REGULATORY IMPACT STATEMENT: 2011/12 ACC LEVIES

AGENCY DISCLOSURE STATEMENT

The update of ACC levies is a robust, structured process that takes place annually. ACC levy recommendations are based on the ACC's funding policy, which is reviewed annually by the Board, and feeds into the actuarial process set out below.

- An independent actuarial valuation of ACC's liabilities as at 30 June is undertaken.
- This valuation is independently reviewed by the Department of Labour's 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. This is used to calculate levy rates in line with the Board's funding policy.
- The Department's actuaries perform an independent actuarial review of the levy rates recommended by ACC.

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

ACC's levies are based on predictions 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 predictions, 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).

Any increase in the average Work Account levy or the average Motor Vehicle Account levy would impact on businesses. However, the Department does not consider any increase to these levies is necessary.

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Lesley Haines
Deputy Secretary, Workplace

CONCLUSIONS AND RECOMMENDATIONS

1 The table below provides a summary of the current 2010/11 rates, the rates consulted on, the ACC Board's recommended levy rates for 2011/12, the Department's advice, and the Minister for ACC's recommended rate.

Recommended levy rates for 2011/12[1]

	Work Account Average levy per $100 of liable earnings	**Earners' Account** Levy per $100 of liable earnings (GST inclusive)	**Motor Vehicle Account** Average levy per vehicle
Current 2010/11 rate / DoL recommended rate	$1.47	$2.04	$334.52
Consultation and ACC recommended rate for 2011/12	$1.47	$2.18	$342.96
Minister's recommended rate	$1.47	$2.04	$334.52

2 ACC is recommending the same levy rates as those consulted on for all Accounts. Following actuarial advice, the Department of Labour considers that there is no need to increase the levies above the 2010/11 level.

3 Although the methodology and assumptions used by ACC to reach their recommended rates are reasonable, the Department differs from ACC in a number of areas of funding policy:

a we do not consider that funding a risk margin is necessary. Not funding a risk margin would reduce levy rates.

b we do not consider that a funding target of 105% of liabilities is appropriate. Funding to a 100% level would reduce levy rates.

c we consider that the funding horizon (the time taken to return the Account to the funding target) should be shorter than the current 10-year horizon. A ten-year funding horizon significantly reduces many of the benefits of a full-funded scheme (costs falling where they lie, better price signalling, less intergenerational transfer, transparency). Reducing the funding horizon would increase levy rates.

4 Also, we consider that ACC's funding position looks considerably better if the approximately $5 billion that it is required to collect for the residual portion through till 2019 is taken into consideration.

5 The Department considers that the residual amount should remain at the same level as for the 2010/11 levies. It is better for costs to fall where they lie and the administration and collection costs for the residual amount should be paid as part of the residual portion rather than the current portion of the levy.

6 There are also a number of policy issues that have been raised by ACC. The Department supports the following changes that ACC is proposing:

ACC recommendation	**Reason for Department's support**
Increasing the petrol levy by 3 cents per litre from	Improves affordability for levy payers, more

[1] Levy rates quoted are GST exclusive for the Work and Motor Vehicle Accounts unless indicated otherwise, and GST inclusive for the Earners' Account (rates shown include current rate of 15%). The rate shown for the Earners' Account levy is the rate that earners will see coming out of their pay.

9.90 cents to 12.90 cents with a corresponding decrease in the licence fee levy	user pays
Capping the changes in levies resulting from changes in classification units at plus or minus 15%	Smoothes large increases in levies
Introducing a new classification unit in the Work Account to provide a suitable classification for existing levy payers that do not fit well within the current definitions	Correctly classifying this group will mean better pricing, which will improve the signals from pricing.
Increasing the maximum liable earnings entry criteria for the Workplace Safety Discount Programme from $495,000 to $499,000	This increase is in line with increases in the average wage which is appropriate because the maximum liable earnings is supposed to represent ten times the average wage
Updating maximum liable earnings levels to keep up with indexation of maximum weekly compensation	It is appropriate that levies are paid based on the level of income that claimants would get if they are injured
Updating minimum liable earnings levels in line with minimum wage	This change updates the regulations in line with increases to the minimum wage

7 We do not agree with ACC's recommendation to reclassify goods service vehicles because the reclassification would increase the levy for heavy vehicles significantly without giving affected levy payers sufficient opportunity to comment on the change (ACC did not propose this change in its classification document).

STATUS QUO AND PROBLEM DEFINITION

8 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 must be updated to ensure that the Accounts are fully-funded. Decisions also have to be made about how these levies are applied and collected.

Background on status quo

9 Each year Cabinet is required to make decisions on ACC levies so that these can be set in regulations. The Accident Compensation Act 2001 (the AC Act) requires ACC to consult with levy payers as part of this process. Public consultation was carried out from 1 October 2010 to 29 October 2010. Consultation and analysis of submissions has been completed, and the ACC Board provided its recommendations to the Minister for ACC on 12 November 2010. These recommendations must be advertised and gazetted by ACC.

10 The Department of Labour 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.

11 ACC is a Crown entity providing comprehensive, no-fault personal injury cover to all New Zealand residents and visitors to New Zealand. The objectives of the ACC scheme are:

- the promotion of injury prevention
- rehabilitation so that claimants' health, independence, and participation are restored to the maximum extent practicable
- ensuring that during rehabilitation claimants receive fair compensation for loss from injury.

ACC provides entitlements to claimants including treatment and rehabilitation costs, weekly compensation for earners, and lump sum compensation for permanent impairment.

12 ACC cover is managed under five separate Accounts. The source of funding and a general description of what these Accounts fund is listed below.

13 Three Accounts are funded exclusively through levies:

- *Work Account* – this Account is used to meet the costs of entitlements for work-related personal injuries, including work-related gradual-process, disease or infection and earners' non motor-vehicle injuries suffered prior to 1 July 1992. Employers can take on some level of self-insurance through the Accredited Employers' Programme. This allows employers to provide entitlements to injured workers in place of ACC, for a set period of time and/or to a set value of claim. This approach gives these employers a significant discount on their Work Account levy rate.
- *Earners' Account* - this Account is used to meet the costs of entitlements for earners' non-work injuries (that is, personal injuries other than work-related injuries, motor vehicle injuries, and treatment injuries) from 1 July 1992 onwards.
- *Motor Vehicle Account* – this Account is used to meet the costs of entitlements for motor vehicle injuries (that is, personal injuries suffered because of the movement of a motor vehicle, except for personal injuries suffered because of off-road use of a motor vehicle and certain work-related personal injuries).

14 One Account is funded from Parliamentary Appropriation:

- *Non-Earners' Account* – this Account is used to meet the costs of entitlements for non-earners' personal injuries (other than motor vehicle injuries or treatment injuries).

15 One Account is currently funded from the Non-Earners' Account and the Earners' Account:

- *Treatment Injury Account* – this Account is used to meet the costs of entitlements for personal injury caused by treatment by, or at the direction of, a registered health professional (other than treatment for a work-related personal injury).

16 The following table illustrates what levies levy payers pay, and how they pay it:

	Motor Vehicle Account levy			
Levy payer	**Licence fee levy**	**Motor spirit (Petrol) levy**	**Earners' Account levy**	**Work Account levy**
employee	If owns a vehicle according to vehicle type	If uses a petrol vehicle, according to petrol usage	to IRD through PAYE, at flat rate	No
non-earner	If owns a vehicle according to vehicle type	If uses a petrol vehicle, according to petrol usage	No	No
self-employed	If owns a vehicle	If uses a petrol vehicle,	Direct to ACC, at flat rate	Direct to ACC based on industry

	according to vehicle type	according to petrol usage		risk
standard employer	If owns a vehicle according to vehicle type	If uses a petrol vehicle, according to petrol usage	No	Direct to ACC based on industry risk
accredited employer	If owns a vehicle according to vehicle type	If uses a petrol vehicle, according to petrol usage	No	Reduced amount direct to ACC based on industry risk

Current levy rates

17 Levy rates were last set in December 2009 based on the information that was available at 30 June 2009. 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 the levy rates must be reconsidered to check whether they remain appropriate. Current levy rates for each Account are set out below.[2]

	Work Account Average levy per $100 of liable earnings	**Earners' Account** Levy per $100 of liable earnings (GST inclusive)	**Motor Vehicle Account** Average levy per vehicle
Current 2010/11 rate	$1.47	$2.04	$334.52

18 There are a number of regulations around the levy rates that affect who pays the levy or how it is paid. These decisions are reassessed because of changes in inflation or legislation, or to improve outcomes by altering incentives or improving equity.

PROBLEM DEFINITION

19 This year ACC is expecting only small increases in the cost of claims (which are a product of claim numbers, cost per claim, and claims duration), well within the current levy rate. The key question that Ministers must consider in setting levies this year is the rate at which they wish ACC to make up the deficit in its Accounts. As well as reviewing the levy rate for current year claims the fundamental questions for Cabinet are:

- what level of funding ACC should be targeting, and
- how quickly ACC should get to that level of funding.

20 There are a number of other changes recommended by ACC relating to how much individual levy payers should pay. These relate to sending appropriate signals to levy payers on injury prevention, affordability, equity, and balancing individual and community responsibility. Some of the recommendations are policy changes, and some are updates which are machinery in nature, or are due to inflation or other regulatory changes. The policy changes recommended by ACC this year, which are discussed further in this paper are:

a not charging administration costs on the residual portion of levies

b reclassifying goods service vehicles

[2] Levy rates quoted are GST exclusive for the Work and Motor Vehicle Accounts unless indicated otherwise, and GST inclusive for the Earners' Account (rates shown include current rate of 15%). The rate shown for the Earners' Account levy is the rate that earners will see coming out of their pay.

c changing the proportion of Motor Vehicle Account levy paid on petrol levy as opposed to on the licence fee levy.

d capping the effect on Work Account levies of classification unit changes

Updates which are machinery in nature, or are due to inflation or changes to the minimum wage and are not discussed in this paper are:

e changes to classification units within the levy risk groups in the Work Account

f creating a new classification unit in the Work Account

g increasing the maximum and minimum liable earnings

h increasing the maximum liable earnings for the Workplace Safety Discount Programme

OBJECTIVES

Principles underlying levy setting

21 The Woodhouse principles continue to be the overarching principles guiding the ACC scheme. Falling out of the broad principles are a number of objectives for the Accident Compensation Scheme, including that:

a the scheme is sustainable in the long-term and is therefore adequately funded

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

c employers and individuals received strong incentives to prevent injuries

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

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

23 There is no legislative requirement to review levies. However the levies are required to fully-fund ACC's liabilities. Because there are so many variables that affect these calculations ACC reviews its financial position and the sustainability of its levies on an annual basis.

24 Levies need to be set at rates that are appropriate to meet the objectives of the scheme, especially for the Accounts to be sustainable and fully-funded, this means that ACC's deficit must be recovered. The overall aim of the levy setting process is to determine appropriate levy rates that achieve these objectives.

REGULATORY IMPACT ANALYSIS

Analysis undertaken - actuarial review

25 The Department engaged Finity Consulting Actuaries (Finity) to undertake a quality assurance of ACC's methodology and assumptions in setting the levy rates.

26 Finity concluded that ACC has considered the last year to be a step change with the improved performance setting a new level to begin from, but with ACC expecting future performance to be similar to historic trends:

> ACC has estimated future claim costs and expenses based on the most recent experience, fully allowing for an additional year of claims inflation and forecast changes in frequency for each account. The levies also allow ACC to fund part of the deficit that has amassed for claims that occurred in previous years ("funding adjustments").

Total expected cost of claims

27 Claims experience over the last year has been significantly more favourable than ACC anticipated on each of the Work, Motor Vehicle, and Earners' Accounts.

28 As a result of improved experience, expected current year claims costs for both 2010/11 and 2011/12 are now lower than previously expected. Because of the reduced amount required to fund current year claims costs, a larger proportion of levy income collected has been apportioned to funding adjustments and this has helped improve ACC's overall funding position.

29 ACC's reports compare the updated expected cost of claims for 2010/11 with the expected cost of claims for 2011/12 rather than the expected cost of claims that were used in the last levy setting round. These reports show that the reasons for the changes in average levy rates across the Accounts between 2010/11 and 2011/12 are as follows:

Work Account

Levy Component	Current 2010/11	Proposed 2011/12	Increase in Levy $	%
Expected Cost of New Claims in Levy Year	0.68	0.71	0.03	4.4%
Expenses	0.19	0.21	0.02	10.5%
Cost of Incentive Programmes	0.04	0.07	0.03	75.0%
Funding Adjustment	0.15	0.17	0.02	13.3%
Residual Levy	0.41	0.31	(0.10)	(24.4%)
Total	1.47	1.47	0.00	0.0%

30 For current year claims ACC has allowed for inflation in average claim size and incorporated a small increase in claim frequency moving back towards longer term average claim rates. The portion of the levy collected for current year claims costs increased from 68 cents per $100 of liable earnings in 2010/11 to 71 cents in 2011/12. The reason for the increase is set out below.

Factor	%change
Number of workers	+1.8%
Frequency of entitlement claim	+2.7%
Cost of claim	+4.6%
Total increase	+9.4%
Earnings base	+4.3%
Total increase in levy for current claims	+4.9%

31 The allowance for expenses and the cost of incentive programmes (including experience rating) has also increased. However, ACC is reducing the funding adjustment collected towards prior year deficits, thereby offsetting increases in the current year levy components.

Motor Vehicle Account

Levy Component	Current 2010/11	Proposed 2011/12	Increase in Levy $	%
Expected Cost of New Claims in Levy Year	145	152	8	5.4%
Expenses	22	23	1	4.5%
Motorcycle Safety Levy	1	1	(0)	(20.9%)
Funding Adjustment	66	90	23	35.1%
Residual Levy	100	77	(23)	(23.3%)
Total	335	343	8	2.5%

32 ACC has allowed for inflation in average claim size, with claim frequency assumed to remain at the same level as in 2010/11. The reason for the $8 per vehicle increase in expected claims costs for the current year is set out below.

Factor	**%change**
Number of vehicles	+1.8%
Frequency of entitlement claim	No change
Cost of claim	+5.44%
Total increase	+6.7%
Total increase in levy for current claims	+5.4%

33 The overall amount per vehicle ACC proposes to collect towards prior year deficits is unchanged.

Earners' Account

Levy Component	Current 2010/11	Proposed 2011/12	Increase in Levy $	%
Expected Cost of New Claims in Levy Year	1.22	1.25	0.03	2.5%
Expenses	0.36	0.37	0.01	2.8%
Funding Adjustment	0.15	0.24	0.09	60.0%
Residual Levy	0.05	0.04	(0.01)	(20.0%)
Total	1.78	1.90	0.12	6.7%

34 The main driver of change is that ACC is increasing the amount collected towards prior year deficits. ACC has also allowed for inflation in average claim size which has increased the levy for current claims costs by 3 cents to $1.25 per $100 of liable earnings. The reason for the increase in expected claims costs for the current year is set out below.

Factor	**%change**
Number of earners	+2.0%
Frequency of entitlement claim	No change
Cost of claim	+4.8%
Total increase	+6.9%
Earnings base	+4.4%
Total increase in levy for current claims	+2.5%

Funding policy

35 The key reason that the Department considers that the levy rates do not need to increase is that we do not agree with many of ACC's funding policies. A change in funding policy would change the levy rate required.

36 Collecting a 75% probability of sufficiency risk margin and having a funding target of 105% means that ACC collects significantly more money than it expects to pay out in claims. The assumption of achieving only risk-free investment returns also adds to this over-collection. Mitigating these is that we consider that ACC should attempt to return to full-funding faster than ACC's policy of a 10 year funding horizon. Overall we consider that ACC's recommended levy rates are too high.

Risk margin

37 The risk margin on liabilities is intended to cover estimated future claims costs at a 75% probability of sufficiency. This means that there is an estimated 3 in 4 chance that actual claims costs will be less than is provided for in the levy rates. There is a 1 in 4 chance that actual costs will exceed the amounts allowed for in the levies.

38 ACC's chosen risk margin aligns with accounting principles, and is therefore appropriate for reporting purposes. However, it is a conservative approach when considering ACC's financial health because the risk margin is not expected to be paid out. In addition ACC's investment earnings, which supplement levy income, are expected to outperform risk free (Government bond) returns.

39 In summary, measuring funding using an accounting approach (i.e. risk free discounting plus a risk margin) has the following advantages and disadvantages:

a *Advantages:* consistency with financial statements; results in a stronger financial position and therefore increases the certainty that funds in each Account will be adequate to cover future costs

b *Disadvantages:* the level of over-collection of levies is not easily observed in the levy rates; intergenerational cross-subsidies are expected to arise and there is an opportunity cost to levy payers that could be avoided given ACC's ability to post-fund. The true "financial health", whether the existing assets and future levy and investment income can cover the future obligations of the ACC, is misrepresented under this approach.

Funding target

40 ACC has proposed to change its targeted funding ratio from 100% of liabilities to 105%. ACC previously targeted a funding ratio of 105% for residual liabilities and 100% for other liabilities. ACC's consultation documents state that the target funding ratio has increased to reduce the risk of insufficient assets to pay for future claim costs.

41 In other documents ACC has noted that a higher target funding ratio would provide reserves for one-off catastrophes such as earthquakes and provide a buffer to absorb investment risk. ACC has also noted that private insurance companies hold an excess of assets over liabilities.

42 Unlike a private insurance company ACC is able to adjust future levies to address deficits or surpluses. Although aiming to have more assets would increase the ability of ACC to pay claims, the legislated ability to post-fund deficits arguably gives ACC an even stronger ability to pay claims than actually holding the assets. If it were decided to introduce competition, this would likely still be the case because it would be appropriate for claims received prior to the introduction of competition to be separately managed and funded.

43 In a catastrophe ACC's ability to pay would relate to the level of liquid assets that ACC holds, not the total level of assets. ACC has large amounts of liquid assets available to

meet any short-term needs, for example claims arising from an earthquake. Holding more total assets would not improve ACC's ability to respond to a catastrophe.

44 To build up the additional 5% margin of assets over liabilities, in the short term ACC would need to charge levies that exceed the claims costs. This would lead to intergenerational cross-subsidies and there would be opportunity costs to levy payers of funding this margin rather than putting their money to other economic uses.

45 The Department's actuaries consider that, if the government or ACC wish to hold margins, then further work should be undertaken to articulate the purpose of the margin and quantify the size of the margin required. It may be helpful for ACC to identify the range of scenarios the margin mitigates and those it does not. The assessment of any overall margin to be held by ACC should allow for implicit margins already held, specifically the margins on liabilities and the conservative investment assumptions.

46 Moreover, a 5% buffer over 100% funding is small in comparison to the annual fluctuations in funding level that can be expected due to differences between actual and expected investment returns, changes in interest rates, and updated views on the value of very long term liabilities.

Funding horizon

47 The Department considers that a shorter funding horizon would provide better pricing signals, provide less cost shifting between levy payers in different years, and better reflect a full-funded scheme.

48 The Department's actuaries have advised that it is difficult to view a horizon of more than ten years as being consistent with a fully-funding philosophy. In a "normal" environment ACC should consider adjusting this horizon for returning to full funding to be more like 3-5 years. Anything less than three years would create too much volatility in the levy rates.

Proportion of the levy apportioned to the Residual Amount

49 Currently the administration and levy collection costs are split across the current and residual portions of the levy. ACC recommends that all administration and levy collection costs be collected on the current portion of the levy to make the proportion of the levy going to the Residual Amount (an amount set in legislation to pay-off pre-1999 claims liabilities) more transparent to levy payers.

50 The effect of this change would be to reduce the residual portion of the average Work Account levy by $0.10 per $100 liable earnings, the Earners' Account levy by $0.01 per $100 liable earnings, and the average Motor Vehicle Account levy by $23.39 per vehicle, with an offsetting increase in the current portions of each levy.

51 The Department considers that administration and levy collection costs for the residual portion of the Account should continue to be charged to residual levy payers because it is fairer for costs to fall where they lie.

Why is this an issue?

52 Because of the offsetting increase in the current portion of the levy, the proposed change would have no effect on those who pay the Earner's Account and Motor Vehicle Account levies.

53 However, this change would have an effect in the Work Account. The residual portion of the Work Account levy is paid by all employers based on historic industry risk rating,

while the current portion is paid based on current industry risk rating, and the employers of 20% of the workforce (those in the Accredited Employers programme) pay only a portion of the current levy.

54 Because of the difference in those who pay the levy and the rate they pay in the Work Account it is important that the costs be correctly allocated.

Work Account

55 The AC Act requires the Work Account to be fully-funded with certain flexibility to allow for levy stability and uncertainty over time. Cabinet must decide what levy rate ACC will charge for the 2011/12 year in order for ACC to fully-fund claims for the 2011/12 year and to return the Account to a "fully-funded" level. Any level of funding could be set so long as it achieves these goals. ACC and the Department agree that the levy rate should remain at $1.47 per $100 of liable earnings.

Funding for work related gradual process, disease, or infection claims

56 Given the funding position of the Work Account (expected to be a deficit of $933 million at 31 March 2011) and the residual amount yet to be collected (expected to be $2,668 million at 31 March 2011) there may be an opportunity to reduce levies from the 2010/11 rate. However, we do not consider that this is appropriate now because there will be additional claims made on the Work Account in future years that relate to exposure to injury-causing agents in the current year but where the gradual process, disease, or infection will not present itself for several years.

57 Officials consider that further work ought to be done on the funding of work related gradual process, disease, or infection claims, which could potentially require legislative change to require ACC to charge levies for these claims at the time of exposure.

Capping in the Work Account

58 In the Work Account ACC has capped the changes for any levy payer resulting from movements in classification units to +/- 15%. If the calculated change in levies is outside this range then ACC spreads the cost difference over all other levy payers. Cabinet can choose to cap the effect of changes in classification units at any level, or for there to be no cap. Last year capping was applied at +/- 25%.

59 Capping helps reduce the impact of changes in levies on individual employers, and the ability to smooth rates is a potential advantage of ACC being a monopoly provider of workers' compensation insurance. However, industry relativities are intended to signal high claims cost to employers, and so capping rates can reduce the effectiveness of these signals. In addition, the resulting smoothing required from capping rates results in a cross-subsidy between levy payers because it prevent levies reflecting relative claim costs.

60 Although capping distorts pricing signals we consider that a cap is necessary and a 15% cap on classification unit changes is reasonable if experience rating is also being introduced. This is because experience rating would also provide significant changes to pricing for individual levy payers.

Earners' Account

61 The Accident Compensation (AC) Act requires the Earners' Account to be fully-funded with certain flexibility to allow for levy stability and uncertainty over time. Cabinet must decide what levy rate ACC will charge for the 2011/12 year in order for ACC to fully-fund claims for the 2011/12 year and to return the Account to a "fully-funded" level. Any level of funding could be set so long as it achieves these goals. ACC recommends a

rate of $2.18 (including GST) per $100 of liable earnings while the Department of Labour recommends a rate of $2.04. The reason that the Department recommends a lower rate is because we consider ACC's funding policy is overly prudent, as set out in the section on funding policy above.

Modelling the economic effect of changes to levies

62 Modelling the effects of increases in levies was only done for the Earners' Account because ACC did not propose any increase to the Work Account, and the Motor Vehicle Account increase of $8.44 per vehicle was considered too small to have any effect on the economy.

63 The Treasury has run the proposed changes to the Earner's Account levies through their tax models and believe that they have no discernable distributional effect. Costings are indicative estimates only – the figures presented may differ from official departmental forecasts and cost estimates.

	Current Settings 2010/11	**Proposed Settings 2011/12**	**Difference**
Levy Rate - GST inclusive	$2.0 / $100	$2.18 / $100	$0.18
Max Earnings Limit	$110,018	$111,669	$1,651
Revenue ACC/GST ($ millions)	$1,902	$2,077	$175
Impact on equality measures			
Gini Coefficient 80 / 20 Ratio	No discernable first round aggregate impact on equality measures of HHs equivalised disposable income from proposed changes		

64 **Notes to the table**:

- The analysis compares fiscal cost estimates for the tax years 2010/11 and 2011/12 using Treasury's static micro-simulation model 'Taxwell'.
- The Treasury developed the Taxwell static microsimulation model to model the taxation and benefit impact on individual disposable income, for costing and analysis purposes. All attempts have been made to ensure the correctness of the model and the information used, although some statistical inaccuracies may still be present. The results presented are based on sufficient sample sizes, and the size of the sampling and non-sampling errors are not calculated.
- The analysis is based on Statistics New Zealand's 'Household and Economic Survey' (HES) 2008/09 – the data is adjusted to reflect macroeconomic assumptions and settings from the Budget Economic and Fiscal Update (BEFU), 2010 and Statistics New Zealand's population forecasts for the tax year 2011/12.
- Scenarios reflect the new personal tax rates from 1 October 2010.

65 The proposed increases in levy rates will have the following effect on the economy:

a The proposed increase in the composite Earners' Account levy rate from $2.04 to $2.18 per $100 of liable earnings would reduce in the hand earnings for people earning under approximately $110,000 by 0.14%. With liable earnings expected to be approximately $100 billion in the 2010/11 year this would remove $140 million of spending power from the economy.

66 Not increasing the levy in line with ACC's recommendation would have the following effects on ACC:

a the Earners' Account levy would receive $120 million less levy revenue compared to ACC's projections. Assuming no other changes to ACC's projection assumptions the funding ratio at the end of 2011/12 would be approximately 1.7% lower than the 91% projected by ACC.

Motor Vehicle Account

67 The AC Act requires the Motor Vehicle Account to be fully-funded with certain flexibility to allow for levy stability and uncertainty over time. Cabinet must decide what levy rate ACC will charge for the 2011/12 year in order for ACC to fully-fund claims for the 2011/12 year and to return the Account to a "fully-funded" level. Any level of funding could be set so long as it achieves these goals. ACC recommends a rate of $342.96 per vehicle while the Department of Labour recommends a rate of $334.52. The reason that the Department recommends a lower rate is because we consider ACC's funding policy is overly prudent, as set out in the section on funding policy above.

68 The proposed increases in levy rates will have the following effect on the economy:

a The proposed increase in the composite average Motor Vehicle Account levy from $334.52 to $342.96 averages $8.44 per vehicle, this works out to be approximately $27 million plus GST across road users.

69 Not increasing the levy in line with ACC's recommendation would have the following effects on ACC:

a the Motor Vehicle Account would receive $27 million less levy revenue compared to ACC's projections. Assuming no other changes to ACC's projection assumptions the funding ratio at the end of 2011/12 would be 0.4% lower than the 72% projected by ACC.

Options for adjusting the petrol levy or annual licence fee levy for petrol powered vehicles in the Motor Vehicle Account

70 ACC consulted on increasing the motor spirit (petrol) levy portion of the composite Motor Vehicle Account levy by 3 cents to 12.9 cents per litre of petrol. Cabinet can choose any level of petrol levy from 0 cents through to collecting 100% of the Motor Vehicle Account levy on petrol. The Department agrees with ACC's recommendation to increase the petrol levy by 3 cents per litre.

71 The levy for diesel vehicles is paid entirely on the licence fee and is not affected by changes to the petrol levy. Work to introduce a levy for diesel vehicles based on distance travelled is a separate project being discussed with the Ministry of Transport.

72 The main benefits of the licence fee levy are that petrol use is only a rough proxy for risk, and a fuel efficient vehicle is not necessarily safer but its user would pay less petrol levy, which is not fair to owners of less fuel efficient vehicles.

73 The main benefits of the petrol levy are:

a increases affordability, particularly for those on low incomes (for whom the lumpy cost of licensing fees has a greater impact than the small variable cost of a petrol levy). Warrant of Fitness compliance is also associated with licence fee compliance and therefore this has implications for vehicle safety.

b it is unavoidable for petrol-driven vehicles, which means less free-riding by people avoiding paying levies c reduces the level of cross-subsidisation for owners of two or more vehicles who do not use more than one vehicle at a time

d allows people, particularly those on fixed income such as retirees, to alter their behaviour to reduce their levy payment.

74 For these reasons the Department supports increasing the petrol levy.

Changes to the goods service vehicles categories

75 ACC recommends that the Motor Vehicle Account levy for light goods service vehicles (GSVs) be differentiated from heavy GSVs to better reflect the actual risk of these vehicles, and to reduce cross-subsidies.

76 During the 2011/12 public consultation ACC consulted on no changes to the structure or membership of the current vehicle classes, or their relativities. However, it received a number of submissions suggesting that light GSVs be differentiated from heavy GSVs.

77 GSVs includes utes, vans, and trucks and can be used for commercial purposes or for private use. The levy relativities (against passenger vehicles) for GSVs increased last year.

78 For 2010/11 it is estimated that non-petrol powered vans and utes are paying between $25-28m too much in levies. For petrol powered vans and utes the level of cross-subsidisation is much lower at around $3m.

79 The available data shows that GSVs do not present a homogenous risk within the existing GSV classes for levy setting and there is a significant cross-subsidy between trucks and smaller GSVs. Splitting heavy GSVs from light GSVs would provide more homogenous groupings and more closely link claims experience to levy rates.

80 ACC recommends that the relativities for GSVs be based on indicative experience for the new sub-classes, with light vehicles set at 112% of a standard vehicle and heavy vehicles at 223%. The impact on levy rates of such a change is set out below:

	Petrol powered				Non-petrol powered			
Vehicle	**Current 2010/11 levy (total incl. petrol)**	**Current total levy relativity**	**Rec. 2011/12 levy (total incl. petrol)**	**Rec. total levy relativity**	**Current 2010/11 levy**	**Current total levy relativity**	**Rec. 2011/12 levy**	**Rec. total levy relativity**
Light goods service vehicles 3,500 kg or less	$383.02	121%	$366.17	112%	$467.08	150%	$366.17	112%
Heavy goods service vehicles over 3,500 kg	$383.02	121%	$729.07	223%	$467.08	150%	$729.07	223%

81 The Department advises against agreeing to this change now because more consideration and consultation is required, particularly with the trucking sector. Also it seems inconsistent to address this area of cross-subsidy in the Motor Vehicle Account when other areas (particularly motorcycles) are not being addressed.

82 The Department also has concerns that ACC has not included an adjustment of the petrol usage assumption for petrol GSVs over 3,500kg in its proposal. We consider it likely that these vehicles will already be paying higher ACC levies through the levy on petrol consumption.

83 The Department considers that this proposal has merit and should be included in next year's levy consultation.

CONSULTATION

84 Section 331 of the AC Act 2001 requires that ACC undertakes public consultation on proposed levy rates for each of its levied Accounts prior to recommending rates to the Minister. ACC carried out public consultation with levy payers from 1 October to 29 October 2010.

85 A total of 81 parties responded to the consultation on Work Account levies, predominantly from significant stakeholders (employers' representatives and unions), and major employers. Some of the key themes evident in submissions were:

- general concern that the 'current portion' of the work levy is increasing but the compensating effect of the 'residual portion' reducing appears to not be taken into account
- a significant number of industries and employers are seeking further information on the way in which proposed prices and Levy Risk groupings have been assessed
- general support for the proposed restructuring of the Levy Risk Groups
- a number of requests that current incentive programme discounts are maintained, at least for a transitional period
- a number of requests that injury prevention programmes be maintained or expanded.

86 A total of 14 submitters [significant stakeholders (employers' representatives and unions), and private individuals] responded to the consultation on Earners' Account levies. The main theme of the feedback was a lack of support for a 6.7% increase for the composite earners' levy. The New Zealand Council of Trade Unions recommended that any increase should be limited to a 2.5% increase in claims costs. Other submitters did not support any increase.

87 A total of 50 parties responded to the consultation on Motor Vehicle Account levies, predominantly significant stakeholders (motoring bodies and the motor vehicle trade) along with a few from individuals. Common themes within the submissions received were:

- a number of proposals to introduce measures to differentiate light diesel vehicles (often used by private persons) from heavy commercial vehicles
- widespread support for further investigation into options for risk based levy setting
- support for investigation and/or introduction of a safety-related discount programme. This would be welcomed by private owners of multiple vehicles, as well as commercial fleet operators.
- the majority of submissions related to the petrol levy support the proposed increase
- there was some support for collecting levies on a mileage basis from diesel vehicles
- there was little comment on the overall vehicle classification structure.

88 The ACC Board provided its recommendations to the Minister on 12 November 2010. These recommendations must be advertised and gazetted, and the Minister has asked the Board to do this in line with his announcements of the 2011/12 levy rates.

89 ACC and the Treasury were consulted on the Cabinet paper; Inland Revenue Department, NZ Transport Agency, the Department of the Prime Minister and Cabinet, the New Zealand Customs Service, Te Puni Kokiri, and the Ministries of Social Development, Transport, Womens' Affairs, and Pacific Island Affairs were informed.

IMPLEMENTATION

90 New levy regulations are required to be set by 31 March 2011 for the Work and Earners' Accounts. Otherwise the 2010/11 levy rates will remain in place from 1 April 2011.

91 If changes to the Earners' Account levy rates are to be in place on 1 April 2011 the Inland Revenue Department processes would require notification of approved Earners' Account rates by 10 December 2010 so that Payroll software developers can update, test, and distribute their systems updates.

92 New levy rates are required to be set by 30 June 2010 for the Motor Vehicle Account. Otherwise the 2010/11 levy rates will remain in place from 1 July 2011.

93 If new Motor Vehicle Account levy rates are to be charged on 30 June 2011, the New Zealand Transport Agency and the New Zealand Customs Service require any proposed changes to the classification structure before the end of the calendar year in order to make the necessary system changes.

MONITORING, EVALUATION, AND REVIEW

94 ACC levies are reviewed on an annual basis using the following process:

- The review of levies begins with the 30 June independent actuarial assessment of ACC's liabilities. 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 the 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 provide advice to the Minister for ACC.
- The Minister for ACC presents his recommendations to Cabinet.

95 The Department recommends undertaking further work to look at the funding of gradual process disease and infection claims in the year of exposure rather than at the time the injury presents itself.