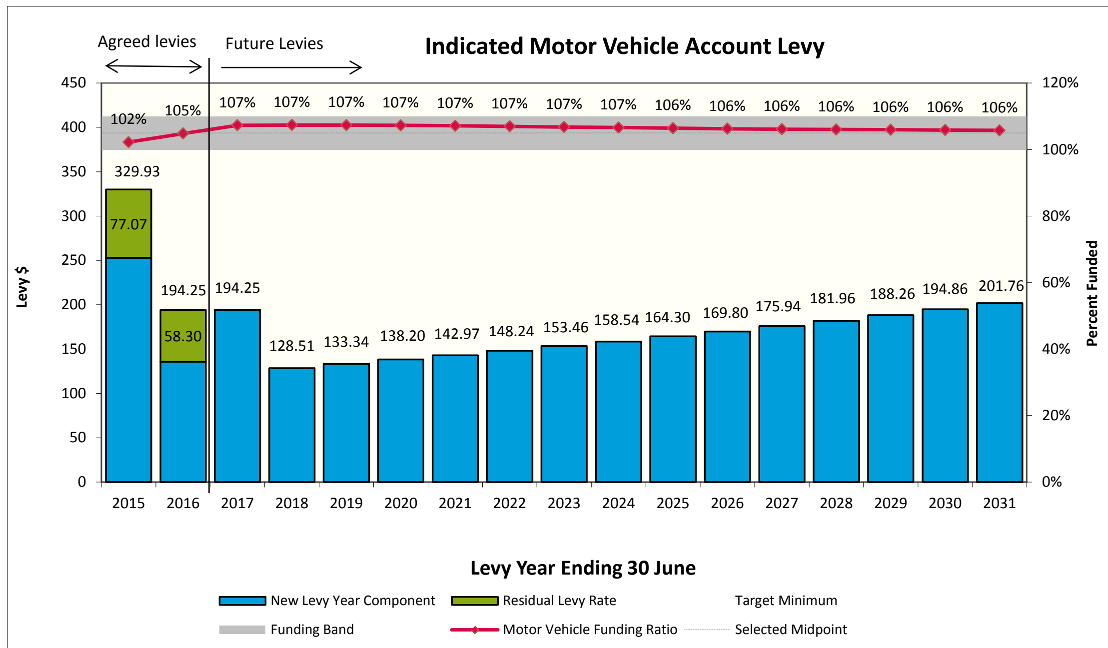


Figure 8: Projected Motor Vehicle Account funding position under Option 3



Impact analysis

50. The following tables assess the three options outlined above against the principles of financial responsibility in the AC Act and factors that MBIE considers to be in the public interest.

51. The impacts to the Work and Earners' Account have been assessed together as these Accounts are in similar positions – both Accounts are above target solvency and levy reductions are required to move the Accounts towards their funding target.

52. The Motor Vehicle Account is forecast to reach the funding target by the end of the 2015/16 levy year. The Motor Vehicle levy needs to be reduced to better align with the estimated cost of claims in 2016/17.

Table 12: Analysis of options against assessment criteria and levy-setting objectives for the Work and Earners' Accounts

	Criteria and objectives	Option 1: ACC's recommendation	Option 2: Return to target in 3 years	Option 3: Maintain 2015/16 rates
Work and Earners' Accounts	**Work levy:** **Earners' levy:**	**$0.80** **$1.21**	**$0.56** **$0.98**	**$0.90** **$1.26**
	Meeting the lifetime cost of claims each year: • reflect the true cost of injuries so that ACC, the Government, and levy payers can make informed decisions • provide accurate price signals to incentivise injury prevention • intergenerational equity	✓ ACC's proposed Work and Earners' levy rates align with the rate sufficient to meet the lifetime cost of claims in 2016/17, with a small funding adjustment (to return one tenth of surplus funds in each Account). This provides levy payers with an accurate signal of the true cost of injuries.	× More significant funding adjustments mean rates under Option 2 would not reflect expected costs of claims in 2016/17. The costs of injuries over the next three years would be subsidised by surplus funds in the Accounts.	✓ These rates provide a fair reflection of the cost of new year claims expected in 2016/17. However, maintaining the Work levy rate at $0.90 will increase the solvency of the Work Account from 115% to 116%. This means these funds will need to be returned in future years (all else equal) resulting in a small intergenerational transfer.
	Correcting for any surplus or deficit: • return to target solvency • provide certainty to ACC clients that funds will be available to meet their rehabilitation costs • return surplus funds to levy payers so ACC does not remove more form the economy than required	✓ This option returns one tenth of surplus funds in the Work and Earners' Accounts, in line with the 10 year horizon prescribed by ACC's funding policy. This would return surplus funds in the Work and Earners' Accounts more slowly compared to Option 2.	✓ This option returns one third of surplus funds in the Work and Earners' Accounts. This takes the solvency of the Work Account from 115% to 112%, and the Earners' Account from 123% to 117%. This option provides the fastest path to return to target solvency by trading off levy stability and accurate price signalling.	✓/× Maintaining 2015/16 levy rates would return a very small portion of the surplus funds in the Earners' Account. Maintaining the current Work levy rate will see solvency in the Work Account move further above the solvency target by 1%.
	Avoiding large changes in levies • provide levy stability for levy payers to allow levy payers to plan financially	✓ The application of the funding policy will mean gradual increases to the Work and Earners' levies in future years as the Accounts return to target solvency and levy rates move to reflect new year costs.	× Keeping levies significantly below new year costs in order to reach target solvency would require larger increases to the Work and Earners' levy rates in 2019/20 as rates would need to return to new year costs once target solvency is reached.	✓/× Maintaining the current Work levy rate would see the Work Account move further above target solvency. This would require a greater levy reduction to the Work Account levy in the future. The current Earners' levy rate would gradually move the Account towards target solvency, and would require greater changes in future levy rates.
	Public interest considerations • impact on Crown accounts • mitigating distributional effects from removal of Work residual levy inflationary impacts	✓ These rates include gradual funding adjustments to return excess funds in the Work and Earners' Accounts. This minimises impact to Crown Accounts by spreading levy (and therefore revenue) reductions over the upcoming and future levy periods. Reducing the Work Account levy from $0.90 to $0.80 will partially offset the distributional impacts from the Work Account levy. This would reduce the number of businesses who would otherwise experience a levy increase if 2015/16 levy rates were maintained (Option 3)	✓/× Option 2 would see more significant funding adjustments to new year costs in order to return excess funds in the Accounts over the next three levy periods. This would mean more significant levy reductions and therefore a larger impact to OBEGAL relative to ACC's consultation rates (Option 1). The reductions to the Work Account levy would offset the distributional impacts from the removal of the residual levy more than Option 1, meaning most businesses would see a levy decrease under this average Work levy rate. However, this would not provide accurate signals of future levy rates and levy rates would need to increase significantly after three years in order to reflect new year costs.	✓/× Option 3 would see ACC collect similar revenue compared to 2015/16 (slightly more due to an increase in the levy base). Maintaining the Work Account levy rate at $0.90 would mean more Work Account levy payers would see a levy increase next year due to the distributional impacts of removing the Work Account residual levy compared to Options 1 and 2.
	Comment MBIE considers that ACC's recommended consultation rates (Option 1) performs the best when assessed using the criteria above. While Option 2 returns excess funds in the Work and Earners' Account more quickly than ACC's proposed rates, this requires rates to be set significantly below new year costs and does not provide levy payers with a fair reflection of the true cost of claims. Returning funds more slowly reduces price distortion to new year costs. Maintaining 2015/16 rates for the 2016/17 levy period would return less than 10% of surplus funds in the Earners' Account, and would increase solvency of the Work Account further above the funding target.			

Key: ✓ = objective is likely to be met; ✓/× = objective is likely to be partially met; × = objective is not likely to be met

Table 13: Analysis of options against assessment criteria and levy-setting objectives for the Motor Vehicle Account

	Criteria and objectives	Option 1: ACC's recommendation	Option 2: Return to target in 3 years	Option 3: Maintain 2015/16 rates
Motor Vehicle Account	**Motor Vehicle levy:**	**$130.26**		**$194.25**
	Meeting the lifetime cost of claims each year: • reflect the true cost of injuries so that ACC, the Government, and levy payers can make informed decisions • provide accurate price signals to incentivise injury prevention • intergenerational equity	✓ Options 1 and 2 both reflect the expected lifetime cost of claims in 2016/17. This provides levy payers with accurate price signals of the costs of new claims expected in 2016/17. Intergenerational equity is maintained as levies collected in 2016/17 would, on best estimates, meet the cost of new year claims.		× Option 3 includes a positive funding adjustment of $44.30 meaning that maintaining the 2015/16 Motor Vehicle levy rate would not reflect the expected costs of injuries 2016/17. This rate would see Motor Vehicle levy payers in 2016/17 subsidise the cost of injuries in future levy years.
	Correcting for any surplus or deficit: • return to target solvency • provide certainty to ACC clients that funds will be available to meet their rehabilitation costs • return surplus funds to levy payers so ACC does not remove more form the economy than required	✓ The Motor Vehicle Account is forecast to be at target solvency of 105% at the beginning of the 2016/17 levy period, meaning a small funding adjustment has been applied to maintain the Motor Vehicle Account funding position. Maintaining the current solvency position of the Motor Vehicle Account is consistent with the principle to correct for any surplus or deficit, and would allow levies in future years to reflect new year costs		× As the Motor Vehicle Account is now at target solvency, the 2016/17 levy rate should largely reflect new year costs (with a funding adjustment to maintain the Account at target solvency). This option includes a large positive funding adjustment which would see ACC collect more that it needs to fund Motor Vehicle claims. This would take solvency of the Account from 105% to 107%, and therefore is inconsistent with the principle to correct for surpluses and deficits in the Accounts.
	Avoiding large changes in levies : • provide levy stability for levy payers to allow levy payers to plan financially	✓ Reducing the average Motor Vehicle levy to reflect new year's cost will maintain the Account at target solvency of 105%. This will improve the stability of levies in future years as levy rates should (all else equal) reflect new year costs.		× Maintaining the current levy rate for 2016/17 would move the Motor Vehicle Account above its target solvency, requiring funding adjustments in future years to return surplus funds.
	Public interest considerations • impact on Crown accounts	✓ Applying the Governments funding policy sees a large decrease in levy revenue for the Motor Vehicle Account, as the average Motor Vehicle levy rate must fall to reflect the lifetime cost of claims expected in 2016/17. This reduction in levy revenue was accounted for in Budget 2015.		✓ Collecting more revenue than needed to fund the Motor Vehicle Account would improve the Crown's OBEGAL. However surplus funds would be returned in future years.
	Comment As the Motor Vehicle Account is currently at the target solvency of 105%, the funding horizon applied (10 years under Option 1, return to target in 3 years under Option 2) does not impact the average Motor Vehicle levy or projected funding position of the Motor Vehicle Account. This is because the levy rates under Options 1 and 2 reflect expected new year costs in 2016/17 (with a funding adjustment to maintain the Account at target solvency). Maintaining 2015/16 levy rates for 2016/17 would move the Account from the target solvency of 105% to 107% meaning ACC would collect more funds than required.			

Key: ✓ = objective is likely to be met; ✓/× = objective is likely to be partially met; × = objective is not likely to be met

Impact on economy

53. Changes in levy rates transfer directly to changes in the incomes of businesses, workers, and motor vehicle owners. This means when levy reductions are made, this revenue reduction flows through into the economy.

54. Table 14 below summarises the changes in levy revenue (compared to the levy revenue collected in 2015/16) under each Option.

Table 14: Total levy reductions under each Option

	Work Account	Earner's Account	Motor Vehicle Account	Total
Option 1	$171 million	$61 million	$218 million	$450 million
Option 2	$378 million	$342 million	$218 million	$938 million
Option 3	$85 million[8]	$0 million	$0 million	$85 million

55. Option 2 provides for the most levy reductions as these levy rates return approximately one third of excess funds in the Work and Earners' Accounts.

Impact on Crown accounts

56. ACC's preliminary Half Year Economic and Fiscal Update (HYEFU) submission is based on ACC's consultation rates (Option 1). Table 14 below shows the change in the Crown's Operating Balance Excluding Gains and Losses (OBEGAL) between the Budget Economic and Fiscal Update (BEFU) numbers used in Budget 2015 and ACC's HYEFU submission.[9]

Table 14: Comparison of impact to Crown Accounts in HYEFU compared to BEFU

$000	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
BEFU	(199,983)	(684,392)	(1,111,662)	(855,567)	N/A
Option 1 (HYEFU)	(30,596)	(192,934)	(145,998)	(182,276)	(218,430)
Change	169,387	491,458	965,664	673,291	N/A

57. Option 2 provides greater levy reductions to the Work and Earners' levies. Relative to Option 1 (HYEFU), this reduces ACC's levy revenue and therefore has a negative impact on OBEGAL. Tables 15 and 16 show the forecast OBEGAL impacts under Options 2 and 3 relative to HYEFU.

[8] The $85m reduction in the Work Account is a result of keeping the aggregate rate at $0.90 but removing the residual levy.

[9] Note that as HYEFU has not been finalised at the time of this analysis, we have used ACC's preliminary HYEFU submission.

Table 15: Option 2 impact to Crown accounts relative to HYEFU

$000	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
HYEFU	(30,596)	(192,934)	(145,998)	(182,276)	(218,430)
Option 2	(531,426)	(774,822)	(815,926)	(70,982)	(134,208)
Change	(500,831)	(581,888)	(669,928)	111,295	84,222

58. Levy rates under Option 2 have a negative impact on OBEGAL in the next three years as surplus funds in the Work and Earners' Accounts are returned. Thereafter, levy rates in the Work and Earners' Accounts will increase to align with new year costs, which would have a positive impact on OBEGAL relative to HYEFU.

Table 16: Option 3 impact to Crown accounts relative to HYEFU

$000	Jun-16	Jun-17	Jun-18	Jun-19	Jun-20
HYEFU	(30,596)	(192,934)	(145,998)	(182,276)	(218,430)
Option 3	122,165	3,373	(165,887)	(200,496)	(250,984)
Change	152,761	196,307	(19,889)	(18,219)	(32,554)

59. Maintaining levies at 2015/16 rates would have a positive impact in the next two fiscal years due to the increase in levy revenue in 2016/17 relative to HYEFU (Option 1). Applying the Government's funding policy from 2017/18 will result in levy rates that return surplus funds in the Accounts. As maintaining 2015/16 rates in 2016/17 would see the surplus in the Work and Motor Vehicle Accounts increase, greater levy reductions would be required from 2017/18. This has a negative impact on OBEGAL from the Jun-18 fiscal year onwards.

Impact on individual levy payers

60. Table 17 shows the impact of the options on different levy payers. Note that average Motor Vehicle levy rates have been used so these numbers would vary depending on which risk rating band a person's car falls in. For petrol vehicles, a portion of the Motor Vehicle Account levy is paid through a petrol levy so the actual levy paid is also dependent on fuel consumption.[10]

Table 17: Impact to different Earners' and Motor Vehicle levy payers

	Household with average income and two cars	One minimum wage Earner and one car	One average income earner and one car	One earner above maximum liable earnings
Current levy rates	$1,501.80	$1,307.55	$967.39	$843.55
Option 1	-$172.16	-$108.17	-$94.67	-$89.76
Option 2	-$375.38	-$311.39	-$235.80	-$208.28
Option 3	No change	No change	No change	No change

[10] The average annual household income (wages and salaries) is $88,357, Household Economics Survey: Year ended June 2014, Statistics NZ. The average annual income for an individual (wages and salaries) is $51,532, New Zealand Income Survey: June 2014 quarter, Statistics NZ.

Impact on businesses

61. The Work Account levies paid by individual businesses are determined by the claims experience of their classification unit, and loadings or discounts based on their individual claims experience (experience rating).

62. The removal of residual levies will have distributive effects on the Work levy that businesses pay in 2016/17. This is because Work levy rates will reflect only recent risk relativities where previously the portion attributed to the residual levy was based on risk relativities relating to years 1999 and prior.

63. High level impacts of the recommended levy rates are outlined in Table 18 below.

Table 18: Average levy reductions for businesses of various sizes[11]

	Firm size by number of employees (assuming average liable earnings per worker of $50,000)				
	5	**10**	**20**	**50**	**100**
Current levy rates	$2,250	$4,500	$9,000	$22,500	$45,000
Option 1	-$250	-$500	-$1,000	-$2,500	-$5,000
Option 2	-$850	-$1,700	-$3,400	-$8,500	-$17,000
Option 3	No change	No change	No change	No change	No change

Results of public consultation

64. Section 331 of the AC Act requires ACC to undertake public consultation on proposed levy rate change. This occurred over the month of October 2015.

ACC's analysis of public consultation

65. The number of submissions received this year and last year for each Account are set out in Table 19.

Table 19: Number of submissions received during public consultation

	2015/16	**2016/17**
Work Account	49	70
Earners' Account	30	18
Motor Vehicle Account	419	1,047

66. Key themes in the Work Account were:

- There was broad support for reducing the Work levy. Respondents generally believe the way ACC sets Work levies is fair. Most agree that those who work in areas with higher claims experience should pay a higher Work levy.

[11] Note these are based on reductions to the average Work Account levy rate. A businesses actual rate will depend on their industry and may be subject to an experience rating adjustment.

- A major stakeholder has welcomed the cessation of the residual levy, with another making some suggestions on how to reduce the impact of the removal of the residual levy on its industry.

- There was general support for ACC recognising businesses with good safety performance, with many comments that ACC should look at overseas models to improve its return-to-work programmes.

- One major submitter proposed that rather than reduce the rate, the available extra funding could be used to increase entitlements.

  MBIE comment: Cover and entitlements are legislated for and should not be determined by the solvency position of the Accounts.

- Three submitters did not believe that the removal of the residual levy should result in adjustments to levy rates (up or down).

  MBIE comment: It is important to understand that it is inevitable that updating risk relativities following the discontinuation of the residual levy implies redistribution of levy rates. MBIE considers it important that levy rates that businesses pay reflect their underlying risk to the scheme.

67. Key themes in the Earners' Account were:

    - General support for the proposed reduction in the levy rate.

68. Key themes in the Motor Vehicle Account were:

    - There is general support for the proposed reductions in the Motor Vehicle Account.

    - There was noticeable support for the levy to be based on/paid via a user pays mechanism, mainly through fuel. This includes support to maintain the petrol levy and explore ways to add a user pays element to diesel vehicles.

      MBIE comment: We support the collection of the Motor Vehicle levy through a combination of vehicle licence fee and the petrol levy, as risk of injury on the road is influenced by both vehicle model and time spent on the road. The ratio of levies collected through these mechanisms is ultimately a judgment call given the lack of underlying evidence allocating respective risk.

    - Submissions from individuals mainly focused on the requirement to pay the ACC levy on every motor vehicle they owned; and that the ACC levy should be calculated based on more subjective factors, such as driver experience, crash history and age.

    - ACC's proposals were generally supported by industry groups: reducing the Motor Vehicle levy is popular and smoothing of levy rates is supported.

Recommendations

ACC levy rates for 2016/17

69. As discussed in our analysis, setting ACC levy rates involves balancing the principles of financial responsibility in the AC Act while considering matters of public interest.

70. The assessment of options for setting levy rates for 2016/17 show that ACC's recommendation (Option 1) performs better than Options 2 and 3 when evaluated against our criteria. Levy rates under Options 2 and 3 either propose levy rates that do not reflect the cost of injuries expected in the upcoming year, result in large increases to levy rates in future years, or move the Accounts away from the Government's funding target.

71. MBIE supports ACC's recommendation as we consider this approach places appropriate weighting on levy stability, returning to target solvency, and reflecting the cost of new year injuries. While Option 2 would see the Work and Earners' Accounts return to target solvency more quickly, this would require levy rates to be set significantly below the lifetime cost of injuries expected in 2016/17.

Table 20: MBIE's recommended levy rates

	Work Account	Earners' Account	Motor Vehicle Account
MBIE's recommended 2016/17 levy rate	$0.80	$1.21	$130.26

Implementation plan, monitoring, evaluation and review

Implementation plan

72. To enable the collection of the new levy rates from 1 April 2016 for the Work and Earners' Accounts, and 1 July 2016 for the Motor Vehicle Account, regulations must be made by 2 March 2016 and 1 May 2016 for the respective Accounts. If new regulations are not made, existing 2015/16 levy rates will roll over to the 2016/17 levy year.

73. To enable the new Earners' Account levy rate to be in place on 1 April 2016, Inland Revenue would require notification of the approved Earners' Account rates by mid-December 2015 so that payroll software developers can update, test, and distribute their systems updates.

74. There are no proposals that would significantly change levy collection mechanisms, so implementation of these changes would be business as usual for ACC.

75. ACC will be undertaking further consultation on the Vehicle Risk Rating programme which will include consulting on the relativities of each levy band compared to the average Motor Vehicle Account levy rate.

Monitoring, evaluation and review

76. Monitoring, evaluation and review is built into the annual review of ACC levies. The process for the review is as follows:

- The review of levies begins with the ACC commissioned independent actuarial assessment of ACC's liabilities as at 30 June. This assessment is then reviewed by The Treasury's independent actuaries.

- ACC's internal actuaries then apply the assumptions and methodologies used in the independent actuarial review, along with other material, to make assumptions about claims costs for the upcoming year.

- The ACC Board reviews its funding policy for the levied Accounts and uses this to determine the levy rates it publicly consults on (ACC will be required to use the Governments funding policy to inform levy rates from 2017/18 onwards).

- ACC then publicly consults on levy proposals and provides recommendations to the Minister for ACC both on levy rates and on other changes to levies (such as changes to classification unit groupings and maximum liable earnings).

- MBIE commissions an independent quality assurance review of the recommended levy rates and provides advice to the Minister for ACC.

- The Minister for ACC recommends regulations to set ACC levy rates for the upcoming year.

- Once regulations are made, the AC Act requires ACC to publish a report detailing the long-term implications of the prescribed levies.