Regulatory Impact Statement

2012/13 ACC levies

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Department of Labour (the Department). It provides an analysis of options for setting the ACC levies for 2012/13.

ACC levies are based on forecasts of a number of factors including injury rates, ACC performance, health care costs, wage inflation, long-term discount rates, and investment returns. Because these factors are forecasts, they are inherently uncertain. The robust actuarial process that levies go through each year aims to provide the most accurate levy rates from the available information. However, changes to the factors from year to year will change the level of funding that ACC requires (which is why ACC levies are updated annually).

A full actuarial review of ACC's liabilities and costs used in levy setting has been undertaken. This review has been independently actuarially quality assured and found to be reasonable.

The Department's advice to Ministers is based on consideration of ACC's funding policy and the independent actuarial review performed by the Department's contracted actuaries.

The policy options contained in this regulatory impact statement are not likely to have effects which do not align with the commitments in the Government Statement on Regulation.

22/9/11

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Problem definition

1 ACC's Work, Earners', and Motor Vehicle Accounts are funded on an annual basis by levies set in regulations. Because claims costs and other factors that affect ACC's assets and liabilities change, levies should be updated to ensure that the Accounts are fully-funded (or on the path to achieving full-funding). The paper first considers levy rates, and then discusses the funding target because this has a significant effect on the levy rates. The paper also briefly addresses minor changes to related levies policy.

Background on status quo

2 Each year Cabinet makes decisions on ACC levies so that these can be set in regulations. The Accident Compensation Act 2001 (the AC Act) requires ACC to develop a funding policy, consult with levy payers, and provide recommended rates to the Minister for ACC as part of this process. Public consultation was carried out from 19 July 2011 to 16 August 2011. Consultation and analysis of submissions has been completed, and the ACC Board provided its recommendations to the Minister for ACC on 26 August 2011. The Act also requires that these recommendations be considered by the Minister for ACC prior to the making of levies regulations.

3 The Department of Labour (the Department) provides the Minister for ACC with advice on the proposed levy rates. Each year the Minister for ACC, in consultation with Cabinet, makes decisions on ACC levies so that these can be set in regulations.

4 The following table outlines the ACC levies, who pays them and how they are paid:

Table 1: Who pays ACC levies and how

<table>
<tr><th rowspan="2">Levy payer</th><th rowspan="2">Work Account levy</th><th rowspan="2">Earners' Account levy*</th><th colspan="2">Motor Vehicle Account levy</th></tr>
<tr><th>Licence fee levy</th><th>Motor spirit (Petrol) levy</th></tr>
<tr><td>Employee</td><td>N/A</td><td>to IRD through PAYE, at flat rate</td><td rowspan="5">If they own a vehicle according to vehicle type</td><td rowspan="5">If they use a petrol vehicle, according to petrol usage</td></tr>
<tr><td>non-earner</td><td>N/A</td><td>N/A</td></tr>
<tr><td>self-employed</td><td>Direct to ACC based on industry risk and business' experience</td><td>Direct to ACC, at flat rate</td></tr>
<tr><td>standard employer</td><td>Direct to ACC based on industry risk and business' experience</td><td>N/A</td></tr>
<tr><td>accredited employer</td><td>Reduced amount direct to ACC based on industry risk</td><td>N/A</td></tr>
</table>

*Includes funding the Earner's Account portion of the Treatment Injury Account

Current levy rates

5 Levy rates were last set in December 2010 based on the information available at 30 June 2010. Since then there have been a number of changes to ACC's performance, the financial position of ACC and the assumptions used to calculate ACC's liability. This means that levy rates should be reconsidered to check whether they remain appropriate. Current levy rates for each Account are set out below (rates are GST exclusive).

Table 2: Current levy rates

	Work Account Average levy per $100 of liable earnings	**Earners' Account** Levy per $100 of liable earnings	**Motor Vehicle Account** Average levy per vehicle
Current 2011/12 rate	$1.47	$1.77	$334.52

Objectives

6 The AC Act requires levies to be set so that each Account achieves full-funding, having regard to levy stability over time and forecast uncertainty.

7 There are a number of other objectives for setting levies for the ACC, including that:

a the scheme is sustainable in the long term and is therefore adequately funded (the adequacy of funding is determined by the level of assets and liabilities; there is an outstanding question which is the subject of legal advice over whether ACC's interpretation of what should be included in its liabilities is correct around work related gradual process, diseases or infection (WRGPDI) claims)

b levies are relatively stable to allow businesses to plan with certainty

c there are incentives on employers and individuals to prevent injuries

d the principles of community and individual responsibility are appropriately balanced.

8 At a broad level, the Scheme is also premised on cost recovery, and over time levies should be responsive to changes in funding requirements to ensure fairness.

9 The Government is required to consider the wider interests of the Government and the public. Section 300 of the AC Act requires the Minister to have regard to the public interest and in particular the interests of taxpayers, levy payers, claimants and potential claimants when exercising any functions or powers under the AC Act.

Regulatory impact analysis

10 The AC Act requires each Account to be fully-funded with flexibility to allow for levy stability and uncertainty over time. It is Cabinet's decision what levy rate

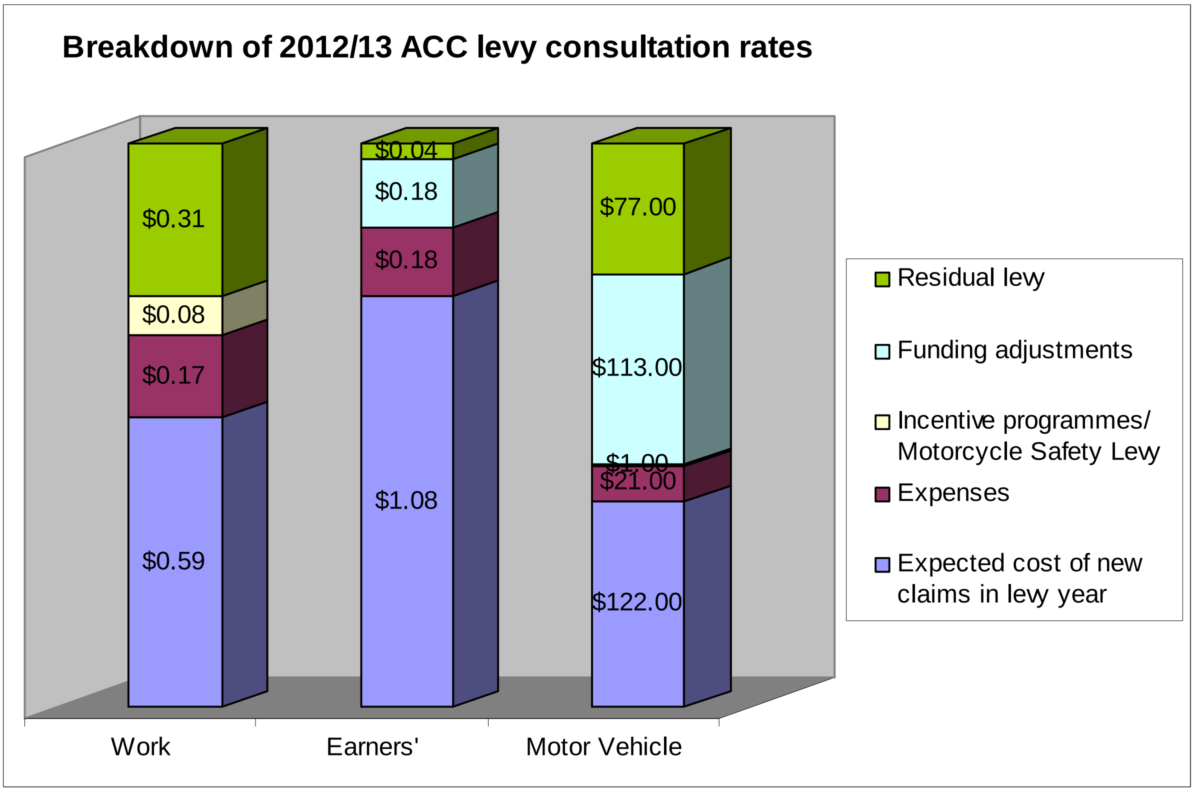
ACC will charge for the 2012/13 year in order for ACC to fully-fund claims for the 2012/13 year and what funding adjustment to apply to each Account to ensure that it is at a "fully-funded" level.

11 The portions of the 2012/13 levy rates which fully-funds claims for the 2012/13 year have been set based on a full actuarial review, followed by independent actuarial quality assurance. We consider the figures to be as robust as current information allows. This year ACC is expecting significant decreases in the cost of claims compared to the levy rates set last year.

12 The key question that Ministers should consider in setting levies this year is what funding position they wish ACC to be in, and therefore what funding adjustments (the portion of the levy used to increase or decrease ACC's funding position) to apply. While it is possible to choose any level of funding adjustment (so long as it is consistent with the Act's requirement for the Accounts to be fully-funded) we have presented two options for each Account based on different funding targets.

13 The following chart shows the proposed breakdown of the levy for each Account as consulted on by ACC (option A). The Work and Earners' Accounts are in dollars per $100 of liable earnings, and the Motor Vehicle Account is in dollars per vehicle (all excluding GST).

Chart 1: Breakdown of the levy for each Account



14 The following table shows the current levy rates, and two alternative options (all rates exclude GST):

Table 3: Levy rate options

	Work Account Average levy per $100 liable earnings	**Earners' Account** Levy per $100 liable earnings	**Motor Vehicle Account** Average levy per vehicle
Current 2011/12 rate	$1.47	$1.77	$334.52
Option A	$1.15	$1.48	$334.52
Option B	$0.84	$1.30	$230.00

Funding band

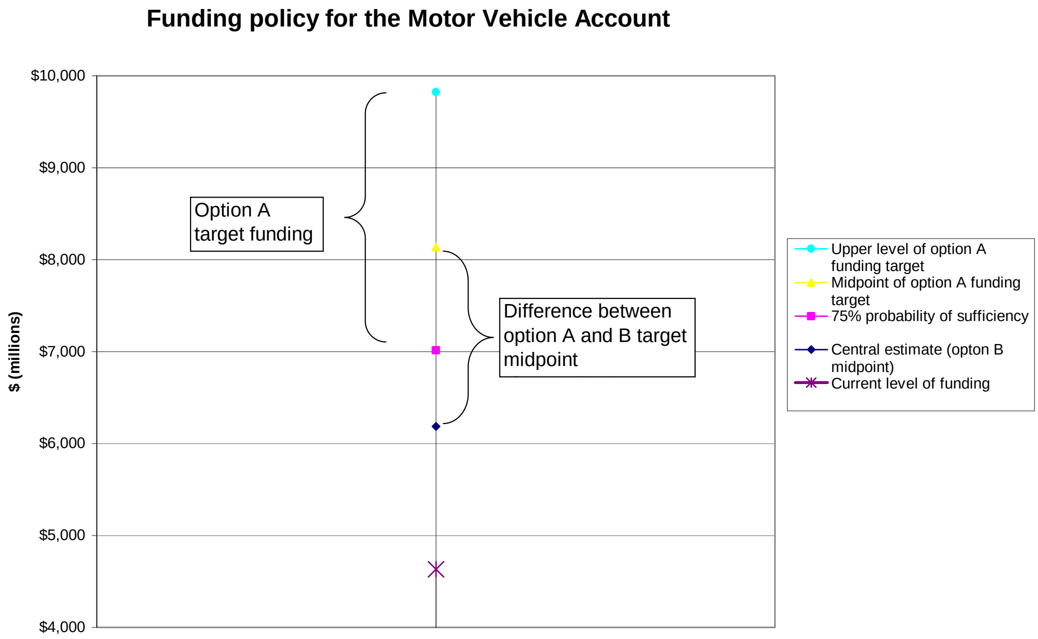
15 The targeted funding band for option A incorporates a one-in-twenty chance of breaching the upper and lower bounds of the proposed funding band, with a return to the mid-point over a 3-5 year period. The lower bound of the funding band is set at 100% of the expected liabilities which include a 75% probability of sufficiency risk margin. The midpoint of the funding band is set at 115.5% to 117.5% (depending on Account) of the expected liabilities including a 75% probability of sufficiency risk margin.

16 The funding band for option B has a mid-point of 100% of the expected liabilities without a risk margin. This would effectively be the target point for funding. Another reason that option B allows lower levy rates is because it considers the revenue stream required to be collected for the Residual Amount[1] through until 2019 to be an asset.

17 The following graph uses the Motor Vehicle Account as an example, and shows the current level of funding (at the central estimate, and with a 75% probability of sufficiency), the size of the funding band for option A, and the difference between the midpoint of options A and B.

[1] The Residual Amount relates to the unfunded liability for pre-1999 claims (and an allowance for work-related gradual process disease or infection claims in the Work Account) as at 30 June 2009 for each Account and was set by the 2010 Accident Compensation Amendment Act. It requires that a portion of the ACC levies be used to pay off these amounts by 2019.

Graph 2: Difference in funding targets for the Motor Vehicle Account



18 The difference in the levies set out in table 3 funding adjustment portion of the rates have been derived from Table 4:

a For the Work Account, under option A there is no funding adjustment; under option B, there is a negative $0.31 funding adjustment.

b For the Earners' Account, for option A, there is a positive $0.18 funding adjustment; under option B, there is no funding adjustment.

c For the Motor Vehicle Account for option A, there is a positive $113 funding adjustment, for option B, there is a positive $9 funding adjustment.

Table 4: Comparison of funding bands[2]

	ASSETS		LIABILITIES / FUNDING TARGETS		
Account	**Current assets**	**Current assets plus Residual Amount**	**Central estimate of liabilities and midpoint of Option B**	**75% probability sufficiency of liabilities (as shown in ACC accounts)**	**Midpoint of Option A**
Work*	$5,030m	$6,580m	$4,892m	$5,477m	$6,435m
Earners'	$5,270m	$5,540m	$5,021m	$5,606m	$6,475m
Motor Vehicle	$4,490m	$6,180m	$6,186m	$7,015m	$8,137m

* Work Account does not include work-related gradual process, disease, or infection (WRGPDI) claims where the exposure has occurred, but the claim has not yet been suffered.

[2] These figures are based on the information available at 30 June 2011. Since this time assets and liabilities will have fluctuated, and will be different.

19 In making decisions about the targeted funding policy, it is important to consider the most appropriate level of assets and how prudent the approach to estimating liabilities should be, and whether any additional margins should be applied over and above this.

20 The table above shows the difference between the assets as they currently stand and where they would be if the legislatively required income stream for the Residual Amount is included. It also shows the difference between the central estimate of liabilities (which is the funding target for option B), the estimate of liabilities if a risk margin with a 75% probability of sufficiency is included, and the target funding level for option A.

21 The second column in the above table shows the current level of assets of each Account.

22 The third column shows the level of assets plus the present value of the Residual Amount (the amount that the AC Act requires ACC to collect through until 2019). The reason for showing these together is that the liabilities of each Account include the costs of residual claims, so the amount that ACC is legally required to collect to fund these costs should also be shown.

23 The fourth column shows the central estimate of liabilities – the best estimate of how much claims will cost (with 50% chance it will be too high, and 50% chance it will be too low). This is also the midpoint of option B.

24 The fifth column shows the liabilities that are declared on ACC's accounts. This includes a risk margin which means that ACC has a 75% probability that assets will be too high, and a 25% chance it will be too low. This is also the low point of option B.

25 The sixth column shows the midpoint of option A

Objective: *The scheme is sustainable in the long term and is therefore adequately funded.*
Objective: *At a broad level, the Scheme is also premised on cost recovery, and over time levies should be responsive to changes in funding requirements to ensure fairness.*

26 Option A would result in ACC targeting a permanently "over-funded" position. This would represent a significant opportunity cost and revenue transfer from levy payers. Using the 30 June 2011 estimate of liabilities, if ACC was at its funding target for each of the Accounts, it would have held approximately $5 billon of levy payer funds over and above the central estimate of liabilities. Option A would impose a greater cost on business and taxpayers hampering economic growth.

27 For the Crown the risk of over-funding is no less than that of under-funding. There are no material short-term cash implications of under-funding, and a return to full funding can be achieved within a short period because of the statutory nature of levies.

28 The disadvantage of Option B is that this would mean that ACC's accounts would frequently appear to be in deficit because ACC has chosen to add a risk

margin, with a 75% probability of sufficiency, to the liabilities it declares in its accounts. This deficit would show on the Crown's Accounts. If ACC chose to use a probability of sufficiency closer to the central estimate, this would reduce the frequency that ACC would appear to be in deficit.

29 Option A involves building up large reserves compulsorily levied from businesses, earners and motorists. This would involve ACC collecting significantly more than required to cover its costs. These higher levies would build up a reserve until ACC reaches its funding targets and then, all things being equal, ACC would give the investment earnings from this reserve to future levy payers in the form of lower levies. This would involve transferring funds from today's levy payers to future years' levy payers, raising concerns about fairness.

30 There is an outstanding issue about whether the current funding method for post-1999 WRGPDI claims complies with the requirements of the AC Act. A legal opinion on this matter is being sought, however, if these claims should be funded from the date of exposure, then ACC's liabilities and funding requirements would increase significantly, affecting the adequacy of funding in the Account.

Objective: *Levies are relatively stable to allow businesses to plan with certainty.*

31 Option A is a smaller change from the current levy rates, and has been signalled in ACC's consultation documents. It would therefore be more stable and be more expected by businesses.

32 It is important that levy rates that are set are sustainable, and are not likely to need to change significantly in the future.

Objective: *There are incentives on employers and individuals to prevent injuries.*

33 Neither of these options would have significant effects on incentives to prevent injuries. However, option B would give more consistent pricing incentives to employers and individuals to prevent injuries. Option A involves building up large reserves in the short-term, and using these to reduce levies in the future, thereby giving inaccurate pricing signals.

Objective: *The principles of community and individual responsibility are appropriately balanced.*

34 This relates to differentiation of classes of levy payers within the aggregate rate, which is not at issue.

Other changes to levies policy

35 There were a number of other changes proposed in ACC's consultation document. These are all relatively minor and relate to sending appropriate signals to levy payers on injury prevention, affordability, equity, and balancing individual and community responsibility. The proposed changes, and the Department's comments on these changes are briefly set out in the following table:

Table 5: Other changes to levies policy

Proposed change consulted on	Department's comments
Not charging administration costs on the residual portion of levies (equal to $0.01 per $100 of liable earnings in the Work Account).	Department does not support this proposal. It considers admin costs should be charged on the residual portion because it is more important to avoid cross subsidisation than to make it is easier for ACC to explain.
Increasing the maximum and minimum liable earnings for the Work and Earners' Accounts	Department supports this update for inflation so that levies match up with income-related benefits
Capping the impact of classification unit changes on Work Account levies +15% or 0.02 cents, whichever is the greater, or -25%	Cap should be set with a balance between levy stability and charging the appropriate levy rate. Department does not support this change and recommends cap should be +/– 25%.
Changes to a classification unit in the Work Account	Department supports this update to improve risk pools
Creating a new classification unit in the Work Account	Department supports this update to improve risk pools
Increasing the maximum liable earnings for the Workplace Safety Discount Programme	Department supports this update for inflation
Increasing the minimum liable earnings for entry to the No-Claims Discount programme	Department supports this update for inflation
Changes to the classifications of motor spirit that the petrol levy is charged on.	Request from Customs New Zealand due to concern of potential over charging.

Effect of ACC levy rate proposals on the economy

36 The proposed decreases in levy rates would reduce the costs to individuals and the economy by the following amounts compared to existing levies:

Table 6: Effect of ACC levy rates on the economy

	Work Account		Earners' Account		Motor Vehicle Account	
Effect on the:	Individual	Economy	Individual	Economy	Individual	Economy
Option A	0.32% of wages	$280 million	0.34% of wages	$350 million	No decrease	No decrease
Option B	0.63% of wages	$550 million	0.53% of wages	$550 million	$114.52 per vehicle	$365 million

37 The Treasury has run ACC's proposed changes to the Earner's Account (option A) through their tax models and believes that the proposed changes to levy rates have no discernable distributional effect.

Results of public consultation

38 Section 331 of the AC Act requires ACC to consult on levy changes with levy payers. Public consultation was carried out from 19 July 2011 to 16 August 2011.

39 Many of the significant representative groups (Business New Zealand, NZ Council of Trade Unions, NZ Automobile Association and Federated Farmers)

do not support the high level of ACC's proposed funding bands (option A), with a number stating that funding at such a high level is inappropriate for a government monopoly.

ACC's analysis of public consultation

40 A total of 28 parties responded to the consultation on Work Account levies, significantly fewer than the 81 responses received last year, and the lowest number for many years. Submissions received were predominantly from significant stakeholders (employers' representatives and unions), and major employers.

41 Some of the key themes evident in submissions were:

a general support for the proposed reduction in the Work Account levy, with some concerns that the underlying assumptions may be fragile and optimistic

b general support for the change in funding policy, with some concerns related to the level of funded risk margin

c support for the proposed changes to classifications

d mixed comments relating to the proposed changes to workplace programmes

e a number of requests that injury prevention programmes be maintained or expanded

42 A total of five parties responded to the consultation on Earners' Account levies. These were from significant stakeholders (employers' representatives and unions), an employer, and a private individual.

43 The significant matters raised in the submissions were:

a general support for the proposed reduction in the levy rate

b some concern that the assumptions underlying the levy rate reductions might be optimistic

c Business New Zealand repeated their proposal that residual claims be funded from general taxation, and suggested that the level of funded risk margin be re-examined.

44 A total of 18 parties responded to the consultation on Motor Vehicle Account levies. These were predominantly from significant stakeholders (motoring bodies and the motor vehicle trade) along with a few from individuals. Key themes focussed on rates of levies for different classifications within the Account.

Conclusions and recommendations

45 The AC Act requires each Account to be fully-funded with certain flexibility to allow for levy stability and uncertainty over time. Cabinet chooses what levy rate ACC will charge for the 2012/13 year in order for ACC to fully-fund claims for the 2012/13 year and what funding adjustment to apply to each Account to ensure that it is at, or on a path to, a "fully-funded" level.

46 The portions of the 2012/13 levy rates which fully-fund claims for the 2012/13 year have been set based on a full actuarial review, followed by independent actuarial quality assurance. We consider the figures to be as robust as current information allows.

47 The Department considers that the key decision for Ministers relates to the level of funding adjustment. The key factor in determining the funding adjustment is whether ACC should hold a margin above the central estimate, and if so how much this margin should be.

48 Cabinet's decisions on levies should reflect the level of funding for ACC that it feels comfortable with. Table 4 "Comparison of funding bands" shows the level of assets, the level of liabilities, and the midpoint of the two funding bands.

49 In principle, the Department supports option B. The Department takes this position because we consider that, as a statutory monopoly with the power to post-fund any shortfalls if required, the midpoint of ACC's funding band should be 100% using a 50% probability of sufficiency. However there are some extenuating circumstances in both the Work and Motor Vehicle Accounts which lead the Department to recommend the higher rate of option A for these two accounts.

50 For the Earners' Account, consistent with option B, the Department recommends a levy rate of $1.30 (plus GST) per $100 of liable earnings.

51 While the Work Account could be considered overfunded, there is an outstanding issue about whether the current funding method for post-1999 WRGPDI claims complies with the requirements of the AC Act. For this reason we suggest the higher rate of $1.15 (equivalent to option A) for the Work Account. If WRGPDI claims are included, this would mean that the Account was not adequately funded, and therefore it would be inappropriate to charge a levy that would reduce ACC's funding position by returning funds to businesses.

52 For the Motor Vehicle Account we consider the levy rate should remain at $334.52 (equivalent to option A) because of the large deficit between current assets and the central estimate of liabilities and to be sure that improvements in performance are sustainable. We do not consider it would be in the interests of levy stability to significantly reduce levies in the Motor Vehicle Account when we are unsure that these levies will be sustainable.

53 The Department recommends the following levy rates:

Table 7: Department's recommended rates

	Work Account Average levy per $100 liable earnings	**Earners' Account** Levy per $100 liable earnings	**Motor Vehicle Account** Average levy per vehicle
Department's recommended 2012/13 rate	$1.15	$1.30	$334.52

54 If the option B funding band is used, as recommended by the Department, and current experience continues, significant levy reductions in both the Work and Motor Vehicle Accounts would be possible in future years.

Implementation

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

56 New levy regulations are required to be set by 31 March 2012 for the Work and Earners' Accounts. Otherwise the 2011/12 levy rates will remain in place from 1 April 2012.

57 If changes to the Earners' Account levy rates are to be in place on 1 April 2012 the Inland Revenue Department processes would require notification of approved Earners' Account rates by early-December 2011 so that payroll software developers can update, test, and distribute their systems updates.

58 New levy rates are required to be set by 30 June 2012 for the Motor Vehicle Account. Otherwise the existing levy rates will remain in place from 1 July 2012.

59 If changes to the Motor Vehicle Account levies are to be in place on 1 July 2012, the New Zealand Transport Agency and the New Zealand Customs Service require decisions on any changes to the classification structure before the end of the calendar year in order to make the necessary system changes.

Monitoring, evaluation, and review

60 ACC levies are reviewed on an annual basis using the following process, this is in effect a monitoring, evaluation and review process:

- The review of levies begins with the ACC commissioned independent actuarial assessment of ACC's liabilities as at 30 June (Due to election timing, this year ACC used an interim 31 March review, and subsequently updated its figures once the 30 June report was available). This assessment is then reviewed by the Department'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 policies, with the key goal of ensuring that the levies set will mean that ACC is fully-funded (or on the right path to achieving full-funding)
- ACC then publicly consults on proposals and provide recommendations to the Minister for ACC both on levy rates and on other changes to levies (such as changes to classification unit groupings or maximum liable earnings)
- The Department of Labour commissions an independent actuarial review of the recommended levy rates and provides advice to the Minister for ACC
- The Minister for ACC presents his recommendations to Cabinet.