Regulatory Impact Statement: Introducing experience rating in the ACC Work Account

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the Accident Compensation Corporation (ACC). It outlines, and analyses, proposals to introduce experience rating in the ACC Work Account.

An amendment to the Accident Compensation Act 2001 in March 2010 enabled the introduction of experience rating in the ACC Work Account, and in July 2010, the Minister for ACC announced the Government's plans to introduce experience rating in the Work Account from 1 April 2011.

Experience rating is intended to create a financial incentive, through discounts and loadings on an employer's work levy, for employers to:

- reduce the number and severity of injuries in their workplace/s
- improve employer involvement in an injured employee's rehabilitation
- reduce cross subsidies, and improve equity, so that the levy an employer pays better reflects their risk (in terms of number and cost of injuries) to the ACC Scheme.

Given the Government's intention to introduce experience rating, the analysis in this RIS is focused on how an experience rating system/s can be effectively designed to meet the policy objectives outlined above. ACC undertook public consultation on proposals to introduce experience rating, as required by sections 331 and 332 of the Accident Compensation Act 2001. Two specific proposals were consulted on:

- a No-Claims Discount Plan for small employers
- an Experience Rating Programme for large employers.

These proposals were developed after consideration of experience rating systems operating in other workers' compensation schemes, actuarial analysis, and an assessment of the impacts of introducing experience rating.

Many of the likely impacts of experience rating have been assessed, such as the estimated level of discounts and loadings that may be applied to an employer's levy. Some impacts, such as the extent of possible perverse behaviours resulting from experience rating (for example, under-reporting or mis-reporting of work-related injuries), cannot be accurately assessed at this point in time. Where possible the design of the proposed experience rating system looks to mitigate such potentially negative impacts. In addition, the RIS outlines how areas such as potential perverse behaviours, and increases in the number of employer-initiated reviews of work-related injury claims, can be monitored and reviewed.

Experience rating is explicitly intended to incentivise employers to increase their focus on, and investment in, injury prevention and the rehabilitation of injured employers. There will be some additional compliance costs on businesses associated with experience rating, however, these will be minimal as experience rating will be integrated into ACC's existing levy process.

The proposals in this RIS do not override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines) or impair private property rights.

Peter Wood

Head of Insurance Products and Injury Prevention, ACC

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Introduction

1. This Regulatory Impact Statement supports consideration of the proposal to introduce experience rating in the ACC Work Account, which would introduce a system of modifying an employer's ACC levy based on their claims experience.

2. An amendment to the Accident Compensation Act 2001 in March 2010 enabled the introduction of experience rating in the ACC Work Account, and in July 2010, the Minister for ACC announced the Government's plans to introduce experience rating in the Work Account from 1 April 2011.

Status quo and problem definition

Levy setting principles in the Work Account

3. ACC's Work Account provides cover and entitlements (including medical costs, rehabilitation and earnings-related compensation) for employees and the self-employed for work-related personal injuries. Currently, ACC levies employers and self-employed people to fund the:
   - current and future costs of work-related injury claims made in the levy year
   - ongoing costs of claims for work injuries that happened before 1 July 1999, and non-work injuries that happened before 1 July 1992 (residual levy).

4. ACC applies insurance principles to levy setting, particularly through risk pooling. Risk pooling means that people or businesses whose individual likelihood of having a claim is low, but the individual cost would be high, share the risk and costs with other people or businesses.

5. In setting levies in the Work Account, ACC takes a targeted approach to risk pooling. Employers and the self-employed are classified, for levy purposes, by the type of industry in which they are engaged. ACC uses an industrial classification system based on the Australian and New Zealand Standard Industrial Classification (ANZSIC). These classification units (CUs) are modified for ACC's use based on activity and risk and grouped into Levy Risk Groups (LRGs).

6. The claims experience of LRGs is used to estimate the cost and frequency of future injury claims, and determine the levies that the businesses included in respective LRGs will pay. Industry-based levies reflect the weighted average cost of all activities, or occupations, within each industry.

Cross subsidies within the Work Account

7. ACC's 'collective industry insurance' approach to levy setting leads to two

major cross subsidies within the Work Account:

- **Large businesses subsidise small businesses:** Small businesses and the self-employed are unlikely, or unable, to invest in systems and technology to reduce/manage injuries and represent a higher cost to ACC per worker than large businesses. The process of averaging levies across industry-based levy risk groups results in small businesses, within these groups, benefiting from the low claims experience of large businesses.
- **Businesses with a low risk profile subsidise high risk profile businesses within LRGs:** Businesses of similar sizes within LRGs may adopt different attitudes to risk management and injury prevention. Because levy rates are calculated on an average basis, this means that a business that actively and effectively manages its health and safety practices, and reduces the incidence and impact of injury, subsidises businesses that do less to manage their injury profile.

8. The current approach to industry-based levy setting in the Work Account means that there is limited financial incentive for many employers to improve their workplace safety, or injury management practices, because any such changes will not directly affect the levy they pay. In addition, averaged levy rates mask the true cost of accidents that occur in an employer's workplace/s.

Financial incentives to reduce work-related injuries

9. Currently, ACC offers employers several ways to discount their work levy:
    - The **ACC Partnership Programme** gives employers significant discounts on their ACC levies, in exchange for taking responsibility for their employees' work injury claims. This programme is more suitable for larger employers. Employers who join the programme are referred to as 'accredited employers' and are responsible for delivering all statutory entitlements to injured employees, such as weekly compensation for lost earnings.
    - ACC operates several behaviour incentive programmes aimed at recognising and promoting good injury prevention practices. The **Workplace Safety Discount** (WSD) programme and the **Workplace Safety Management Practices** (WSMP) programme provide a levy discount (ranging from 10 – 20 per cent of the current portion of the standard work levy depending on the level achieved) for businesses if they can demonstrate that they meet specific workplace health and safety standards and practices.

10. ACC also operates the **Workplace Safety Evaluation** (WSE) programme, which is designed to help employers with poor injury statistics improve the safety of their workplace/s. If an employer does not address identified safety issues, and subsequently fails a workplace audit, the employer's standard work levy is increased by 50 per cent for the cover year in which the audit took place.

11. While these programmes take account of an employer's risk management

practices, they do not, with the exception of the WSE and Partnership Programme, have a complementary focus on injury management (such as supporting return to work for injured employees), or connect a levy discount with outcomes, such as whether there has been a demonstrable change in an employer's claims history.

12. In addition, ACC's current incentive programmes (WSD and WSMP) are not available to all employers[i], and of those employers that could apply to join the programmes, not all do. As at 31 March 2010, there were 2,291 employers in the WSMP and 1,822 in the WSD. In comparison, ACC levies just over 557,000 employers (including self-employed and shareholder employees).

Injury and expenditure trends in the Work Account

13. Despite recent downward trends in work-related injury claims[ii] there is significant room to reduce the number and severity of injuries. The number of new work-related injury claims has decreased between 2005 and 2009 in absolute terms and as a proportion of the total number of new ACC claims. However, a consistent proportion of claims in the Work Account still go on to receive entitlements, such as weekly compensation and social rehabilitation, which are a significant driver of Scheme costs.

Objectives for experience rating

14. Experience rating is a method of modifying employers' levies to reflect their claims experience (ie the number of claims they have, and the duration of those claims). The intention is that experience rating will be a mandatory pricing change to all eligible employers' Work Account levies.

15. Experience rating is intended to create a financial incentive, through discounts and loadings on an employer's work levy, for employers to:

- reduce the number and severity of injuries in their workplace/s (eg through investing in risk management practices within their workplace)
- improve rehabilitation (return to work) outcomes (eg through engagement with employees and ACC during the rehabilitation process)
- improve risk differentials and equity, so that the levy an employer pays better reflects their risk (in terms of number and cost of injuries) to the ACC Scheme, and employers are more aware of the cost and impact of the claims that occur within their workplace.

Regulatory impact analysis

16. The issues outlined in the status quo and problem definition section above cannot be addressed within existing, or non-regulatory arrangements because:

- the Government has signalled its intention to introduce experience rating into the Work Account from 1 April 2011

- the highly prescriptive nature of the Accident Compensation Act 2001 in relation to levy setting means that there is no way of introducing experience rating into the Work Account other than through regulations.

17. Given the Government's intention to introduce experience rating, the options analysis below focuses on how an experience rating system/s can be effectively designed to meet the desired policy objectives.

Analytical approach

18. ACC has undertaken the following analysis to inform the development of an experience rating framework:

    - review of international jurisdictions/workers' compensation schemes that operate experience rating schemes, and the experience rating scheme that operated in the Work Account in the 1990s, to inform thinking about approaches to, and potential issues with, introducing experience rating
    - actuarial analysis to develop a robust experience rating pricing model, including modification formulas that are statistically credible, appropriately account for differences in employer size and risk, mitigate against perverse behaviours (such as mis-reporting or under-reporting of claims), and that are financially sustainable
    - assessment of the operational/implementation impacts, including the resourcing and capability requirements for ACC and compliance requirements for employers.

The application of experience rating in workers' compensation schemes

19. Many other jurisdictions operate workers' compensation schemes similar to the cover provided to workers under the ACC Scheme. Most of these schemes, including those in Australia, Canada, and the United States, incorporate elements of experience rating into their levy setting processes.

20. There are a number of possible approaches to experience rating. One approach is to modify an employer's industry-based work levy based on whether their claims experience is better, or worse, than the average of their peers (ie other similarly sized employers in their industry). Employers whose performance is better than average, in comparison to their peers, will receive a discount on their levy, while employers who have worse than average performance will receive a loading.

21. Experience rating can also be applied in the form of 'no-claims bonuses' or 'high-claim loading'. Under this approach, if an employer's claims history (ie number of claims) is below a specified threshold (over a particular period of time) they will receive a discount on their industry-based work levy. However, if an employer's claims history is above a specified threshold they will receive a loading on their levy.

22. A review of various experience rating systems[iii] found that for experience rating to work well:

- the cost of insurance needs to be perceived as high in absolute terms. Rates above 1% or 2% of payroll appear to motivate employers (the aggregate work levy represents approximately 1% of the total liable earnings in the Work Account)
- the value of discounts or loadings needs to be perceived as high, either in absolute terms or relative to the firm’s overall turnover/profit. Typically, 25% of the normal levy
- discounts or loadings need to be received within one to three years to influence firms
- rates varying greatly from one year to the next can aggravate employers
- the motivational impact of experience rating can be diluted by factors such as competition between insurers, which can result in insurers offering lower rates regardless of actual claims.

Proposed methodology for experience rating

23. Based on the analysis outlined above, ACC developed, and consulted on two proposed methods for applying experience rating (further details of the consultation are provided below):

    - **Experience rating programme for medium and large employers -** For employers whose annual work levy is equal to, or more than, $10,000 in each of the three years of the experience period, an experience rating modification will be applied to the current portion of their levy. The modification will be applied at the industry-based classification unit level (excluding the residual portion) to adjust their levy based on their own experience as measured by claim frequency and duration. The maximum modification will be +/-50% of the employer’s standard industry levy rate.
    - **No claims discount / high claims loading programme for small employers (including self-employed people) -** Employers whose annual levy is less than $10,000 in any, or all, of the relevant claims years, will receive a no claims discount of 10% on the current portion of their work levy if they have had no weekly compensation claims over the experience period. Employers in this group who have between one and three weekly compensation claims over the experience period will not have their levy modified, whereas small employers who have four or more weekly compensation claims over the experience period will receive a 10% loading on their standard levy. The ACC Board recommended a different experience measure for this programme to the Minister, details of which are in paragraph 81.

Experience rating for medium and large employers

24. The proposed experience rating programmes for medium and large employers would use an employer’s claims history to modify their standard levy based on two independent components: an industry modification and an experience modification. Under this approach employers are categorised into peer groups, based on their size (medium or large as defined by their liable

earnings). The following modifications would be applied:

- **Industry size modification -** As large and small businesses within a LRG have different claims experience, the modification compares the performance of a peer group against that of all employers in their LRG.
- **Experience rating modification -** This modification reflects an employer's experience relative to their peer group. If an employer's claims experience is better than the average for comparable programme participants they will receive a discount, but if their experience is worse they will receive a loading.

25. The maximum modification for an employer will be +/-50% of the standard industry levy rate, of which +/-15% will be from the industry size modification and +/-35% will be from the experience rating modification.

26. An individual employer's experience rating modification will be based on the areas where an employer can actively influence the risk and impact of workplace injuries. These areas are their safety practices and procedures, and employees' rehabilitation from injury. It was proposed that:

- **Safety practices are measured through injury frequency, as measured by the number of claims receiving medical payments of $500 or more**

  Where an employer has a sound risk management programme in place they should have fewer injuries occurring, and if an injury does occur it should be less severe. Medical payments (including both medical treatment and elective surgery) are an indicator of injury severity, and are relatively independent of ACC's decisions regarding rehabilitation. Therefore they provide an appropriate proxy for an employer's injury prevention practices.

- **Rehabilitation is measured based on the number of weekly compensation days paid by ACC**

  The number of days an employee receives weekly compensation reflects an employer's use of the Scheme and their participation in the employee's rehabilitation, as well as reflecting a driver of significant costs in the Work Account. In order to alleviate the impact of a serious injury, the number of weekly compensation days counted on a claim will be capped at 365 days over the past three years.

Business grouping and transfers

27. ACC also developed and consulted on proposals to group businesses for the purposes of experience rating. The intention of the grouping rules is to ensure that experience rating is, as far as possible, based on actual common control of workplaces and that the claims history of all entities that are under common control are taken into account when determining a levy modification. The rules intend to give clarity to employers, minimise the compliance burden for both employers and ACC, and ensure that employers are not able to deliberately structure their business to get the maximum benefit from experience rating.

28. Business transfer rules were also developed and consulted on. These rules are based on those applied for GST purposes. Under these rules, where all or part of a business's activity is acquired or disposed of by an employer, the historical payroll and claims history will remain associated with that activity for a specified period of time, and move to the new owner of that activity (or part-activity) for experience rating purposes.

29. Similarly, where an employer ceases a business activity, in whole or part, without passing it to another employer, the claims history associated with the ceased activity will remain with the employer, and will continue to be considered as part of that employer's total claims history.

Impact of these proposals

30. Most of the impacts below are related to experience rating in general. Where impacts have been quantified the key assumptions used in the analysis are outlined, specifically if these are based on the experience rating proposals that were publicly consulted on by ACC.

Impact on Employers

Not all levied employers would be eligible for experience rating

31. The participation criteria for the approach to experience rating that was publicly consulted on means that not all employers will be experience rated:

- employers that have liable earnings less than the minimum liable earnings for self-employed people, or have not been invoiced by ACC for each of the years of the experience period will be exempt. This is because these employers have limited claims experience, which does not provide a credible basis for the application of experience rating
- members of Partnership Programme will be exempt as they are effectively already experience rated given that they have taken on responsibility for managing their employees' work-related injury claims.

32. Table one provides a breakdown of the expected spread of employers between the different experience rating programmes, including those in the Partnership Programme, based on the proposed experience rating framework that was consulted on.

Table one: Expected spread between programmes as at 30 June 2010

Type of employer	Proposed Incentive	Number of employers	Percentage of employers	Percentage of liable earnings
ACC Partnership Programme	Partnership Programme[a]	136	0.02%	20%
Employers Large	Experiece Rating Programme[b]	5,050	1%	31%
Small	No-Claims Discount Programme[c]	110,500	20%	31%
Non-PAYE shareholder-employees and self-employed	No-Claims Discount Programme	126,000	23%	8%
Ineligible group	No incentive programme[d]	315,500	56%	10%
Total		**557,186**	**100%**	**100 %**

Table Notes:

a) Current Partnership Programme discounts available to employers for a specified claim management period. Partnership Programme participants are counted by the number of contracts.

b) For large employers, including non-PAYE shareholder-employees.

c) No claims discount/high claims loading programme.

d) These employers, self-employed, and shareholder employees are exempt from experience rating as their earnings are below the minimum liable earnings or they have not been in business consecutively for the previous three years.

Different approaches to experience rating based on employer size

33. To ensure that an experience rating system is credible, the weight given to an employer's experience will reflect the size of their exposure to risk and be based on a reliable volume of claim activity. Consequently, larger employers will be eligible for the Experience Rating Programme, with smaller employers eligible for the No-Claims Discount Programme.

34. Table one above shows that approximately 5,050 employers will be in the Experience Rating Programme and around 236,500 employers will be in the No-Claims Discount Programme.

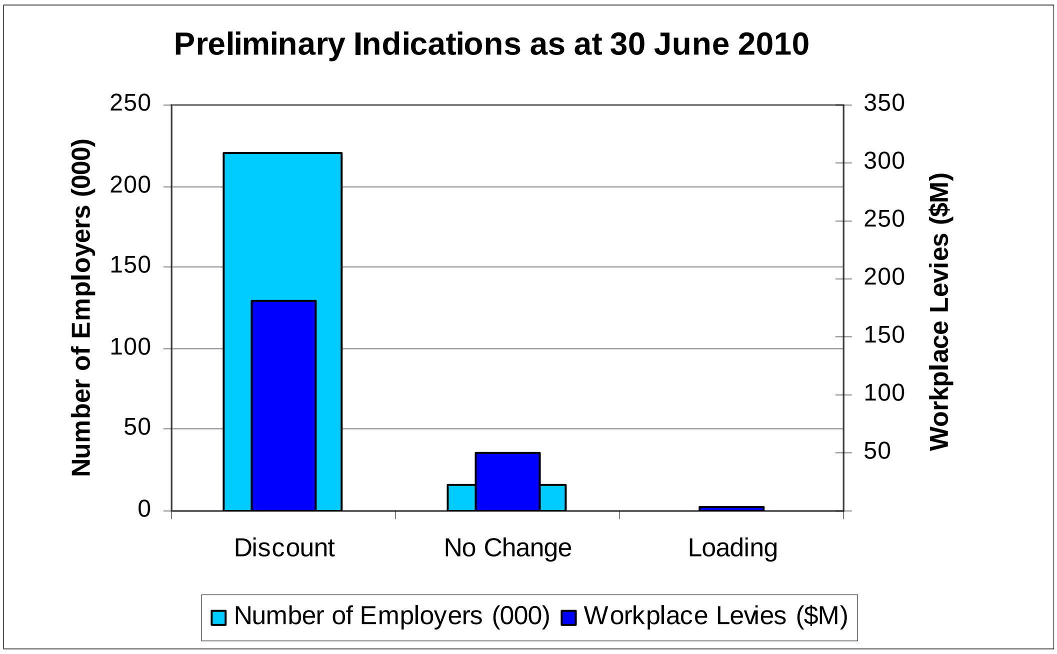
Discounts and loadings on the industry-based work levy

35. Experience rating results in some eligible employers receiving a discount on their standard industry-based work levy, and others receiving a loading. The graphs below outline the distribution of discount and loadings for employers based on the No-Claims Discount Programme and Experience Rating Programme consulted on by ACC.

36. Graph one shows preliminary indications of the distribution of discounts and loadings for employers in the No-Claims Discount Programme. The distribution is heavily weighted towards a discount because the majority of small employers do not have work-related injuries that result in weekly compensation being paid, which the programme recognises and rewards.

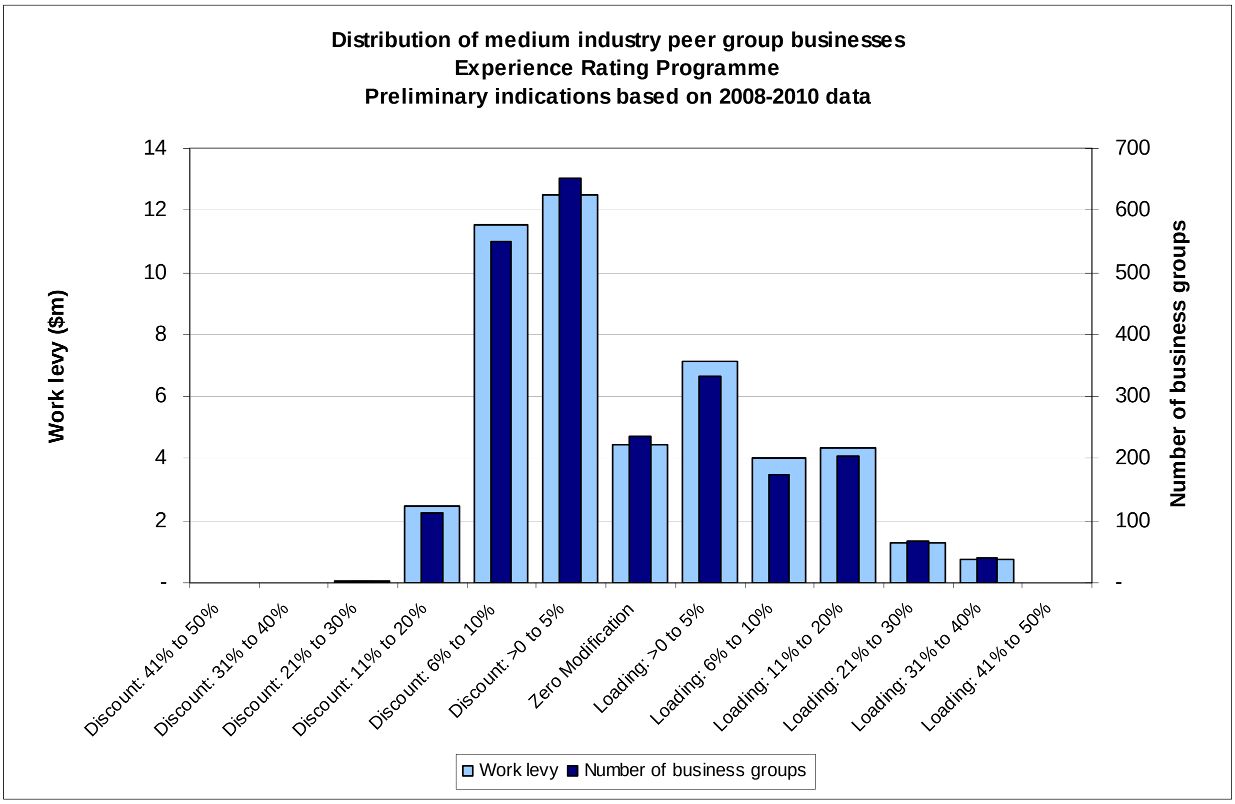
The maximum discount/loading that an employer could receive under this programme is $1,000; however, many employers will have a lower value discount/ loading.

Graph one: Distribution of discounts and loadings for employers in the No-Claims Discount Programme as at 30 June 2010

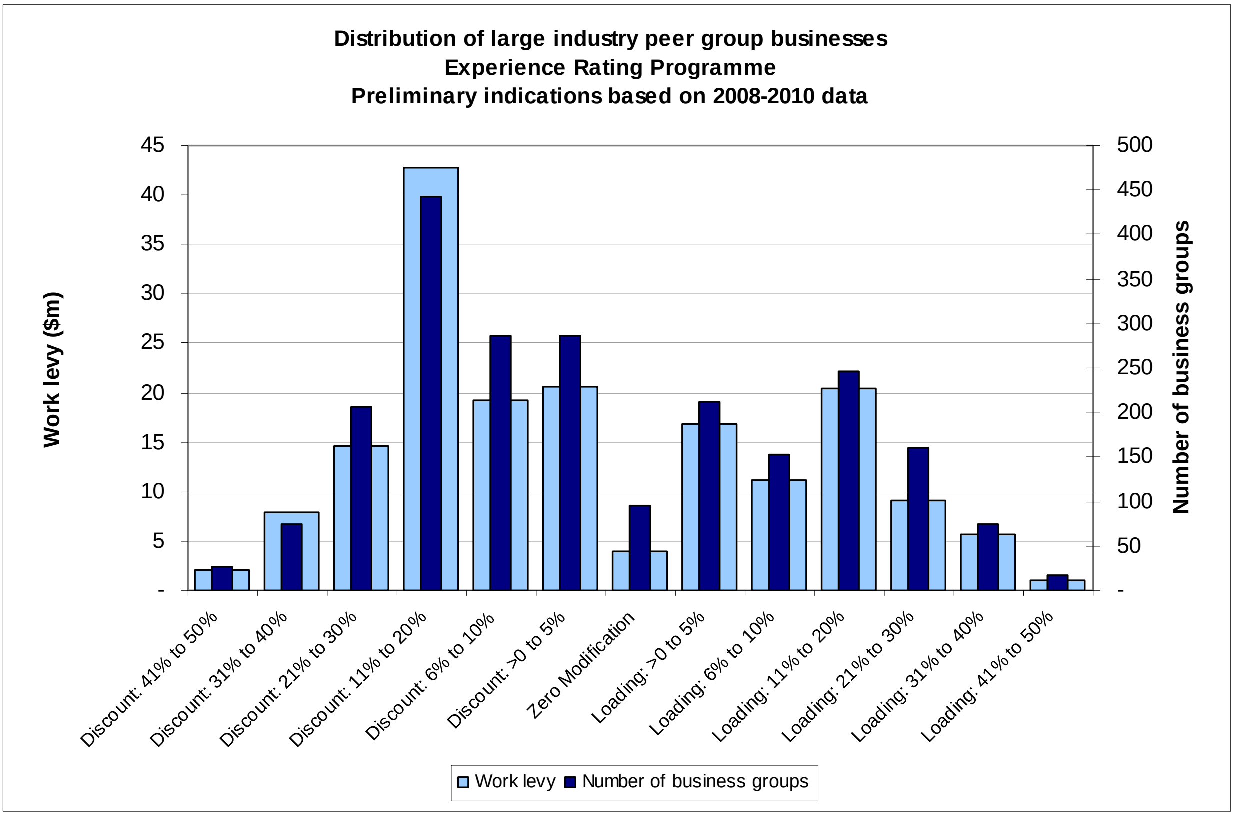


37. Graphs two and three show preliminary indications of the distribution of discounts and loadings for business groups in the Experience Rating Programme. As highlighted in the graphs, this Programme has a wider range of discounts and loadings and a greater distribution of employers across the different discount/loading thresholds. This reflects the extent to which an employer's claims history is sufficiently credible to be used for experience rating.

Graph two: Distribution of discounts and loadings for medium industry peer group businesses in the Experience Rating Programme as at 30 June 2010



Graph three: Distribution of discounts and loadings for large industry peer group businesses in the Experience Rating Programme as at 30 June 2010



Reduction in the incidence and impact of work-related injuries

38. One of the expected impacts of introducing experience rating in the Work Account is that the number of work-related injuries will decrease. Analysis of international experience rating systems indicates that such systems can result in lower claim numbers. The exact size of any reduction varies between systems, for example, from around 8% in British Columbia to 15% in the Netherlands.[iv]

39. While it is expected that experience rating will contribute to a reduction in the number and severity of work-related injuries, the exact size of this change is difficult to estimate due to the range of variables that influence the number of work-related injuries. These variables include the size and nature of the economy and workforce (ie the distribution of workers in low vs high risk industries), and wider macro-economic conditions (for example, during a recession businesses may reduce their output, and therefore their staff numbers, which can result in fewer work-related injury claims).

40. It is possible to model the potential impact of changes in particular areas of the Work Account. Table two illustrates the potential impact of the reduction in claims payments resulting from a decrease in new weekly compensation claims and the average number of weekly compensation days paid (1% in Year 1 and 2% in Year 2 and subsequent years) due to the introduction of experience rating.

Table two: Estimated reduction in claims payments as a result of introducing experience rating in the Work Account

	Year 1	Year 2	Year 3	Year 4	Year 5

Reduced claim payments for employer claims ($ m)[a]	2.62	5.32	5.61	5.92	6.13
Reduction in weekly compensation expenditure (%)[b]	2.3%	4.2%	3.9%	3.8%	3.7%

Table Notes:

a) It is assumed that new weekly compensation claims will reduce by 1% in Year 1, and by 2% in each subsequent year.

b) These figures represent the percentage difference between the estimated expenditure on weekly compensation under the status quo, and the estimated expenditure on weekly compensation as a result of introducing experience rating in the Work Account, as per a) above.

Impact on aggregate levy rates

41. While the costs of any experience rating levy discounts and loadings will largely offset each other, a small loading on the aggregate levy rate will be needed to account for some of the costs associated with experience rating

42. As the No-Claims Discount Programme is heavily weighted towards a discount, there will need to be a loading on the current portion of the average work levy. For the 2011/12 levy year this is expected to be approximately $0.03 for every $100 of liable earnings.

43. A loading on the current potion of the average work levy is also required to account for the fact that the industry size modification component of the Experience Rating Programme is also biased towards a discount. For the 2011/12 levy year this is expected to be approximately $0.02 for every $100 of liable earnings.

44. Loading the aggregate levy rate means that all employers, not only those who are experience rated, will pay for the experience rating programmes to some extent (depending on the size of their levy).

45. A reduction in the number and severity of injuries would, over time, have a positive impact on aggregate levy rates. Given the complexities of levy setting, including the need to estimate the liable earnings of levied employers and the cost of entitlements such as compensation and treatment, it is difficult and potentially misleading, to estimate the impact of a reduction in claims numbers and costs on the aggregate levy rate.

Impact on the Partnership Programme

46. For some members of the Partnership Programme (PP), specifically those in the Partnership Discount Plan (PDP), there is a possibility that the level of discount from the Experience Rating Programme may be similar to the discount they receive under the PDP. This may encourage PP participants to reconsider if there are sufficient benefits for them to remain in the PP, or whether they can achieve similar benefits (ie lower levies and less risk regarding claims costs and management) through experience rating.

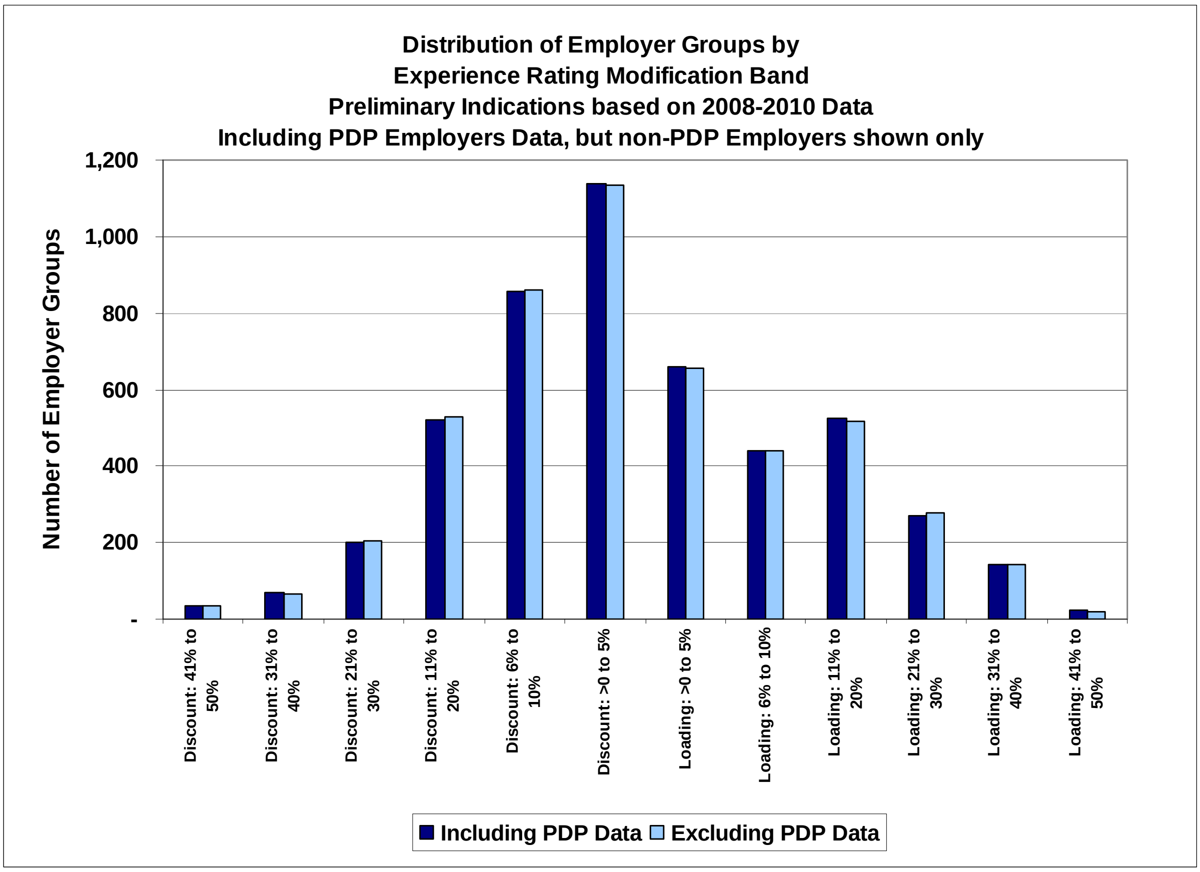
47. The employers most likely to consider leaving the PP are those in the PDP

that believe that they can achieve at least the same level of levy discount through experience rating. This group of employers already limits its risk exposure in comparison to those in the Full Self-Cover programme.

48. It is assumed that there is a lower likelihood of Full Self-Cover employers exiting the programme, particularly if they will pay a higher levy under experience rating or where the predominant reason for managing their own claims is to increase their control over injury management.

49. Analysis has been undertaken to look at the potential impacts on the Experience Rating Programme if all members of the PDP were to leave the PP and be experience rated. Graph four below compares the distribution of employers across the different recommended discount and loading levels for the Experience Rating Programme, with PDP employers included and excluded.

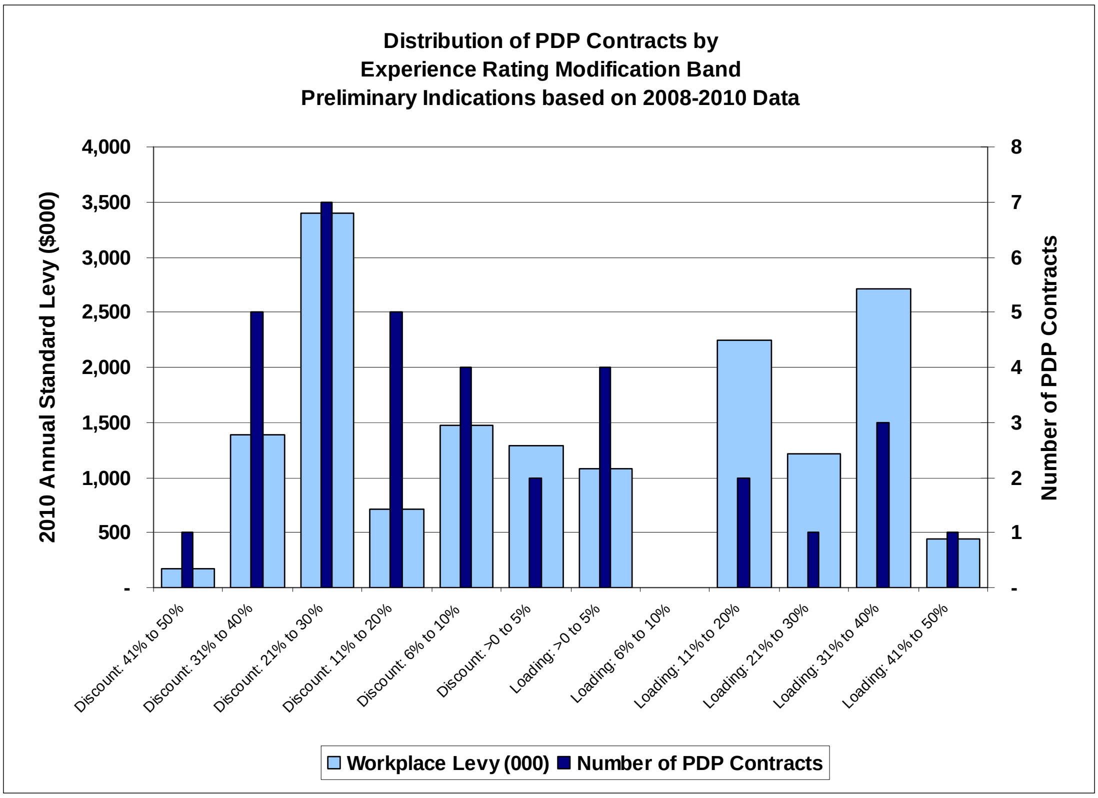
Graph four: Distribution of discount and loading levels for the Experience Rating Programme with PDP employers included and excluded



50. If all PDP participants were to join the Experience Rating Programme, the majority (99%) of employer (business) groups would have their experience rating discount or loading increased or decreased by less than 5% (against current estimates of the distribution of discounts and loadings). There is a bias towards an increase in the loading and a decrease in the discount due to the majority of PDP employers having better claims experience than non-PDP employers.

51. Graph five below shows the estimated distribution of experience rating discounts and loadings for PDP employers.

Graph five: Distribution of discount and loading levels experience rated PDP employers



52. Some levy risk groups would be affected more than others if all PDP employers were to be experience rated. This would occur where a PDP

employer dominates (in terms of liable earnings) the levy risk group. However, this effect is less if PDP employers who would receive a loading under experience rating remained in the PP.

53. If all PDP employers were to leave the PP and be experience rated no alteration would be needed to the aggregate work levy.

54. It is possible that some employers, such as those who receive significant loading on their levy through experience rating, may consider entering the PP as way of managing their risk and costs of work-related injuries.

Other potential impacts on employers

55. There are also a number of other potential impacts on employers, including:

- *Additional administrative requirements (eg around establishing business groups for experience rating*) – these are expected to be minimal as experience rating will be incorporated into the existing levy process. ACC has identified ways to minimise compliance costs on businesses (eg establishing a representative employer as the primary contact between ACC and a business group, and requiring business groups to be confirmed only once a year).
- *An increase in the number of disputes/reviews relating to whether a work injury has been allocated to the right employer, or disputing their levy calculation* – anecdotal evidence from when experience rating was applied in the Work Account in the 1990s suggests that reviews relating to claims attribution are likely to increase. However, at this point in time there is no strong basis for projecting the extent of this increase. ACC meets most of the costs of the review process, including engaging a Review Officer. If an employer has legal representation for a review they meet this cost themselves, unless the Review Officer awards them costs if their review is successful.
- *Employers who receive a loading through experience rating may have difficulty paying their levy* - this could result in debt management activity by ACC and potentially impact on the viability of a business. However, this risk should be offset by the fact that under the experience rating framework that was consulted on, more employers would receive a discount than a loading, which could result in more employers finding it easier to pay their levy. ACC will continue to employ its existing debt management processes, such as early contact with levy payers whose invoices are overdue, and working with those employers to identify appropriate payment options.

Impact on employees

56. The potential positive impacts of experience rating for employees are related to the incentives for employers to improve their focus on, and investment in, workplace health and safety, which is intended to result in fewer workplace injuries and less severe injuries where they do occur.

57. Research on experience rating models operated by other workers'

compensation schemes suggests that while there can be gains in workplace safety practices resulting from levy incentives, such schemes have a risk of incentivising perverse, or unintended, behaviours. These are discussed below. To varying extents, some of these potential impacts are already current issues within the ACC Scheme.

Work-related injury claims not being reported

58. Research on experience rating systems in other jurisdictions suggests that there is a risk that employees will be actively encouraged not to lodge a work-related injury claim with ACC. While it is not possible to quantify, it is almost certain that not all injuries that could qualify for cover under the ACC Scheme are lodged (for example, a person may have a minor injury that they do not seek treatment for). Given the lack of information about the extent to which injuries may be under-reported currently, it is not possible to estimate the scale of this potential impact.

59. The proposed experience rating measures (ie claims with over $500 in medical costs, and weekly compensation days paid) would mean that only moderate to severe, rather than all injuries, will be counted for experience rating purposes, which should mitigate the risk of large numbers of claims being under-reported, as more serious claims are likely to require medical treatment.

60. ACC will be working with health providers to ensure that they are fully informed about the ACC Scheme and experience rating, and to emphasise that where a patient seeks treatment they need to make appropriate enquiries to determine the cause of the injury and whether an ACC claim should be lodged.

Claims not being attributed to the correct ACC account

61. It is likely that the introduction of experience rating will increase the risk of work-related injury claims being deliberately misattributed to other ACC Accounts, particularly the Earners' Account. Currently, there is evidence[v] to suggest that a proportion of work injuries are misattributed to the Earners' Account, and that some of this may be deliberate. However, for claims that may be deliberately misattributed it is not possible to determine if this is due to employer pressure or other causes.

62. ACC already has a significant programme of work underway aimed at improving the accuracy of claims attribution across all Accounts. The main activities include:

- data validation (eg reviewing high cost claims to ensure they are correctly attributed)
- process improvements (eg data checks of injury type in the Earners' Account)
- systems improvements (eg removing some of the incentives for health

providers to lodge claims as non-work claims such as improving functionality so that work-related injury claims can be lodged faster and more accurately than previously)

- training and education for staff and providers (eg ACC's Relationship Performance Managers will provide training to health providers working with ACC, and follow up where data quality issues are known to exist).

63. Work is ongoing to address issues around deliberate misattribution of claims, including education of health providers, employers and employees on the experience rating system and the importance of accurate claims attribution, monitoring any abrupt changes in a business's safety record, and investigating them if necessary.

Inappropriate return to work

64. It is possible that the introduction of experience rating could increase the risk of employees returning to work before they are fully rehabilitated. There are checks and balances within ACC's legislative framework and operational practices that should mitigate against this risk, including:
    - ACC's involvement with clients in a case management capacity. ACC's requirement to prepare an individual rehabilitation plan in consultation with the client, their employer, and medical practitioner providing treatment, will help establish an appropriate approach to the employee's return to work
    - programmes such as 'Stay at Work' and 'Better@Work'[vi], which provide targeted claims management services to clients whose injury may affect their ability to work. Coordinators work with the employee, employer and medical practitioner to identify how a client may be able to take on alternative duties in order to reduce the period of incapacity, minimise economic loss, improve access to treatment and rehabilitation, assist with job retention and prevent the adverse consequences of unemployment.

65. In addition, ACC will be communicating regularly with employees, employers and treatment providers about experience rating, and improving their understanding of the benefits of appropriate, supported return to work for injured employees. ACC does not have the ability to address issues around the inappropriate return to work of employees who may have a work-related injury but have not lodged an ACC claim for that injury.

Potentially discriminatory employment practices

66. Experience rating may increase the risk that employers will ask job applicants about their injury and/or ACC claims history, and use any such information to make hiring decisions. ACC does not have the ability to identify or address any such practices.

67. The Human Rights Act 1993 provides protections against discrimination on prohibited grounds (including disability) for employees and job applicants. Employees and job applicants have the ability to make an enquiry to, or lodge

a complaint with, the Human Rights Commission.

Impact on other levy payers

68. There is a risk experience rating will result in work-related injuries being lodged as non-work related injuries, most likely to the Earners' Account. If this does happen there is a risk that it could negatively affect the levies charged in the other Accounts, especially the Earners' Levy.

69. As experience rating will only be applied in the Work Account, there may be an incentive for employers to focus on return-to-work outcomes for employees who have work-related, rather than non-work related injuries, as these outcomes are likely to affect their experience rating modification.

70. Both of the risks outlined above are mitigated by existing ACC policies and practices including active monitoring of claims attribution and ACC's case management and return to work practices (as outlined in the impacts on employees section above).

Operational impacts for ACC

71. There will be a number of operational impacts for ACC associated with the policy initiative, including:
    - commitment of organisational resources to the design and implementation of experience rating. The estimated costs associated with the implementation of experience rating are $14.9 million in 2010/11 and $3.5 million in 2011/12. Approximately half of the expenditure in 2010/11 is on developing the systems capability to introduce experience rating, with the majority of the remaining expenditure associated with operating costs, such as personnel.
    - increased administrative workloads and costs associated with any increase in the number of employer disputes/reviews (as outlined in paragraph 56 above)
    - greater involvement with employers in the ACC claims management process.

The relationship between experience rating and the Health and Safety in Employment Act 1992

72. Due to their different purposes and functions, there is no direct link between the ACC Scheme and the Health and Safety in Employment Act 1992 (HSE Act). As such, it is possible that an employer who has an enforcement action taken against them under the HSE Act may receive either a discount or a loading under the experience rating programme/s during the same period. The risk of a employer receiving a discount is minimised by the proposed experience measures, which should capture moderate to serious injuries (as a proxy for risk of harm), the time periods over which those measures will be applied (ie an employers poor experience will be captured over time), and the relatively small number of interventions taken by the Department of Labour (approximately 6,000 serious harm notifications and about 100 cases

prosecuted annually) in comparison to the volume of claims in the Work Account. Therefore, while an employer may receive a discount within the same year as an enforcement action is taken, their levy in future years will be based on any experience that led to the enforcement action (such as a serious harm incident in the workplace resulting in an ACC claim and time off work).

73. This will be an area where ACC will continue to work with the Department of Labour, particularly in relation to whether any changes are required, such as enhanced information sharing between the two agencies, to ensure that incentives are aligned, and the experience rating framework and HSE Act operate in a complementary way.

Consultation

74. ACC undertook a public consultation process seeking feedback on proposals to introduce experience rating into the Work Account[vii]. ACC also consulted, on behalf of the Minister for ACC, on the information collection requirements that employers will need to comply with for the purposes of experience rating.[viii] The consultation process started on 1 October 2010 with publication of notices in the New Zealand Gazette and in the five metropolitan newspapers. Submissions closed on 29 October 2010.

75. ACC's Chief Executive and General Manager of Insurance and Prevention Services sent letters and email advice of the start of public consultation to around 500 government agencies, District Health Boards, health sector organisations, major sector interest groups, trade associations and other interested parties. In addition, ACC has consulted directly with stakeholders most likely to be substantially affected by experience rating (eg large employers) and other interested parties (eg Business New Zealand, New Zealand Council of Trade Unions, and Federated Farmers).

Submissions on the experience rating proposals

76. A total of 113 parties provided substantive responses to the consultation on proposals to introduce experience rating in the Work Account. These were predominantly major employers and significant stakeholders (business and labour associations), together with a number of small employers.

77. The predominant sentiment from larger employers and industry representatives was one of support for the introduction of experience rating, though a number expressed concern at some aspects of the proposal. Employees' representatives and some small employers were more cautious, and highlighted possible negative aspects of the scheme, particularly related to claims reporting and claims management.

78. Some of the other themes to come through in the submissions were:

- there is wide support for continuing the existing discount programmes (WSD and WSMP) alongside experience rating

- the 10% loading/discount proposed for participants in the No-Claims Discount programmes was seen by some to be an inadequate incentive to produce behavioural change
- the increased risk of perverse or unintended behaviours was noted by many submitters. Employee representative organisations stressed the possibility of adverse effects on employees, including pressure to under-report injuries, and a stigma against previously injured job applicants
- several submissions emphasised the need for extensive training within ACC, within employers and employees, and within providers if the scheme is to be effective in reducing injuries
- a small number of submissions expressed lack of confidence in ACC's ability to promptly and accurately make work/non-work assessments, to manage injured persons back into work within an appropriate period, or to ensure that 'malingerers' are identified and correctly managed
- most employers and representative groups were supportive of the 50% maximum proposed for the experience rating programme modification. No submissions were received that questioned this proposed maximum.

Changes to proposals as a result of consultation

79. ACC consulted on proposals to change the discount levels provided through the WSD and WSMP, in both the experience rating consultation and the 2011/12 levy consultation process, to support the introduction of experience rating. Numerous submitters considered that reducing the discounts provided by these programmes would be counter-productive as they would serve as an insufficient behavioural incentive. As such, ACC recommends maintaining the current discount levels for these programmes.

80. No other changes to the proposed experience rating framework are recommended as a result of the submissions received. However, the recommended experience measure for the No-Claims Discount programme is different from that consulted on. In the consultation document the proposed experience measure for the No-Claims Discount programme was the 'number of weekly compensation claims reported on injuries that happen during the experience period'. To ensure consistency between the two proposed experience rating programmes, the experience measure that is now proposed is the 'number of weekly compensation days paid by ACC during the claim activity period on injuries incurred during the experience period', which is the same as the proposed rehabilitation measure for the Experience Rating Programme.

81. The Board agreed with Business New Zealand's suggestion that the experience rating framework should be reviewed three years after its introduction to ensures that it is meeting its stated objectives.

Implementation

82. The Minister for ACC received a letter containing the Board's advice on experience rating on 12 November 2010. These recommendations (which are set out in Appendix A) will be publicly released (via the New Zealand Gazette

and major newspapers).

83. Experience rating will be given effect through regulations. The regulations will be administered by the Department of Labour.

84. Experience rating will be incorporated into the existing levy process in the Work Account. Employers will be notified of their experience rated levy modification in their annual levy invoice. If experience rating comes into force on 1 April 2011, the first experience rated levy invoices will be issued to self-employed people in mid-April 2011, and all other employers from July 2011.

85. Employers will receive an ‘Experience Rating Claims Report’ twice a year. This report will provide details of the claims that will be used to determine their experience rating modification.

86. Once the experience rating regulations come into force, ACC will initiate contact with employers to establish business groupings for the experience rating programmes. Employers will be required to confirm their business grouping annually, and to notify ACC of any business transfers when these occur.

87. ACC has developed a communications strategy to support the introduction of experience rating. Communications are targeted at employers, employees, those who support businesses (such as accountants), as well as health providers, to provide them sufficient information with which to prepare for the introduction of experience rating. Experience rating information will be available through a range of channels, including ACC’s website, Account Managers (who work with employers), and Business Relationship Managers (who work with groups that advise employers, such as accountants).

Monitoring and review

88. ACC will regularly monitor and review a number of areas to assess the impacts and effectiveness of experience rating, including:
    - injury and claims attribution trends, particularly any changes in the allocation of claims between, and the type of claims in, the Work and Earners’ Accounts
    - trends in the number of disputes and reviews
    - the eligibility thresholds for the experience rating programmes, credibility weightings applied, and the discount/loading thresholds, to ensure that these continue to provide a credible basis for experience rating
    - the application of the business grouping rules, ensuring that these are appropriately capturing businesses that are commonly controlled and not overly complex for ACC and employers to administer
    - client satisfaction surveys will include questions that enable ACC to investigate whether experience rating may be impacting on rehabilitation outcomes.

89. Any proposals to change aspects of the experience rating system, such as the eligibility thresholds, will be publicly consulted on through the annual levy consultation process.

90. A review of the experience rating framework will be undertaken after the programmes have been in operation for three years. This review will look at whether the objectives of the experience rating programmes are being met, the extent to which the experience rating system may be promoting perverse behaviours, and if so, how any such behaviours are being managed. The views of business and employee representatives will be sought to inform this review.

Appendix A: The ACC Board's recommendations to Minister for ACC on introducing experience rating into the Work Account

1. On 12 November 2010 the ACC Board recommended the following approach to implementing experience rating in the Work Account to the Minister for ACC.

2. The objectives of the proposed experience rating framework are to:
   - provide a financial incentive to prevent injuries
   - encourage appropriate return-to-work programmes
   - make levies fairer for businesses by ensuring that low-risk employers do not subsidise high-risk employers.

   Key components

3. The proposed model applies a different method of experience rating depending on employer size. ACC is recommending that employer size is determined on the basis of the annual current work levy portion (i.e. excluding the residual levy).

4. Two experience rating programmes are recommended:
   - a **No-Claims Discount Programme** for small employers (including self-employed people)
   - an **Experience Rating Programme** for large employers.

5. The programme an employer will participate in will be determined at a business group level, and be based on their size as determined by the level of annual work levy (current portion). Employers will be grouped based on ownership/control of the workplace and assessed as if they were a single business.

6. Business groups must have liable earnings greater than the minimum annual liable earnings in each year of the experience period. The minimum amount will be set annually and mirror that of the minimum liable earnings amount set for full-time self-employed people.

   Time periods

7. The modification applied to an employer's levy in any given levy year will be based on their claims experience over the experience period.

8. Three key time periods are relevant to the application of the programmes:
   - **The experience period**: The three-year period (from 1 April to 31 March) in which work-related injuries happen and are counted for the experience rating programmes.
   - **The claim activity period**: The 3½ year period in which payments are made on claims incurred in the experience period. Payments on injuries incurred during the experience period will be included as at 30 September after the end of the experience period.

- **The levy application year**: The levy year (ending 31 March) in which any modification (either a discount or a loading) will be applied to the current portion of the work levy.

9. The table below illustrates the relevant time periods for the 2011/12 levy application year:

<table>
<tr><th colspan="6">Levy years</th></tr>
<tr><td>1/4/07 – 31/3/08</td><td>1/4/08 – 31/3/09</td><td>1/4/09 – 31/3/10</td><td colspan="2">1/4/10 – 31/3/11</td><td>1/4/11 – 31/3/12</td></tr>
<tr><td colspan="3">Experience period</td><td colspan="2"></td><td rowspan="2">2011/12 levy application year</td></tr>
<tr><td colspan="4">Claims activity period (to 30/9/10)</td><td></td></tr>
</table>

Claim types excluded

10. Asbestosis and work-related hearing loss gradual process disease and infection claims, and sensitive claims, will not be counted for any experience rating levy modification.

No-Claims Discount Programme

11. Business groups (including employers, self-employed people or non-PAYE shareholder-employees) whose current portion of their annual levy is less than $10,000 in any year of the experience period will be included in this programme.

12. Participants must also have liable earnings greater than the minimum annual liable earnings in each year of the experience period.

13. In the consultation proposal the experience measure used for the No-Claims Discount Programme was the number of work-related injury claims that receive weekly compensation during the experience period.

14. Following consideration of the final proposals the Board has decided to amend the proposal and recommend that the experience measure used for the No-Claims Discount Programme is based on the number of weekly compensation days during the experience period.

15. The new proposal will ensure that there is a consistent measure used across both programmes. It is important to note that the application of the measure is different for each programme.

16. A no-claims discount or high-claims loading will be applied to an individual participant's levy rate based on the number of weekly compensation days during the claim activity period for injuries that occurred during the experience period (first week compensation paid by an employer is not included). Any such claim will be measured for a maximum of 365 weekly compensation days.

Weekly compensation claims and duration	Levy adjustment
No weekly compensation claims	10% discount
1 – 70 weekly compensation days paid	no adjustment
more than 70 weekly compensation days paid	10% loading

17. In setting the target of 70 weekly compensation days paid before a loading is applied to a participant's levy, the focus is on rehabilitation of short-term claims, aimed at setting a balance between claim frequency and rehabilitation outcomes.

Experience Rating Programme

18. Business groups, whose current portion of their annual levy is equal to or more than $10,000 for each year during the experience period will be included in this programme. Participants can only be employers and non-PAYE shareholder-employees.

19. A business group's levy rate (current portion) will be modified based on their actual claims experience in comparison to their peers (i.e. similarly sized businesses within the same LRG).

20. The Experience Rating Programme modification will be a discount or loading of up to 50% and will be the total of the following two components:

- the industry size modification (up to +/- 15%)
- the experience rating modification (up to +/- 35%).

Industry size modification

21. The recommended industry size modification compares the performance of an industry peer group (medium or large) with the performance of all businesses within an LRG. The same industry size modification factor will apply to all businesses in the industry peer group.

22. ACC recommends establishing two industry peer groups to reflect the significant variations in risk profile between medium-sized and large business groups:

Industry peer group based at business group level	Average annual liable earnings
medium	up to and including $2 million
large	more than $2 million

23. The experience measure used in calculating the industry size modification is the number of weekly compensation days during the claim activity period for injuries that occurred during the experience period (first week compensation paid by an employer is not included).

Experience rating modification

24. The recommended experience rating modification is the weighted average of two modification components:
    - Rehabilitation component (75% of the experience rating modification)
    - Risk management component (25% of the experience rating modification).

25. The experience measures used in calculating the experience rating modification are:
    - **Rehabilitation component:** the number of weekly compensation days during the claim activity period for injuries that occurred during the experience period (first week compensation paid by an employer is not included). Any such claim will be measured for a maximum of 365 weekly compensation days.
    - **Risk management component:** the number of claims incurred during the experience period with cumulative medical and elective surgery costs greater than $500 as at the end of the claim activity period.

Credibility weightings for the experience rating modification

26. To ensure that the experience rating system is credible, the weight given to an employer's experience should reflect the size of their exposure to risk and be based on a reliable volume of claim activity.

27. The weight given to a business group's own experience is based on the business group's exposure to risk during the experience period, as measured by total liable earnings during that period. Applying a credibility weight to the formula means that business groups will receive more credibility as their exposure increases.

Experience Rating Framework thresholds

28. The recommended framework thresholds are as follows:

Application	Threshold	Recommended level
Programme participation level	Level of annual work levy (current portion) used to determine the programme a business group will participate in	$10,000
Experience period	The period used to determine which claims will be included in the experience rating framework	3 years
No-Claims Discount Programme (small employers)	Maximum discount/loading applied to the current portion of the Work Account levy	+/- 10%

Application	Threshold	Recommended level
• Number of weekly compensation claims and duration	The number and duration of weekly compensation claims used to determine the level of loading or discount for small employers	no claims = 10% discount 1-70 days paid = no change more than 70 days paid = 10% loading
Experience Rating Programme (large employers)	Maximum discount/loading applied to the current portion of the Work Account levy	+/- 50%
• Industry size modification	Maximum proportion of discount/loading applied to experience rating programme modification	+/- 15%
• Experience rating modification	Maximum proportion of discount/loading applied to experience rating programme modification	+/- 35%
- Rehabilitation component	Proportion of discount/loading applied to the experience rating modification	75%
- Risk management component	Proportion of discount/loading applied to the experience rating modification	25%

Business grouping rules and transfers rules

29. ACC is proposing to introduce grouping rules for the purposes of experience rating. The main objective is to group commonly owned or controlled businesses so that:

- experience rating is, as far as possible, based on common control of the workplace
- the claims histories of all entities that are under common control are taken into account when calculating a levy modification.

30. The rules need to ensure that businesses cannot deliberately organise their interests in order to get the most beneficial result from experience rating, for example by isolating poor performing businesses. To enable ACC to monitor and enforce the grouping rules, it is recommended that the regulations enable ACC to require the disclosure of certain information, such as the details of any person or persons who control a business.

31. It is recommended that the grouping rules, and rules about business transfers, are largely based on those that are applied in the Income Tax Act 2007. These rules will require employers to provide additional information to ACC. Each business group will be required to appoint a ‘representative business’ to notify ACC of the group’s make-up, including any subsequent changes. Disclosure of the group structure as at 1 April will be required by mid-April each year.

i The WSD programme is only open to employers in seven high-risk industries, and while any employer is able to apply to enter the WSMP programme, it is primarily targeted at medium to large employers.

ii There is fairly strong evidence that that the frequency of workers' compensation claims per hour worked tends to decline in recessions and increase in times of economic recovery (source: 'Issue briefing: Workers' compensation and the business cycle', Institute for Work and Health, March 2009).

iii Health and Safety Executive, *Changing business behaviour – would bearing the true costs of poor health and safety performance make a difference?*, 2002.

iv Research on the experience rating system applied in British Columbia (Campolieti, Hyatt and Thomason, 'Experience Rating, Work Injuries and Benefit Costs: Some new evidence', *Industrial Relations*, 2006, Volume 61, Number 1) found that the introduction of experience rating resulted in a reduction in the frequency of claims. However, the study was not able to attribute the reduction in claims directly to investment in health and safety or claims management behaviour. The study results indicated that experience rating may have the greatest impact on reducing medical treatment and short-term disability claims, and there was no evidence from this study that experience rating reduced the frequency of fatal injury claims, or the duration of absences from work. A study of experience rating in the Netherlands (Koning, Pierre, *Estimating the Impact of Experience Rating on the Inflow into Disability Insurance in the Netherlands*, Utrecht School of Economics, 2005) suggests that employers are influenced to increase preventative activities once they have experienced substantial increases in their levy rates.

v In 2008 and 2009, ACC undertook a survey to investigate client behaviour in relation to the Account attribution of claims at lodgement. The survey focused on claims attributed to the Earners' Account that possibly should have been attributed to the Work Account. The key findings from the surveys were that 11% (in 2008) and 8% (in 2009) of clients surveyed who had claims attributed to the Earners' Account said that their injury occurred at work. The survey was not sufficiently detailed to determine correct attribution for each accident and the misattribution rate reported in the surveys is based on clients' recollection and/or to what they were prepared to admit.

vi These programmes are based on research that shows that injured workers heal faster and avoid psychological impairment of they can safely recover in the workplace, or return to work as soon as possible after an injury.

vii As prescribed by section 331 of the Accident Compensation Act 2001.

viii Under section 332 of the Accident Compensation Act 2001.