## Regulatory Impact Statement

## Response to the recommendations of the ACC Stocktake

## Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the Department of Labour. It provides an analysis of three options for introducing greater employer choice into the Accident Compensation Corporation's (ACC) Work Account.

The analysis in this RIS focuses solely on the Work Account and assumes that the broader scheme design (including coverage and entitlements) remains unchanged. The options that officials have been asked to consider relate only to the introduction of greater employer choice, and comprise three broad options:

- Expansion of the existing Accredited Employers' Programme (AEP);
- Expanding employer choice to allow all employers access to choose private underwriting but retaining ACC in its current form;
- Opening up the Work Account to full competitive underwriting, with the government participating in the market in a competitively neutral form or not at all.

There are constraints on the quantitative analysis in this RIS. Firstly, there are inherent difficulties in estimating the likely economic benefits. While there are theoretically significant benefits to be achieved from moving to an environment of greater competition, estimating the likely economic gains from competition in insurance provision in the New Zealand context is difficult for the following reasons:

- The New Zealand situation, with 24/7 coverage, no right to sue, and the specific level of entitlements, is unique, and this limits the comparability of overseas experiences to the New Zealand situation.
- What international experience[1] does reveal is that it is very difficult to isolate the impacts from increased competition – significant step-changes are rare, and changes that have been made are typically accompanied by adjustments to other aspects of the system such as entitlements and eligibility. This means it is difficult to make robust statements about the economic benefits of competition in insurance provision in the New Zealand market.
- Experience from Australia also suggests that adjustments to overall scheme design and benefits are pre-requisites to addressing the key drivers of costs, and securing the benefits from increased competition.[2]

---

1 For example, the changes made to the Victorian WorkCare system in 1992 included adjustments to benefits, eligibility, the structure of premiums (through experience rating) and dispute resolution procedures simultaneously with the introduction of competition in claims management.

2 A benchmarking report prepared in 1998 considered the impact of competition on claims costs by reviewing experience in Australian schemes over the previous two decades. A key finding was that "the benefit and legislative structure of the schemes, together with the overall social environment, are the most critical factors affecting claims costs. The effect of competition, if any, is very much

- Furthermore, there is a high degree of uncertainty regarding the magnitude of both costs and benefits (and in some cases, even the sign – i.e. whether they will have a net positive or negative impact) because they are highly dependent on subsequent choices around design and implementation.

The second key constraint on analysis is that consultation on the options considered in this RIS has been limited at this stage. The Department of Labour has consulted with the Treasury and the State Services Commission in the development and analysis of the options (and the Department of Prime Minister and Cabinet has been kept informed). While some consultation was undertaken by the Stocktake group, there has been no consultation with affected stakeholders (such as ACC, employers, the private insurance industry or healthcare providers) or the general public. As a result, it is possible that there are potential impacts or risks that have not been identified or adequately considered by officials. For example, officials have been unable, at this stage, to quantify the likely uptake of the modified AEP by employers, which is critical to identifying the benefits of this option.

The Cabinet paper, therefore, directs officials to undertake further, more detailed policy design work and includes a recommendation for consultation with key stakeholders in undertaking this work. This consultation will provide information to help fill some of the quantitative gaps in this RIS, relating to the options to extend the AEP and introduce private underwriting into the Work Account while retaining ACC in its current form. It will also help identify any impacts or risks of these options that have not yet been identified by officials, and assist with developing measures to minimise costs and ameliorate risks.

As a result of these limitations on its analysis, the Department of Labour considers that it is not possible to provide reliable, quantitative estimates of the size of likely benefits. The analysis summarised in this RIS presents officials' judgements around the relative magnitude of costs and benefits. It draws on the report of the ACC Stocktake Group, as well as the review of employer-managed workplace injury that was undertaken by Melville Jessup Weaver, and actuarial analysis conducted by Finity.[3]

It is also important to note the possibility that the impact of exogenous factors (such as the cost of medical treatments and the economic cycle) and the impact of underlying system design features may mask the impacts delivered by the options considered in this RIS.

There are other areas where potentially significant improvements could be made to the scheme, such as enhancements to the way levies are collected, enhancement to service delivery, and underlying Scheme design issues. Work is

---

secondary to these factors". The report concluded that "focus should first be given to the benefit design and legislative framework. If these aspects are optimal, then it will provide the opportunity for competition to have a measurable effect on claims costs". *Introduction of competition to the provision of ACC services: ACC benchmarking*. Report to the Department of Labour, Coopers and Lybrand (Australia) (1998).

3 Melville Jessup Weaver and Finity are consulting actuary firms.

underway to address a number of these issues, including the development of regulatory proposals relating to experience rating in the Work Account and work on wider scheme performance issues. The options in this RIS have linkages with this other work and will require alignment in order to implement them together.

The options considered in this RIS aim to deliver benefits through better pricing signals and improved incentives for administrative efficiency. Better pricing signals to employers can be achieved through experience rating and self-insurance arrangements. The separate introduction of experience rating would therefore deliver some of the benefits sought from the introduction of greater employer choice (so the, marginal benefits as presented in this RIS would be correspondingly smaller).

The options covered in this paper may impose additional compliance costs on healthcare providers, though the RIS indicates potential options for mitigating these costs. Some options may be more expensive for businesses than current cover e.g. in a fully competitive environment businesses would incur search costs to make decisions on workplace accident cover rather than being automatically covered by ACC. The options considered have the same or greater level of market competition compared to the status quo, indeed the options seek to improve the incentives for investment and innovation in the market. However, some regulation of any new market would be required. The right to sue for personal injury would continue to be excluded under all options so none of the options considered would change whether fundamental common law principles are overridden.

Lesley Haines
Acting Deputy Secretary Workplace, Department of Labour

### Summary of impact analysis

| | Expanding the Accredited Employers' Programme | Including private underwriting to all employers but retaining ACC as a Crown Agent | Full competitive underwriting, with the government participating in the market either in a competitively neutral form, or not at all |
|---|---|---|---|
| **Impacts** | | | |
| **Financial incentives** | • Improved incentives for injury prevention and rehabilitation, for employers who choose to join the AEP | • Improved incentives for injury prevention and rehabilitation, for all employers | • Improved incentives for injury prevention and rehabilitation, for all employers |
| **Quality of service provision** | • Modest improvement in incentives to innovate | • Improved incentives to innovate and specialise<br>• More choice for employers<br>• Variable service quality to claimants | • Improved incentives to innovate and specialise<br>• More choice for employers<br>• Variable service quality to claimants |
| **Economic efficiency** | • Marginal improvement in economic efficiency<br>• Modest improvement in administrative efficiency (private sector only) | • Increased market efficiency<br>• Increased incentives on ACC to improve its administrative efficiency | • Improvement in both economic and administrative efficiency (economic gains potentially significant but unquantifiable) |
| **Direct economic and fiscal costs** | • Marginal increase in compliance monitoring and auditing activity<br>• With private underwriting regulatory machinery required:<br>  • Prudential regulator (potentially under existing Reserve Bank model)<br>  • Market conduct regulator | • Regulatory machinery:<br>  • Prudential regulator<br>  • Market conduct regulator<br>  • Creation and maintenance of claims database<br>  • Creation and maintenance of claims clearinghouse<br>• Higher total administration costs<br>• Private insurers would have higher costs than ACC, which may deter participation, but could also be offset by efficiency gains | • Regulatory machinery:<br>  • Prudential regulator<br>  • Market conduct regulator<br>  • Creation and maintenance of claims database<br>  • Creation and maintenance of claims clearinghouse<br>• Higher total administration costs<br>• Funding for uninsured risk pool |
| **Compliance costs** | • Marginal (increased compliance costs for those employers who choose to join and reduced costs for those already in the scheme)<br>• Some entry and compliance costs for those insurers who choose to enter the market (not faced by ACC) | • Marginal increased compliance costs for those employers who choose to select a private insurance provider<br>• Entry and compliance costs for those insurers who choose to enter the market (not faced by ACC)<br>• Increased compliance costs for healthcare providers | • Entry and compliance costs for those insurers who choose to enter the market<br>• Increased compliance costs for healthcare providers<br>• Potential patient confusion with multiple preferred provider schemes<br>• Search costs on employers for obtaining insurance |
| **Transition costs** | • Small cost of design, implementation, marketing | • Moderate cost of design, implementation, marketing | • Moderate cost of design, implementation, marketing<br>• If SOE participates, costs of capitalisation and establishment |
| **Other impacts** | • Preserves flexibility for future system changes | • Option of moving to full competition in the future<br>• Potentially large levy/premium changes +/- for individual employers | • Potentially large levy/premium changes +/- for individual employers |
| **Additional changes required** | • Establishing benchmarking measures for workplace accident compensation performance<br>• Requires reform of ACC funding policy (unstable without)<br>• Changes to disputes resolution system (possible removal from ACC) | • Establishing benchmarking measures for workplace accident compensation performance<br>• Need to reallocate public health acute levy to account for new insurers<br>• Requires reform of ACC funding policy (unstable without)<br>• Changes to disputes resolution system (possible removal from ACC) | • Establishing benchmarking measures for workplace accident compensation performance<br>• Need to reallocate public health acute levy to account for new insurers<br>• Changes to disputes resolution system (removal from ACC) |
| **Risks** | | | |
| | • Low risk of small increase in decline rates, risk of small increase in claims disputes and delays in claims payments<br>• Risk of small amount of cost-shifting<br>• With private underwriting:<br>  • Low risk from insurer failure (insolvency)<br>  • Low risk from market failure – extent to which private sector can price more accurately/efficiently; may not enter skewed market<br>  • Potential government/regulatory failure | • Potential increase in decline rates, increase in claims disputes and delays in claims payments<br>• Significant risk of cost-shifting<br>• Potential insurer failure (insolvency)<br>• Market failure – extent to which private sector can price more accurately/efficiently; may not enter skewed market<br>• Potential government/regulatory failure<br>• Cherry-picking by private insurers, leaving ACC as default for poor-risk employers (experience rating would mitigate this risk)<br>• ACC failure e.g. due to: cherry picking, inflexibility of ACC pricing, lack of capital to absorb financial results outside forecasts (reformation of ACC funding policy would help mitigate this risk)<br>• ACC able to crowd out market due to different funding models for private insurers and ACC<br>• Potential for confusion in the health sector due to differing insurer requirements | • Potential increase in decline rates, increase in claims disputes and delays in claims payments<br>• Significant risk of cost-shifting<br>• Insurer failure (insolvency)<br>• Market failure – extent to which private sector can price more accurately/efficiently; or may take time for private sector to develop accurate prices<br>• Potential government/regulatory failure<br>• Potential for confusion in the health sector due to differing insurer requirements<br>• Potential for affordability concerns for high-risk employers |

#### Relative assessment of options

| Expanding the Accredited Employers' Programme | Including private underwriting to all employers but retaining ACC as a Crown Agent | Full competitive underwriting, with the government participating in the market either in a competitively neutral form, or not at all |
|---|---|---|
| • Greatest likelihood of economic efficiency gains, but at a less significant level<br>• Administrative efficiency gains unlikely to be significant<br>• **Lowest risk, low level of gains likely. With private underwriting there would be moderate compliance and implementation costs; without private underwriting, low compliance and implementation costs**<br>• Preserves flexibility for future system changes | • Potential for reduced costs and improved outcomes resulting from innovation<br>• Potential gains in administrative efficiency<br>• **Highest risk, high overall cost medium level scope for gains**<br>• Preserves flexibility for future system changes. May necessitate a move to full competition in the future | • Potential for significantly reduced costs and improved outcomes resulting from innovation<br>• Potentially significant gains in both dynamic and administrative efficiency<br>• **High risk, highest overall cost most scope for gains**<br>• High cost of reversal (fiscal and market stability/certainty) |

## Background and context

1. The National party's policy manifesto includes a commitment to improve incentives for better workplace safety and quicker, higher quality rehabilitation by introducing competition into the Work Account (after full evaluation). Following an agreement with the ACT party, the introduction of competition was included in the terms of reference for the Stocktake of ACC Accounts.

2. On 30 June 2010, the ACC Stocktake Group presented their final report to the Government. The Group recommended that the ACC Work Account, as well as some other Accounts, be opened to private underwriting with the Corporation not participating in a competitive environment. The analysis summarised in this RIS considers the impacts of introducing competition to the Work Account only (other Accounts are not discussed). It also considers other options for expanding employer choice in the Work Account, as requested by the Minister for ACC.

## Status quo

### The ACC scheme

3. ACC is a Crown Agent providing comprehensive, no-fault personal injury cover to all New Zealand residents and to visitors to New Zealand (while they are in 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; and ensuring that during rehabilitation claimants receive 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. In return for this universal coverage, the right to sue for personal injury is forfeited.

4. ACC coverage is managed under five separate Accounts: the Work, Earners', Motor Vehicle, Non-Earners' and Treatment Injury Accounts. These Accounts are separately funded and accounted for; and there must be no cross-subsidisation between Accounts.

5. The Work Account is used to meet the costs of entitlements for work-related personal injuries, including work-related gradual-process, disease or infection, as well as earners' non motor-vehicle injuries suffered prior to 1 July 1992.

6. All employers and self-employed people are required to purchase cover from ACC and pay levies for that cover. ACC assigns each employer and self-employed person into one of 117 levy risk groups based on the type of industry they are in. Levies are calculated based on the expected claims of the levy risk group and the liable payroll (earnings under approximately $110,000 per person).[4]

---

[4] Levies for 2010/11 vary from $0.06 per $100 of liable earnings for accounting services to $10.60 for jockeys or professional rugby players.

### Current alternatives to standard ACC cover

7. It is possible for employers and self-employed to reduce their levies through various programmes run by ACC. The Workplace Safety Management Practices Programme (WSMP) gives employers a discount on levies of either 10%, 15% or 20% based on an audit of the organisation's systems and processes for promoting injury prevention. It is mostly suitable for larger employers due to the compliance costs involved. The Workplace Safety Discount allows small employers in one of seven high risk industries to get a 10% discount on levies, once they have completed an industry-specific training course, and correctly completed an assessment of their safety practices.

8. The Workplace Safety Evaluation is a compulsory programme for employers with injury rates that are significantly higher than the average for their industry. ACC identifies these employers, and assists them to put systems in place to lower their injury rates. An audit of the employer's practices is then undertaken, and if the employer fails the audit a 50% loading is applied to their levy.

9. The Accredited Employers' Programme (AEP) allows employers to take on some level of self-insurance. The AEP involves employers providing entitlements to injured workers in place of ACC, for a set period of time and/or to a set value of claim. In return, employers receive a significant discount on their Work Account levy rate. Accredited Employers may choose to self-manage claims or to contract a third party administrator (TPA) to manage claims. Because most businesses do not have the claims management expertise or the volume of claims to support the claims management systems required, the majority of Accredited Employers use a TPA.

### Costs and benefits of the status quo

10. Research published by the National Occupational Health and Safety Advisory Committee (NOHSAC) in 2006 estimated the financial cost alone of workplace injuries in New Zealand was $4.9 billion (3.4% of GDP) in 2004/05. This includes costs associated with injury prevention and rehabilitation, as well the costs of lost production, and the social costs of injury; all of which can be economically significant. The figure does not include costs associated with the loss and suffering of premature death. The study also showed the costs of production disturbance to be around 12% of the total financial cost of occupational disease and injury.[5]

11. In 2009, there were 136 employers in the AEP, accounting for approximately 22% of the employees covered by the Work Account. Analysis commissioned for the Stocktake Group and conducted by Melville Jessup Weaver shows that there are gains achieved through participation in the AEP. The price signals generated by direct payment of claims costs can spur employers to become

---

5 *The economic costs of occupational disease and injury in New Zealand* (NOHSAC, 2006). Production disturbance figures are based on the value of lost production and staff turnover costs brought forward.

more engaged in risk management/injury prevention (and to better target this intervention) and in rehabilitation/return to work.

12. The analysis found that while current AEP participants had similar injury rates to non-accredited employers, they had significantly lower overall costs per average entitlement claim than non-participants. The analysis showed that the longer the claim duration and the greater the Workplace Safety Discount achieved by the employer the lower the relative average claim cost to the AEP. To illustrate, for claims with durations between 3 and 24 months, with medium risk levels and with the employers attaining the intermediate Workplace Safety Discount level, the costs for the AEPs were between 35% and 40% less than those for the equivalent non-participant employer.

13. Associated with these savings are the reduced economic losses associated with the disruption to production from employee injuries (such as recruitment and training of replacement staff).

14. The likely reductions in these costs for AEP employers has not been estimated, but we can expect there to be some relationship (though it may not be linear) between the direct costs of injuries and the related production disturbance.

15. The transaction costs for the current Work Account system as a whole are very low because it is compulsory and the information that ACC uses is all based on the information that the employer or self-employer has provided to Inland Revenue.

### Nature and scale of problem

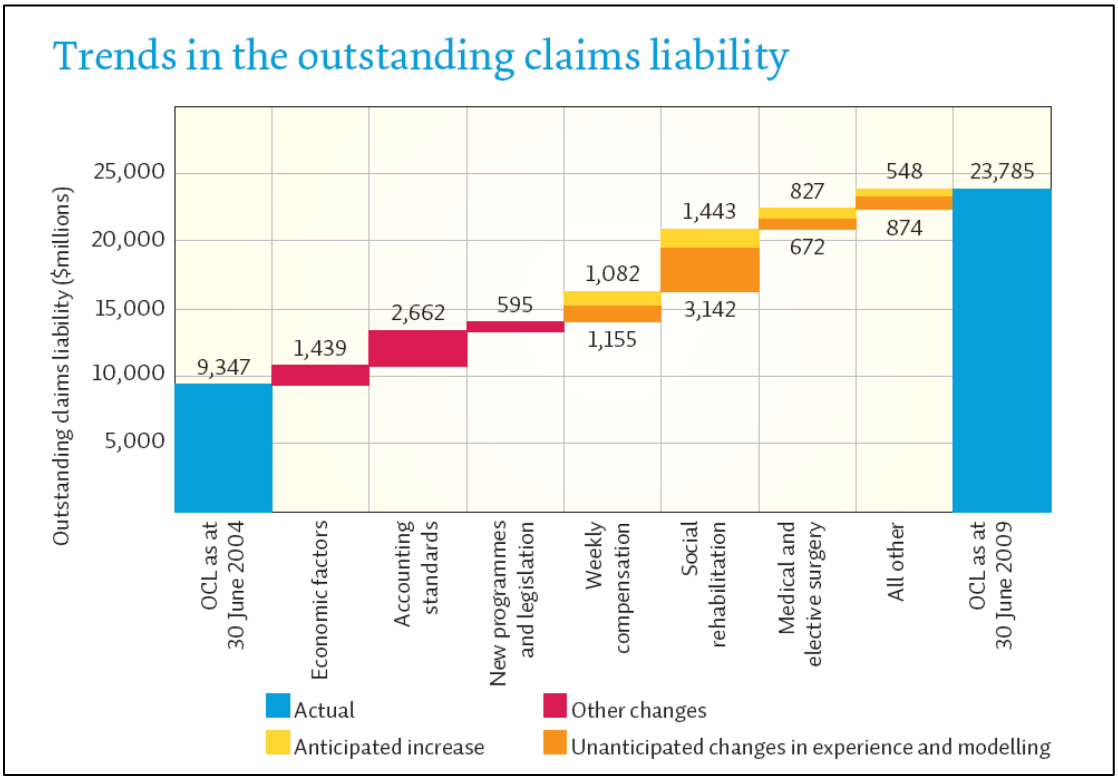
16. There are two key issues that can be addressed by options in this paper:

- The economic incentives for reducing the incidence and costs of workplace injuries; and
- The administrative efficiency and performance of the accident compensation scheme.

17. The current ACC scheme lacks efficient financial incentives for self-employed and the employers of the approximately 80% of the workforce that are not in the AEP to improve injury prevention and provide support for rehabilitation of injured workers. Currently, with the exception of first week compensation, the costs of injury are borne across all employers in the industry classification unit through the ACC Work Account. This means that there is significant cross-subsidisation (from low-risk to high-risk employers) within the industry classification unit and therefore that the prices faced by most employers do not adequately reflect their own risks and costs of employee injury.

18. Because employers are not facing the true costs of their injury claims, the level of injury prevention and risk management being undertaken will be sub-optimal. There will also be an inefficient level of effort invested in rehabilitation and return to work. This has lead to worsening rehabilitation outcomes; from 2004 to 2009 there was a steady decline in rehabilitation rates.

19. Over the history of ACC, its performance has been varied. The variability of ACC's performance indicates that at various times ACC is not achieving administrative efficiency. There has been a recent deterioration in ACC's in claims management performance. The Scheme-wide outstanding claims liability (OCL) for all ACC Accounts increased from $9.347 billion ($3.267 for the Work and Residual Claims Accounts) in June 2004 to approximately $23.79 billion ($5.867 billion for the Work and Residual Claims Accounts) in June 2009. Increases in claims costs have been the primary driver behind the "unanticipated"[6] rise in total liabilities that amounted to $5.843 billion as at June 2009 (shown in the chart below).[7]




## Objectives

20. The Department has been asked to consider options that will increase employer choice in the Work Account. The underlying policy objectives of these options are to reduce the incidence and costs of workplace injuries and improve the administrative efficiency and performance of the Scheme. This can be achieved in a number of ways, including:

- More effective management of the risk of injury in workplaces to reduce the incidence and severity of injuries

---

6 Some growth in the liability was anticipated as the population grows and the scheme matures

7 Sourced from *Accident compensation services in New Zealand: the performance of the ACC scheme and opportunities for improvement.* Report prepared for the Minister for ACC by the Steering Group for the Stocktake of ACC Accounts, 30 June 2010.

- More effective rehabilitation of injured employees to return them to work as soon as practicable
- More efficient administration of services to control the overall costs of treatment and rehabilitation.

21. The options in this RIS focus on the ways in which these benefits can be promoted through the improved efficiency of price incentives that can be achieved through increased competition and improved administrative efficiency.

## Regulatory impact analysis

### Analytical framework

22. The **total economic cost of workplace injuries** is a function of the cost of claims and lost productivity (production disruption including the lost value of production, recruitment and training of replacement staff).

23. **Productivity losses** are influenced by the incidence of injuries and the duration of rehabilitation and time off work.

24. The economic or direct **cost of claims** is affected by:

    - The incidence, nature and severity of injuries (e.g. gradual onset; low probability-high cost; high volume-low cost);
    - Duration of claims;
    - The amount of compensation payable, which depends on the coverage and entitlements payable, and the boundary definitions (i.e. policy settings).
    - Claims management costs (The effectiveness of claims management can also affect the duration (i.e. the relationship is two-way). The institutional settings are an important influence on the incentives for efficient administration of claims).
    - Market costs of healthcare (including the costs of medical treatment and rehabilitation).

25. The total cost of workplace injuries is also influenced by the legal and regulatory settings. That is, system design features other than coverage and entitlements, such as the institutional frameworks for the delivery of the scheme (including the scope for private provision, and the operation of regulatory authorities) and dispute resolution procedures.

26. These relationships are set out schematically in the diagram in Annex A.

27. Employers and employees can influence the costs of work-related injuries in the following ways:

    - Employers have a role in managing the risk of injury through managerial control over the workplace environment, including equipment, work practices, employee training and attitudes to safety.

- Employers also have a role in influencing the effectiveness of rehabilitation and duration of time off work, such as through the temporary provision of light duties.
- Employees may be more aware of potential workplace hazards than anyone else, and have obvious incentives to help prevent injuries to themselves.

28. Employers' incentives to invest in injury prevention are influenced by the costs they face for injury claims – this includes the financial costs of levies and the economic costs of production disruption. There are a number of factors influencing these costs. These include the risk profile of the industry, the risk-sharing options available, and the compliance and transactions costs associated with risk-sharing arrangements. The characteristics of their workforce, such as the cost of staff turnover (e.g. due to the level of training or skill), are also a factor.

### Description of options

29. This RIS presents three broad options along a spectrum, ranging from enhancements to the existing AEP to introducing full competitive underwriting in the Work Account.

- **Expanding the AEP** through:
    - Increased marketing of the programme to employers.
    - Reducing the compliance costs on participating employers by:
        i. Streamlining the application process to reduce unnecessary barriers to entry; and
        ii. Reducing or rationalising the various auditing process requirements.
    - Providing a greater range of risk-sharing arrangements, tailored to smaller as well as large employers.
    - Allowing AEP employers to reinsure with private underwriters.
- **Expanding employer choice to allow all employers to access private underwriting**, but retaining ACC as a Crown Agent.
- **Full competitive underwriting**, with ACC participating in the market either in a competitively neutral form, or not at all. All employers would be required to select an insurer to cover workplace injuries.

### The impacts of competition

30. The three options assessed in this RIS represent a spectrum of varying degrees of competition. The magnitude of the likely costs and benefits, and the probability of the risks eventuating therefore also vary as the options progress across the spectrum.

## Benefits

31. There are theoretically significant gains available from increasing competition in a market. For workplace accident insurance, these benefits include:

- Better alignment of prices and risk (i.e. more efficient pricing);
- Improved employer incentives to prevent injuries, and manage rehabilitation and return to work;
- Improved incentives for innovation and specialisation in insurance provision, leading to increased choice of cover arrangements for employers;
- Incentives to improve efficiency in claims administration;
- Reduced economic/direct costs of workplace injuries

32. Over time, benefits should arise from improved pricing of risk, which would provide incentives to employers to reduce their risk through improved injury prevention and better rehabilitation and return to work outcomes.

33. However, it is perhaps debatable as to the extent to which the private sector is able to more accurately set prices, given the highly technical nature of premium setting for this line of insurance, and the information advantage held by ACC (as it currently holds all the historic data on employer risk and experience). To assist efficient pricing, and to help level the playing field, it is recommended that further work on establishing a data pool of claims information accompany policy agreement on either of the options to introduce private underwriting.

34. It is important to note that the corollary of more efficient pricing is the potential for significant distributional changes, with some individual employers facing substantially higher premia (to better reflect their risk profile) and others much lower rates.

35. An expansion in the number of providers is expected to stimulate the provision of a greater range of risk-sharing arrangements such as increased choice around level of cover and self-insurance options. There may also be benefits from increased specialisation, such as improved service delivery to niche markets, and from product bundling.

36. As noted above, the introduction of experience rating by ACC would diminish the additional gains that could be delivered by the introduction of private underwriting.

## Costs

37. There are costs associated with allowing private underwriting, which will vary depending on the level of competition arising:

- Compliance costs on primary healthcare providers. These are mostly associated with high volume, low cost claims (as opposed to more complex claims).

- There is the possible emergence of preferred provider schemes that vary by insurer, and the potential for patient confusion regarding who their insurer's preferred provider is.
- Private insurers would have higher costs than ACC in its current form, due to profit loading, return on capital and operating expenses (such as marketing). It is possible that these costs would be offset by the efficiency gains that private insurers could achieve, and by some reduction in the deadweight cost that arises from state monopoly provision and cross-subsidisation between employers within a risk-group (though the lowering of deadweight cost is limited because cover will still be compulsory).
- Administration costs – any option that sees the introduction of multiple players into the system is expected to increase aggregate administration costs, due to loss of economies of scale. However, these increased costs will be offset to the extent that providers may be existing third party administrators (TPAs), and/or that there are cost efficiencies achieved through improved rehabilitation and claims management.

38. There are also some new regulatory functions that would be required to cater for private reinsurance arrangements:

    - Prudential regulation
    - Market conduct regulation, including compliance monitoring and disputes resolution.

39. As noted above, officials recommend that if private underwriting is introduced, it is accompanied by the creation and maintenance of a database of claims information which would be available to all insurers, to aid accurate pricing. This would require regulation to establish, and incur set-up and on-going maintenance costs.

### Risks

40. There are a number of risks associated with a move to greater competition:

- Cost-shifting. This could arise from healthcare providers and insurers seeking to avoid any additional compliance costs associated with work-related claims by shifting claims into ACC Accounts with less administration (i.e. into the Earners' Account by categorising claims as non-work) and/or making little effort to ensure correct categorisation. It could also arise from employers, healthcare providers and insurers seeking to lower their own direct costs by categorising claims as non-work.
- Risk of delays in claims payments and an increase in decline rates, associated with increased scrutiny on the part of private insurers and employers. There is a corresponding risk of an increase in boundary/coverage disputes. This risk could be partly managed through a levy to cover healthcare costs where it is unclear which insurer should be paying, as is currently the case with the Accredited Employers' Programme.

- Variability in the service quality experienced by claimants. Claimants may receive different levels of cover depending on who their employer chooses to insure with. It is possible that different interpretations of the legislation will result in different entitlement levels, leading to potentially costly disputes.
- Insurer failure. While this is a risk with a move towards increased contestability, it is also noted that insolvency risks are not unique to workers' compensation schemes and that there are measures that can be put in place to manage them (e.g. requirements for reinsurance coverage and minimum requirements for capital and reserves). However the risk of insolvency is more serious for worker's compensation schemes (compared to general insurance lines) because of the long-term nature of claims, and the fact that the government must stand behind the system (either directly, or through the health and welfare systems).

### Expansion of the Accredited Employers' Programme

41. For the purposes of analysis, officials have considered two variants of this option – one with and one without the presence of competitive underwriting for AEP employers. This has enabled the impacts of competition to be assessed separately from the other components of this option.

**Benefits**

42. The key aspect of this option is the introduction of a greater range of risk-sharing arrangements, which, together with the recommended changes in ACC's funding policy (as indicated in paragraph 83), would go some way towards better alignment of price signals and thereby improved incentives for injury prevention and rehabilitation for participating employers.

43. It is very difficult to estimate the likely magnitude of the dynamic economic benefits. Officials expect that a relatively small number of employers may opt in to the expanded AEP (in the order of 1,000-1,500 firms). However, given that the programme appeals to larger employers, it is possible that up to 50% of the workforce could end up being covered by AEP.

44. Overall, the marginal economic benefits are likely to be tangible, but small and diminishing, due to limited number of additional employers entering the programme, and the expectation that smaller new participants would elect lower levels of risk-sharing, which would result in weaker incentives.

45. The AEP introduces some element of contestability to injury claims management. It is expected that small- to medium- sized employers who opt in to an extended AEP would generally outsource claims management to TPAs, because they would not have the claims management expertise or the volume of claims to support the claims management systems required.

46. The increased use of TPAs may also see some (modest) innovation/administrative cost reduction. There may also be some pressure on ACC to improve its own administrative efficiency in claims management because of the threat of competition to its market share. However, the uptake from employers is expected to be low, and therefore the incentives on ACC to improve its administrative efficiency are likely to be small.

47. This option preserves the flexibility to make further, more substantial policy changes in the future.

**Costs**

48. There are some compliance costs on participating employers, though firms will be able to choose whether to participate in the AEP (based on whether they consider they can achieve net benefits from joining). For those already participating in the AEP, compliance costs would reduce due to the proposed reduction in current audit requirements.

49. Some entry and compliance costs would be involved for those insurers who choose to enter the market (costs not faced by ACC). There would be a very small cost to ACC for marketing/promotion, design and implementation.

50. There is some expansion to existing regulatory machinery that would be required in order to achieve the potential benefits offered by this option:

- Increased compliance monitoring and auditing (as the volume of employers rises) – to retain sufficient checks and balances in the system.
- Changes to the disputes resolution system to deal with an expected increase in boundary disputes (and potentially removing this function from ACC).

51. These requirements would depend on the level of uptake, but it is expected that they will represent only a small marginal increase on current costs (which are recovered through levies), unless the regulatory (gate keeping) function is re-located outside of ACC (in which case there would also be one-off establishment costs). The location of regulatory functions will be considered in the next phase of work.

**Risks**

52. As noted above, there are financial and economic benefits to employers from participation in the AEP. However, the extent to which additional gains from expanding the scheme can be realised will depend on the take-up by employers. Research has found that the most significant disincentive to participating in AEP is that the discounts given by ACC are not enough to make the additional compliance and administration costs worthwhile. The withdrawal of employers over recent years is associated with a drop in ACC's standard levy rates.

53. In addition, the AEP is likely to be less attractive to smaller employers, due to the associated fixed costs of being in the scheme, volatility of claims, and fewer opportunities for workplace based rehabilitations (such as part-time or light duties), compared to large firms. Smaller firms are therefore less likely to opt for full self-insurance, instead opting for more modest risk-sharing arrangements.

54. Analysis suggests that claims managed by AEP employers or TPAs exhibit slightly higher reopen rates (measured by weekly compensation claims which reopen after two quarters of no payments) than claims managed by ACC. For full-self-cover accredited employers this could cause problems around hand-

back of claims to ACC with disputes over the likely future costs of claims. It could also imply that injured employees of employers in the Partnership Discount Programme[8] are having their entitlements delayed until the responsibility and cost returns to ACC. However, it is noted that the available qualitative evidence[9] suggests there are clear incentives for AEP employers to properly rehabilitate claimants.

55. The low level of uptake into any expanded Accredited Employer's Programme is likely to limit the net benefits of this option. Correspondingly, the risks of competition as noted above, such as insurer insolvency and cost shifting, are also considered to be low for this option.

**Overall assessment**

56. The Department if of the view that an expanded AEP offers the best potential for improved incentives in terms of injury prevention and employer participation in rehabilitation. Subject to sufficient take-up by employers, if therefore offers the best potential for economic efficiency gains, though with less corresponding improvement in incentives on ACC's administrative efficiency than other options considered. This option also carries the lowest compliance and implementation costs and has the lowest risks of the three options considered.

### Offering a choice of underwriting to all employers with ACC retained in its current form

57. This option allows all employers the option of selecting a private insurer. Employers that do not wish to exercise this choice would remain with ACC. ACC in its current form would continue to offer workplace accident cover.

**Benefits**

58. This option offers choice to all employers, compared to the expansion of AEP, which will offer benefits only to participating AEP employers. A key benefit is the potential for private insurers to offer employers the opportunity to enter into a range of risk-sharing arrangements, and potentially the bundling of workplace accident insurance with other insurance products.

59. Another key benefit is expected to arise from the improved incentives on administrative efficiency in claims management, both in the private sector and potentially within ACC. The commercial pressure that would be applied to ACC could, in principle, incentivise innovation and efficiency, resulting in moderate cost savings and potentially more consistent scheme performance. However, there are currently no formal incentives to require ACC to respond to a threat to its market share. Formal incentives would need to be designed by

---

8 The Full-self-cover programme requires employers to pay the expected future costs of claims to ACC when they hand the claim back to ACC at the end of the cover period. Under the Partnership Discount Programme the employer only pays the cost of claims during the cover period, when the claim is handed back to ACC the costs fall to ACC.

9 *Review of Employer-managed Workplace Injury Claims*, Melville Jessup Weaver and Martin Jenkins, 4 June 2010

government to encourage ACC to retain market share (such as setting commercial objectives, and reflecting this in changes to governance arrangements and expectations on the Board).

60. Over time benefits should also come from improved pricing of risk, which would provide incentives to employers to reduce their risk through improved injury prevention and better rehabilitation and return to work outcomes. A greater number of providers may also stimulate the provision of a greater range of risk-sharing arrangements and increased specialisation, such as improved service delivery to niche markets.

61. This option leaves open the option of making more substantial policy changes (such as moving to full competition) in the future.

62. There would be changes in levy/premium prices for employers, resulting from a movement towards more differentiated pricing, and subsequently some dynamic efficiency gains. In the short term (e.g. up to five years) there may be more fluctuation in prices compared to state monopoly pricing, as the system beds in and new providers seek to establish appropriate prices.

**Costs**

63. There are costs associated with the set-up and on-going implementation of this option, some of which will depend on the number of competitors entering the market.

64. The compliance costs on primary healthcare providers are estimated to be in the order of $0.5m-$2.4m per annum (though these estimates are based on the previous experience with introducing competition to ACC, and officials are of the view that there are options for mitigating these impacts[10]). Taking these estimates, it is anticipated that these increased compliance costs could be passed on to insurers or claimants) in the order of $2.15-$9.75 per claim.

65. This option would incur the regulatory costs noted in paragraphs 38 and 39.

66. In order to keep levies similar to today's levels, this option would require claims cost savings in the order of 20% to 26% (equating to around $0.17-$0.22 per $100 leviable earnings) to offset the higher expenses of private insurers.

**Risks**

67. The risk of cost shifting is considered to be more significant under this option.

68. Due to the price advantage that ACC would hold (as it is not required to return a profit or pay tax) it is possible that insurers would not secure any market share, and the effects would therefore be limited to the changes made

10 In particular, the introduction of a common claims system (claims clearing house) that is electronically embedded in patient management systems, automatically allocates claims to the correct insurer and guarantees payment for the initial assessment and treatment of injury in primary care or emergency department settings. Such a system could either be run by ACC or by a third party, and would not apply to more specialised treatment such as elective surgery and rehabilitation.

to ACC in order for it to potentially compete (such as more differentiated pricing).

69. Alternatively, there could be "cherry picking" by private insurers. If private insurers do choose to compete against ACC, they may target lower risk employers, leaving ACC as the default provider for high-risk employers, leading to increases in levies for this remaining higher risk pool. This could create an on-going, deteriorating pattern which could make the ACC Work Account unsustainable. If this occurred, it may require an injection of funds from the government to cover outstanding liabilities.

70. The variability of potential outcomes, the range of different options for implementation, and the potential for non-economic factors (such as employer bias towards private provision) makes it impossible to accurately cost this option at this stage.

**Overall assessment**

71. This option offers potential gains in administrative efficiency, as well as potential for reduced costs and improved outcomes resulting from innovation and improved pricing signals. However the overall costs are much higher than those for expanding the AEP, and there are significant risks. If some of these risks eventuated, it could serve to undermine the policy intent. The market dynamics arising from this option may necessitate a move to full competition at some point in the future.

### Introduction of private underwriting with the government participating in a competitively neutral form or not at all

72. The key feature of this option is that the government would participate in the market either in a competitively neutral form, or not at all.

**Benefits**

73. In theory, this would deliver both gains in terms of both dynamic economic efficiency (from the better alignment of prices and risk over time) and administrative efficiency in claims management.

74. As with the previous option, this option would require claims cost savings in the order of 20% to 26% to offset the higher expenses of private insurers.

**Costs**

75. The key additional cost for this option would be the fiscal cost of establishing and capitalising of a State Owned Enterprise, should the Government participate in the market. Based on the capital requirements for a business unit with a market share of around a third of current premia, the initial capital cost could be around $100m, with lesser amounts per year on-going, capping out at a total investment of around $500 -$600 million.

76. Other costs in addition to those for the previous option are the search costs that employers would bear from having to select an insurer. Also, high-risk businesses may be unable to afford cover. The Government may wish to consider developing a system to ensure these employers are able to obtain

affordable cover. There could also be fiscal costs associated with establishing a system or fund for the uninsured risk-pool.

**Risks**

77. In addition to the risks associated with the previous option, the costs of reversing this option would be high. While economic analysis disregards any sunk costs for the purposes of cost-benefit analysis, there would nevertheless be significant additional transition costs to unwind the changes, as well as market uncertainty regarding the political climate and policy settings.

**Overall assessment**

78. As for the previous option, this option offers the potential for reduced costs and improved outcomes as a result of increased innovation. In addition to administrative efficiency gains, there are also potential economic efficiency benefits. However, this option is high cost, involving the costs of opening up the Account to private underwriting, with the additional costs for government of establishing and capitalising a State Owned Enterprise. This option also carries a number of substantial risks.

## Consultation

79. As noted above, there has been limited consultation on the development and analysis of the options considered in this RIS, and targeted consultation with key stakeholders should be undertaken in the next phase of policy work.

80. The State Services Commission (SSC) notes that a further risk of allowing private underwriting while retaining ACC in its current form is the location of two separate objectives in ACC[11], which have the real potential to become competing objectives. SSC advises that this will make it more difficult for the Board to govern with these objectives and for the Minister to determine the performance of the Board in meeting these objectives. The current organisational form, that of a Crown Agent, also risks political influence over the commercial objectives. Mitigation of this risk entails making transparent the mix of objectives and how these objectives will be managed. For instance, a subsidiary of ACC could be set up to govern the commercial objectives.

## Implementation

81. Following a decision on the direction of policy change, officials will need to undertake analysis of the detailed design options, and their associated impacts. Subsequent choices around policy design and implementation are likely to have a material impact on the costs, benefits and risks associated with the policy changes.

82. Some outstanding issues have been indicated in the discussion above – for instance, while there are risks around increased compliance costs to

---

[11] One (primarily social) objective is to ensure that all New Zealanders pay for and receive accident insurance cover); the second is a commercial objectives to reduce the incidence of employers seeking alternative accident insurance cover in the Work Account (i.e. preserving its market share).

healthcare providers, officials believe there are ways in which these could be managed, such as establishing a claims clearing house and a claims data pool. These would need to be explored further, both in terms of design options but also to determine whether the cost of these measures would justify the expected easing in compliance costs.

83. Other design features, such as the development of regulatory machinery required for allowing private underwriting could significantly influence both the incidence and size of impacts, and the robustness and sustainability of the option.

84. Other implementation issues include:

- The possible need to reallocate the public health acute levy to take into account new insurers and to reflect ongoing changes in the populations covered by each insurer (relevant to the options to introduce private underwriting). This is expected to have a minimal impact on health providers unless the calculation moved to a per transaction payment arrangement.
- The need to reform ACC's funding policy (in the case of the options to introduce private underwriting) to allow ACC to offer a greater range of insurance arrangements.

### Monitoring, evaluation and review

85. Each of the options would require different monitoring evaluation and review regimes. Regardless of the form of greater employer choice that is pursued, the Department recommends that benchmarking measures be established for the performance of the Work Account and evaluation and assessments made against those measures on a regular basis. These measures might include average premium rates, claimant experiences, return-to-work rates, and overall cost of claims. Full consideration of monitoring and evaluation will be undertaken following Cabinet decisions on which option to focus further work on.

## Annex A: Drivers of the economic costs of workplace injury