

Regulatory Impact Statement

ACC levies for 2014/15

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment (the Ministry). It provides an analysis of options for setting the ACC levies for 2014/15. It also provides analysis of levy policy proposals that include new regulatory programmes and technical updates to factors used for calculating levies.

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

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

The Minister for ACC is legally required to consider ACC's recommendations prior to making levy Regulations, and the Ministry's role is to advise the Minister on these recommendations. We support ACC's recommendations as a good first step to reducing levies to a sustainable level, and therefore our analysis is based on consideration of ACC's funding policy and the independent actuarial review performed by the Ministry's contracted actuaries. The Government has also identified the importance of the public interest in the fiscal strategy to return to surplus in 2014/15. When this is taken into account other options for ACC levies 2014/15 arise.

On current information the Ministry supports introducing risk rating of passenger vehicles in principle. In order to refine this levy policy proposal, further work should be undertaken to clarify the proportionality of vehicle safety as a risk factor between passenger vehicles and within ACC's pricing methodology, this work should also address how new vehicles can be rated. This can then be introduced in 2015/16 levy year, following Cabinet consideration of the detailed design.



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Kirstie Hewlett

General Manager,

Labour Environment

Background

What is ACC?

- 1 ACC is a Crown Agency which provides comprehensive, no-fault personal injury cover to all New Zealand residents and visitors to New Zealand. ACC coverage is managed under five separate Accounts. A general description of the three levied Accounts is listed below.
 - The Work Account is funded from levies on employers and self-employed and is used to meet the costs of entitlements for work-related personal injuries.
 - The Earners' Account is funded from levies on earners through PAYE (or invoiced directly by ACC for self-employed people), and 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).
 - The Motor Vehicle Account is financed from levies on motor vehicle owners and users and is used to meet the costs of entitlements for motor vehicle injuries.
- 2 The following figure outlines the ACC levies, who pays them and how they are paid:

Table 1: Who pays ACC levies and how

Levy payer	Work Account levy	Earners' Account levy*	Motor Vehicle Account levy	
			Licence fee levy	Motor spirit (Petrol) levy
<i>Employee</i>	N/A	to IRD through PAYE, at flat rate	If they own a vehicle according to vehicle type	If they use a petrol vehicle, according to petrol usage
<i>Non-earner</i>	N/A	N/A		
<i>Self-employed</i>	Direct to ACC based on industry risk and business' experience	Direct to ACC, at flat rate		
<i>Standard employer</i>	Direct to ACC based on industry risk and business' experience	N/A		
<i>Accredited employer</i>	Reduced amount direct to ACC based on industry risk	N/A		

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

The levy setting process

- 3 Each year Cabinet makes decisions on ACC levies so that these can be set in regulations. The Accident Compensation Act 2001 (the AC Act) requires ACC to develop their funding policy to consider levy stability and forecast uncertainty, use this to develop levy rates to consult on, and finally to make recommendations on levy rates to the Minister. ACC's recommended levy rates are based on:
 - the expected costs of claims for each Account for the upcoming levy year, in this case the 2014/15 levy year
 - consideration of ACC's financial position for historical claims (prior to the upcoming levy year), and adding or subtracting a funding adjustment based on

ACC's funding policy to move ACC towards their selected funding target over a period of time.

- 4 ACC carried out public consultation from 17 September 2013 to 15 October 2013 (summarised in paragraphs 87 to 92 below. Consultation and analysis of submissions has been completed, and the ACC Board provided its recommendations to the Minister for ACC on 25 October 2012 [ACC BP 13/056 and 13/058 refer]. The AC Act also requires that these recommendations be considered by the Minister for ACC prior to recommending the making of levies regulations.
- 5 The Ministry of Business, Innovation and Employment (the Ministry) commissioned Finity Consulting Pty Limited (Finity) to carry out an independent actuarial review of ACC's claims cost forecasts in relation to the 2014/15 and later accident years, and payments in respect of earlier accident years. This review focused on the drivers of change for levy rates, long term trends in claims frequency and severity, and assumptions for future periods including exposure, frequency and average costs per claim.
- 6 The Ministry uses the independent actuarial review as a basis to conduct policy analysis and provides the Minister for ACC with advice on the proposed levy rates and related policy. Each year the Minister for ACC, in consultation with Cabinet, is asked to review the funding needs of ACC's levied Accounts by balancing public interest, as required under Section 300 of the AC Act¹ when carrying out the functions and powers under the AC Act, and ACC's assessment of levy rates aimed at full funding having regard to levy stability and forecast uncertainty. An overview of the funding process is set out in Appendix A.

The status quo

- 7 The average levy rates are currently set at:

Table 2: 2013/14 levy rates

Earners' Account Levy per \$100 liable earnings (incl. GST)	Work Account Average levy per \$100 liable earnings	Motor Vehicle Account Average levy per vehicle
\$1.70	\$1.15	\$330.68

Problem Definition

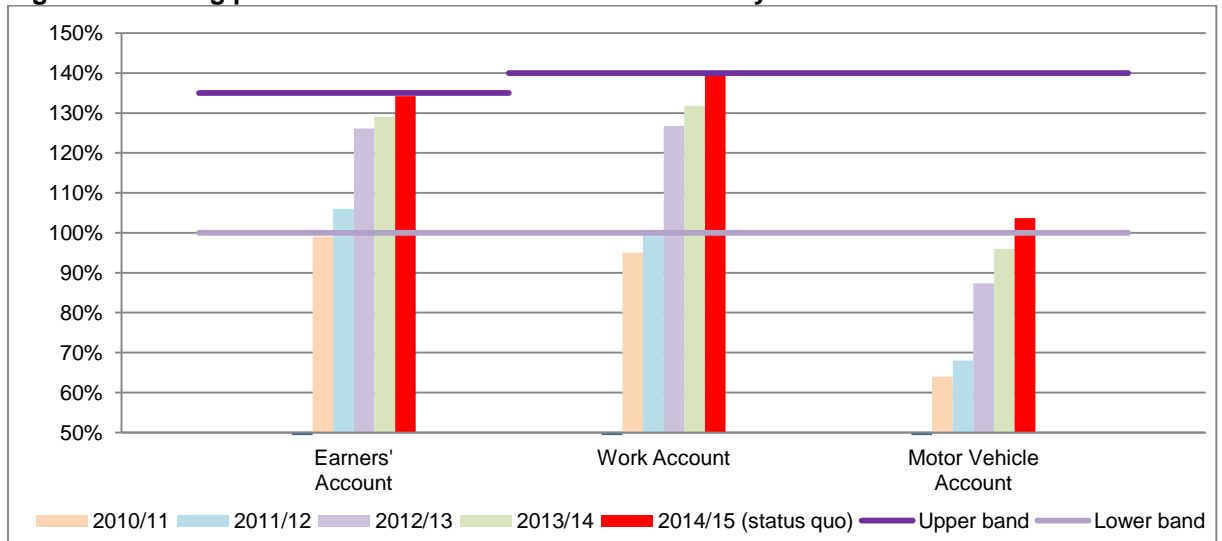
- 8 Work, Earners', and Motor Vehicle Accounts are funded on an annual basis by levies set in regulations. The purpose of levies, and the full-funding approach, is to ensure that there is enough money now and in the future to pay for the cost of injuries that have occurred in the past, and are forecast to occur in the upcoming-levy year.
- 9 Because claims costs and other factors that affect ACC's assets and liabilities change, levies should be updated to ensure that the Accounts would be fully-funded or remain appropriately funded.²
- 10 As discussed in paragraph 3, this involves setting levy rates to cover new claims and any adjustments to funding deficits or surpluses for historical claims.

¹ In exercising any functions or powers under this Act or the Crown Entities Act 2004, the Minister must have regard to the public interest and, in particular, the interests of taxpayers, levy payers, claimants, and potential claimants.

² The financial position is the proportion of assets to liabilities. The liability is the amount required to cover the cost for injuries that have occurred, and the assets are the amount that ACC holds (levies collected and investments held) that could be used to pay for the costs of injuries that have occurred. ACC's assets and liabilities are inherently uncertain, because they are revalued from time-to-time with adjustments from ACC performance outcomes and economic assumptions. This means that funding deficits or surpluses are normal.

- 11 For historical claims, ACC's financial position has continued to improve over recent years due to ACC claims and investment performance. The most recent year has also seen a positive effect from economic assumptions. Figure 1 shows that if the 2013/14 levy rates were to be retained for the 2014/15 levy year, the Work and Earners' Accounts would reach the upper end of ACC's funding band by 30 June 2015 (purple line).

Figure 1: funding position of levied Accounts if 2013/14 levy rates continue for 2014/15



- 12 Retaining the status quo, would see ACC collect more than it needs to cover the life-time costs of injuries for the upcoming levy year and past levy years. The risks associated with this are:
- The levied Accounts would be overfunded or funded quicker than they need to be, they would collect more than is necessary and the excess funds collected now would need to be returned to levy payers in the future, and today's levy payers would pay for the cost of future levy payers (intergenerational transfers).
 - Larger reductions to levy rates would be needed than if the correct amount is collected now.
 - It is best to avoid distortions to future levy rates as much as possible so that levy payers, ACC and the Government can make decisions using the best available information. Larger reductions in the future would hide the true cost of injuries at that time, because future levy rates would need to be lower than the expected cost of claims. This is because excess funds can only be returned through the levy itself.
 - Additional money collected from levy payers removes additional funds from the economy which may negatively impact on economic growth, however this is not lost to today's economy because ACC plays a significant role through its investment portfolio.
- 13 A range of average levy rates would be consistent with the AC Act's requirement for the levies to fully-fund the Accounts. To make recommendations, ACC has gone through an actuarial methodology which includes a variety of judgments. Ministers may have a different view to ACC's recommended rates through their responsibility to also consider public interest. This may lead Ministers to a levy rate that is different to ACC's recommendation but consistent with the AC Act's requirements.

The Ministry's Approach

- 14 The Ministry's preference is for ACC to target a lower funding level³ because there are many risks associated with overfunding ACC's Accounts, as outlined in paragraph 12 above. These risks must be considered having regard to levy stability as well as the effects on levy payers, the economy, ACC, and the Government.
- 15 At this stage, we consider that ACC's recommendations (set out at paragraph 35) are a good first step to reducing levies to a sustainable level. Based solely on the expected cost of claims and ACC's current funding position, the Ministry considers even larger reductions could be possible. However, after weighing up the factors outlined in paragraph 12 especially the principle of levy stability, the Ministry has chosen to support ACC's recommendations for 2014/15 rather than larger reductions. Because the Minister for ACC is legally required to consider ACC's recommendations prior to making levy regulations, this paper will consider the factors taken into account by ACC within their current funding policy. We will then compare ACC's option against one other option for 2014/15 levies using the criteria set out in the objectives section.

Objectives

- 16 The AC Act requires levies to be set so that each Account achieves full-funding, having regard to levy stability over time and forecast uncertainty. Paragraphs 3 and 6 highlight the different factors that the Minister for ACC and ACC must consider.
- 17 The Ministry also considers the following objectives important to levy setting:
- providing claimants with certainty that funds will be available to meet their on-going costs of rehabilitation and treatment
 - taking the minimum amount necessary (having regard to the other funding policy principles) from levy payers
 - providing appropriate incentives by reflecting the true cost of injuries so that ACC, the Government and levy payers can make informed decisions based on the true cost of injuries
 - having levy stability to allow businesses and individuals to plan better
 - minimising inter-generational transfers by each year's levy payers paying the appropriate amount
 - having regard to the public interest⁴, including whether there is an appropriate revenue transfer, any detrimental effects on the Crown accounts and encouraging the wider economic goals of the Government, especially economic growth.
- 18 These principles have also been used to underpin the funding policy review, which Ministers English, Joyce, Collins, and Foss agreed to on 20 March 2012 [BP 12/015611 refers].

3 The Ministry prefers ACC to target 100% of the expected cost of claims (around 87% of expected liabilities) rather than ACC's target of 115.5% - 117% (depending on Account) of the expected liabilities.

4 The Minister is required by section 300 of the AC Act to consider the public interest when carrying out the functions and powers under the AC Act.

Regulatory impact analysis

2014/15 average levy rates

- 19 The following sections discuss the way ACC calculated its expected cost of claims and any funding adjustments. These factors are discussed below.
- 20 This has been through an independent actuarial quality assurance by Finity. After reviewing levy consultation material, technical documents, other in-depth information provided by ACC, and meeting with ACC's actuaries, Finity's opinion is that ACC's recommendations and assumptions are reasonable.

How much is needed for injuries occurring next year?

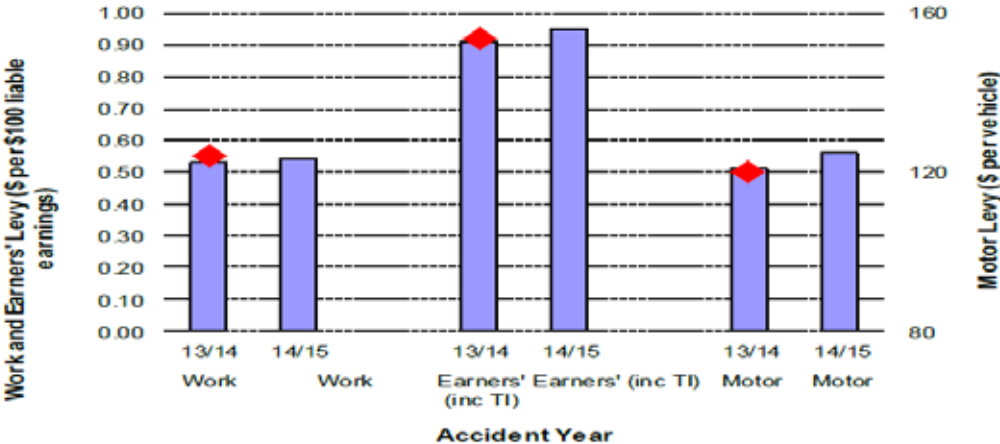
- 21 The portions of the 2014/15 levy rates which fully-fund the expected cost of claims for the 2014/15 year have been set based on an actuarial review by ACC. The 2014/15 expected cost of claims for each Account are set out in Table 3.

Table 3: expected cost of claims for injuries occurring in 2014/15⁵

Earners' Account Levy per \$100 liable earnings (incl. GST)	Work Account Average levy per \$100 liable earnings	Motor Vehicle Account Average levy per vehicle
\$1.43	\$0.78	\$145.00

- 22 Expected 2014/15 cost of claims are slightly higher than the revised 2013/14 costs. ACC has generally assumed that the overall frequency of claims will be unchanged from 2013/14 levels, however the average cost per claim increases in line with inflation, including medical inflation which is higher than wage inflation (comparison of bars in figure 2). Finity considers these assumptions are reasonable.

Figure 2: Comparison of Actual and Expected Claims Costs⁶



5 These figures include Scheme costs and the Earners' Account includes GST. The figures discussed below only includes injury costs.

6 Figure 2 also shows that the most recent projections of 2013/14 claims costs (based on actual and expected costs are broadly in line with expected 2013/14 cost of claims at the time levies for 2013/14 were set (as indicated by the red diamond). Generally underlying claims experience has tended to be better than expected, with fewer people requiring ACC benefits, but this has been partially offset by changes to discount rates.

- 23 Table 4 provides more detail on changes in 2013/14 cost structure and how this impacts on 2014/15 estimated cost for each Account.

Table 4: updated 2013/14 expected cost and estimate of 2014/15 costs

Account	2013/14 experience	2014/15 estimate
Work Account	Expected cost of claims has reduced by \$0.02 to \$0.53 because of improvements in weekly compensation frequency and lower than expected claims inflation for other medical.	The 2014/15 cost is estimated at \$0.54 to reflect a year of claim inflation (which is slightly higher than wage inflation). There has been a minor decrease to frequency and claims severities to reflect positive 2013/14 claims experience.
Earners' Account	The expected cost of claims has reduced by \$0.01 to \$0.91 per \$100 of liable earnings because of favourable claims experience for medical and other payments and lower claim frequency.	ACC assumes the 2014/15 cost will increase by \$0.04 to allow for inflation in average claim size, and a higher frequency (higher expected claim frequencies for Radiologists and Physiotherapists).
Motor Vehicle Account	The expected cost of claims has increased by a \$1 to \$121 because changes to discount rates outweighed the impact of positive claims management.	The estimated 2014/15 claims cost of \$125 per vehicle is \$4 higher than 2013/14 due to the effect of inflation on the average claim size, with claim frequency assumed to remain at the same level as in 2013/14.

- 24 Current year's costs have been through actuarial analysis, and the Ministry considers the figures to be as robust as current information allows.

Funding adjustment

- 25 Levies have to pay for the upcoming year's cost but they also have to make up any deficits or return any surpluses for historical claims through the funding adjustment. The funding adjustment does not affect the cost of claims or how much is collected in the long term, it is about when the funding is collected or returned in the short- or medium-term.
- 26 Current decisions on how fast to make up a historical deficit or how fast to reduce a surplus have implications for future decisions. For instance, choosing to have a small adjustment when there is a large deficit would require larger adjustments at some point in the future to make up the deficit. These decisions around the size and speed of collection can create intergenerational transfers and may distort pricing signals.
- 27 A key question that was considered in setting levies this year was at what level the funding adjustment should be set. The factors included in this question were:
- a whether there is sufficient funding or too much funding to cover the difference between the expected cost of claims that occurred in previous years, and the assets ACC requires in respect of those claims
 - b how quickly the positive funding adjustment should be reduced.

Work and Earners' Accounts

- 28 The Work and Earners' Accounts are expected to be at 132% and 129% respectively at the end of the 2013/14 levy year, well above the midpoint of ACC's funding target of

117.5% and 115.5% for each Account. In dollar terms this is \$1.858 billion and \$1.572 billion above ACC's declared liabilities, or \$776 million and \$744 million above ACC's funding target.

- 29 The highly funded nature of the two Accounts means ACC has chosen to reduce levies as a first step for moving these Accounts away from the top of ACC's funding band in the medium-term. ACC's funding policy states that any corrective measures made by ACC to the levies should be small to maintain levy stability and aim to return the funding position to the midpoint of the target funding band over a three to five year period. This is why the funding adjustment remains positive even though ACC wants the funding level to reduce. ACC has therefore recommended the following changes to funding adjustment for the 2014/15 levy year:

Table 5: funding adjustment due to funding position of the Work and Earners' Accounts⁷

	Funding adjustment		
	2013/14	2014/15	Change
Work Account	+\$0.36	+\$0.16	-\$0.20
Earners' Account (excl GST)	+\$0.28	+\$0.02	-\$0.26

Motor Vehicle Account

- 30 The Motor Vehicle Account is not as well funded as the Work and Earners' Accounts. It is below its target funding band, with an expected funding of 96% by the end of 2013/14.⁸
- 31 The historic underfunding for this Account means a much higher portion of the Motor Vehicle Account levy is a funding adjustment to make up the deficit for historical claims. For the 2013/14 Motor Vehicle Account levy this represents around half of the levy.
- 32 Under ACC's funding policy, it is appropriate for levies to contribute to a high rate of increase (a bigger funding adjustment) in the Account's funding position if there is a large deficit. As the deficit gets smaller (funding position improves), levies and the rate of increase (a smaller funding adjustment) should be reduced. Given the improvement to this Account it is now appropriate for levies to be reduced, thereby reducing their contribution to the rate at which the funding position increases. This reduces the need for very large levy cuts in the future.
- 33 The recommended funding adjustment is:

Table 6: funding adjustment due to improved funding position and future funding position of the Motor Vehicle Account⁹

	Funding adjustment		
	2013/14	2014/15	Change
Motor Vehicle Account	+\$189.34	+135.17	-\$52.17

7 In practice the funding adjustment and residual have the same impact on the funding position, we have therefore included the residual into the funding adjustment.

8 The Motor Vehicle Account requires 4% to enter the funding band, which is around \$305 million. ACC funding target for this Account is 116%.

9 In practice the funding adjustment and residual have the same impact on the funding position, we have therefore included the residual into the funding adjustment.

ACC's recommended levy rates

- 34 The expected cost of injuries for 2014/15 is expected to remain largely similar to 2013/14. The funding adjustments, however, have been reduced to reflect the improvement over the last year to the funding position for all three Accounts, which is the main reason for the lower average levy rates this year.

Table 7: ACC recommended levy rates

	Earners' Account Levy per \$100 liable earnings (incl. GST)	Work Account Average levy per \$100 liable earnings	Motor Vehicle Account Average levy per vehicle
Approach A (ACC recommendation)	\$1.45	\$0.95	\$280.00

Alternative option – levy rates consistent with Budget 2013 announcements

- 35 As mentioned above, when Ministers are considering levy rates, they must have regard to the public interest when considering the need to fully-fund the levied Accounts. This includes the interests of taxpayers, levy payers, claimants, and potential claimants.
- 36 The Government has identified the public interest of the fiscal strategy to balance the books. In *Budget 2012 Fiscal Strategy Report*: “structural fiscal deficits and rising debt are not sustainable, nor conducive to the medium and long-term goals of rebalancing the economy towards tradable activity and lifting potential growth”. The Government continued to reiterate the importance of this goal in Budget 2013.
- 37 It is in the public interest to “consistently run surpluses and pay back debt and to reduce net debt to no higher than 20 per cent of GDP by 2020”, the *Budget 2013 Fiscal Strategy Report* set out some key benefits:
- A sizeable debt also risks keeping interest rates and the exchange rate higher and in turn crowding out the internationally-competitive sectors of the economy.
 - Getting on top of government debt reduces New Zealand's total indebtedness, which helps to maintain credibility with international lenders and, therefore, keeps borrowing costs down for businesses and households as well as the Government.
 - Lower government debt puts New Zealand in a much better position to cope with the next economic shock, or the next natural disaster, to come along.
- 38 Any reduction in levies would have an impact on the Crown's Operating Balance Excluding Gains and Losses. As part of Budget 2013 the Minister for ACC signalled a reduction of around \$300 million in ACC levies for 2014/15.

Balancing the reductions in the Earners', Work and Motor Vehicle Accounts.

- 39 Under this alternative approach, where there is less scope for levy reductions and given Accounts are at different points relative to their funding target, some Accounts must be prioritised over others to focus levy reductions. The high level of funding for the Work and Earners' Accounts requires levy reductions to start managing the level of surplus.
- 40 The high level of funding in the Work and Earners' Accounts means that there is more urgency to return excess funds to levy payers in comparison to the state of the Motor Vehicle Account. While the Motor Vehicle Account levies could be reduced, the purpose of any reductions now is for smoothing that moves the levy incrementally over time to avoid large levy fluctuations in the future rather than correcting a current high funding situation.

- 41 The table below set out levy rates for Approach B, which make no change to the Motor Vehicle Account and decrease the Earners' Account and Work Account in proportion to ACC's recommended allocation. This is consistent with the Budget 2013 announcements.

Table 8: levy rates consistent with Budget 2013 announcements

	Earners' Account Levy per \$100 liable earnings (incl. GST)	Work Account Average levy per \$100 liable earnings	Motor Vehicle Account Average levy per vehicle
Approach B	\$1.51	\$0.99	\$330.68

- 42 Approach A would be approximately a \$508 million reduction for levy payers in 2014/15; Approach B would be approximately a \$303 million reduction for levy payers.

Comparison of options

- 43 The size of the adjustment to levies to fund ACC in the short term is a balance between the effects on levy payers, the economy, the public, ACC, and the government. The merits of having a larger adjustment (consistent with Approach A) or a smaller adjustment (consistent with Approach B) are assessed against the objectives in the following table.
- 44 The Minister for ACC is legally required to consider ACC's recommendations prior to making levy Regulations. The Ministry's role is to advise the Minister on ACC's recommendations, and we support ACC's recommendations as a good first step to reducing levies to a sustainable level.

Table 9: assessment of 2014/15 levy rate options

Objectives	Approach A (ACC recommendation)	Approach B (Consistent with 2013 Budget)
Funding certainty	Both options would see continuing improvement to the financial position of ACC's levied Accounts. ACC is expected to be able to fund claims costs in the upcoming levy year and historical levy years even with larger levy reductions.	
Collect the minimum necessary	Neither option collects the minimum necessary because levy rates for both options collect levies above the expected cost of claims which increase the funding position more than needed across all three Accounts.	
	This option better meets this principle by collecting less in the short-term.	Collects more than needed in the short-term, and leads to a greater increase in the funding position for all three Accounts.
Appropriate incentives	<p>Decision makers and levy payers are able to make informed decisions on more accurate information that better reflects underlying cost.</p> <p>This means individual levy payer behaviour would be based on more appropriate pricing signals, including the relative performance of their industry and to their peers.</p>	<p>This is less consistent because it is a less accurate reflection of the true cost of injuries. The Government, ACC and levy payers would be making decisions on information that less accurately reflects underlying cost.</p> <p>Individual behaviour may be influenced by less appropriate pricing signals.</p>

Levy stability	ACC's funding policy sets a path to reduce levy volatility and moves ACC towards their selected target. Even though this is a larger reduction in the short-term, reducing levies now also allows levies to remain more stable in the long-term.	Smaller reductions in the short-term will require larger reductions or over a longer time period. Less smoothing of levy rates because there would be a larger step reduction to future levy rates. However, it is unclear what the future levy would be and this reduction may be consistent with levy stability when re-examined in the future.
Minimise inter-generational transfers	This minimises the level of over collection from today's levy payers which subsidises future levy payers.	Represents an over collection from today's levy payers which would subsidise future levy payers (based on current information).
Public interest (appropriate levy revenue transfer, avoid detrimental effects on Crown accounts, and support Government's economic goals)	Would represent lower revenue in Crown accounts. This would reduce levy rates and minimises any opportunity cost and revenue transfer by leaving more in the pockets of levy payer for the 2014/15 levy year. Leaving more in levy payer pockets would better support the Government's goals for economic growth.	Would represent higher revenue in Crown accounts. This is consistent with the Government's fiscal strategy to balance the books. This has a larger opportunity cost and revenue transfer from levy payers to ACC.
	The impact on levy payers at the macro-level and on individuals is discussed in two next sections.	

Appropriate revenue transfer from changes to levies

- 45 Approach B would see ACC have a slightly higher funding position in all three Accounts than under Approach A. This would represent a greater opportunity cost and revenue transfer from levy payers to ACC. However, excess funds taken from levy payers are not lost to today's economy. ACC plays a significant role in the New Zealand economy through its investment portfolio.
- 46 Higher levies under Approach B would be expected to take around \$205 million more from levy payer pockets over 2014/15, as summarised in Table 10, and it is likely to negatively impact on the Government's priorities for economic growth and reducing costs for business.

Table 10: total levy reductions under the two approaches for each Account

	Work Account	Earners' Account	Motor Vehicle Account	Total
Approach A	\$151 million	\$236 million	\$122 million	\$508 million
Approach B	\$121 million	\$182 Million	no change	\$303 million
Difference	- \$30 million	- \$54 million	- \$122 million	- \$205 million

- 47 Approach A is expected to better support the Government's priorities for economic growth:
- A lower Earners' Account levy would reduce effective marginal tax rates on wage income, which would generally have positive impacts for labour supply, employment, and consequently economic growth. However, the effects would be modest.

- Reduced levies for businesses would also provide a modest improvement in the investment climate.
- The changes could reduce headline inflation through the reduction in the Motor Vehicle levy, although this would not be expected to have much impact on monetary policy.

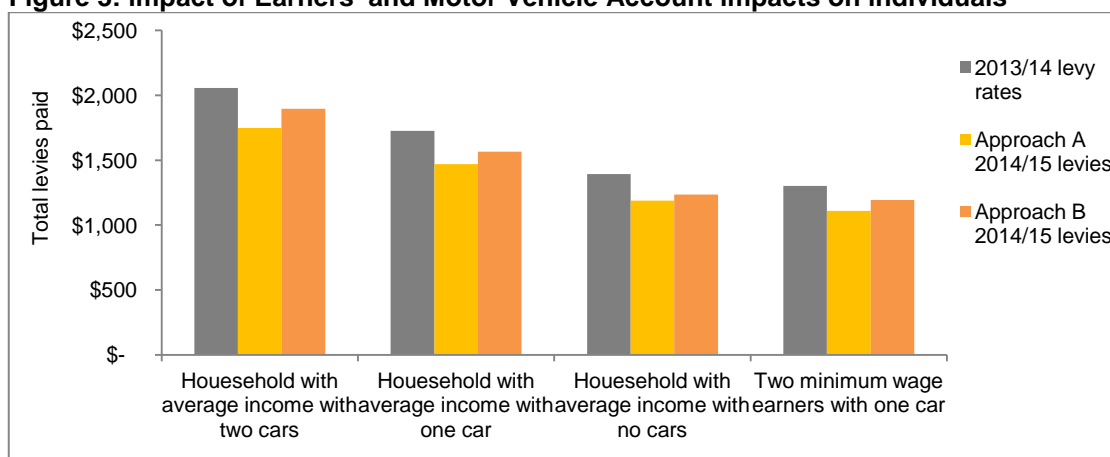
Modelling the economic effects of changes to Earners' Account levies

- 48 The Treasury has run the changes to the Earner's Account under Approach A through their tax models and believe that the proposed changes to levy rates have no discernible distributional effect. They have identified an annual increase of \$30 million in the cost of NZ Superannuation (NZS) because the change in ACC settings affects net wages, and due to indexing there is a subsequent effect on the rates of NZS.
- 49 Modelling the effects of decreases in levies was only done for the Earners' Account because the Treasury's model does not include vehicle information, and the Work Account decrease does not directly affect equality levels for individuals.

Impact of changes to levies on individual levy payers

- 50 A household on the average income in New Zealand with two cars, under Approach A, would see an annual reduction of around \$300, falling from \$2,050 to \$1,750.¹⁰ Approach B is expected to result in a smaller reduction of around \$150. Figure 3 provides an idea of the combined impact of the two approaches for the Earners' and Motor Vehicle Accounts on different hypothetical levy payers.

Figure 3: impact of Earners' and Motor Vehicle Account impacts on individuals¹¹

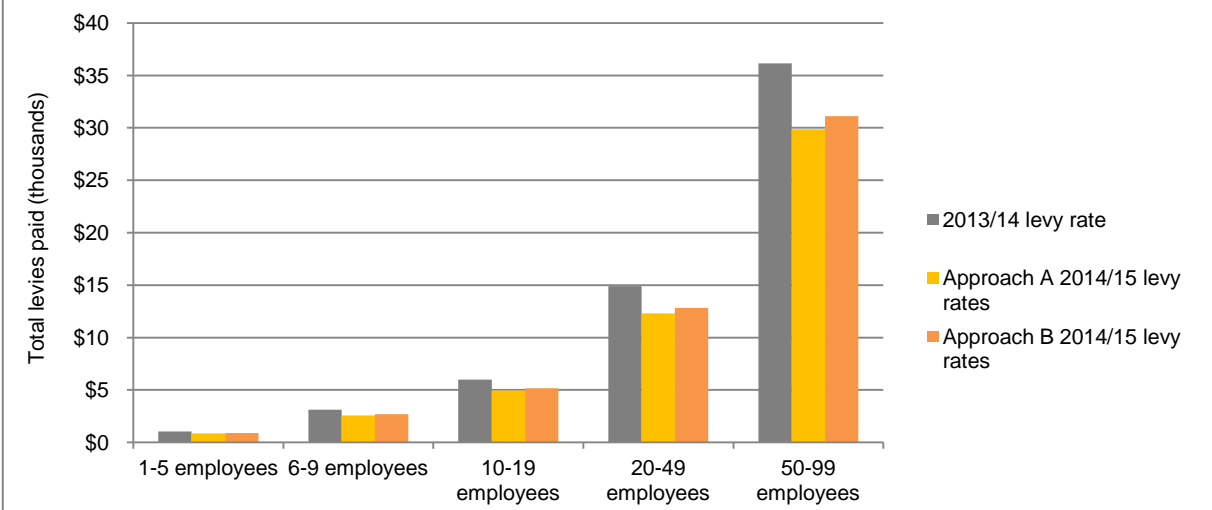


10 Based on average household income of \$82,029 (from wages and salaries, Household Economic Survey (Income): Year ended June 2012, Statistics New Zealand) and owning two vehicles.

11 Minimum wage is currently \$28,600 per annum for a 40 hour week.

51 Figure 4 gives an indication of the average Work Account levy firms of various sizes under the two approaches would pay. The impact on businesses with 100 or more employees is not included in the graph because their levies are on average much higher due to their significantly larger payroll. The average Work Account levy for businesses with 100 or more employees for 2013/14 is \$259,000. This would fall by \$45,000 to \$214,000 under Approach A. And would fall by \$27,000 to \$232,000 under Approach B. Actual levy rates depend on the firm’s classification unit, liable earnings, experience rating adjustments, and work safety management practices.

Figure 4: average reduction of Work Account levies for different sized firms



Other levy policy proposals

Risk rating passenger vehicles

Purpose of risk rating

52 Insurance works by creating homogenous pools of risk that aligns pricing with underlying risk. Within an existing homogenous group a range of factors could be used to identify different risks, or existing cross-subsidies, to create new and more homogenous groups that improve the accuracy of risk profiling. However there is a point where the benefits of creating more homogenous groups are outweighed by high administrative costs, information constraints or both.

Status quo

53 The ACC Motor Vehicle Account provides entitlements for injuries that occur on public roads. There are 2.6 million passenger vehicles in New Zealand that pay a flat levy rate for their licence fees. Owners of petrol vehicles are expected to pay an average of \$123.68 of their total levy through the petrol levy, this is a proxy for exposure to on-road injury risk.

Problem definition

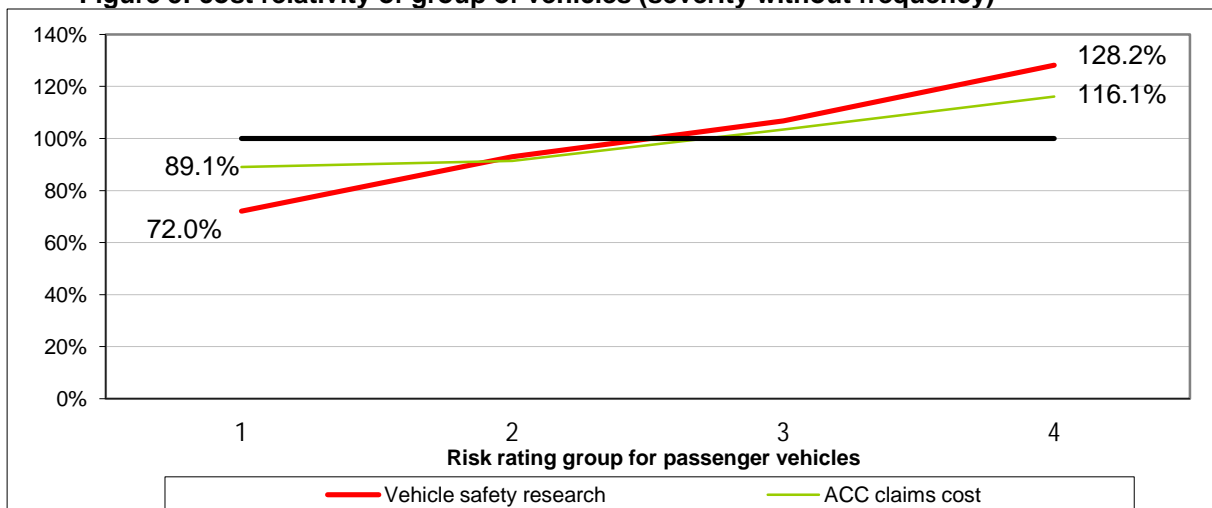
54 There are many factors that contribute to injury risk including the type of vehicle, how it is driven, how often it is driven, when it is driven, and the skill level of the driver. Secondary safety systems are designed to reduce the extent to which the kinetic energy in a crash is transferred to the driver, passengers and other road users.

55 The US National Highway Traffic Safety Administration (2013) found that vehicle safety was “the most important component to reduce serious injury outcomes and injuries

leading to permanent medical impairment".¹² A recent Austroads report into changes in crashworthiness and crash outcomes in light passenger vehicles found drivers of older vehicles were twice as likely to be fatally injured when they crash as those of new vehicle and the most likely reason is the improved secondary safety of the newer vehicles.¹³

- 56 The Monash University Accident Research Centre (MUARC) provides an index of secondary safety of vehicles. The Total Secondary Safety Index (TSSI) is derived from real world crashes where there was a fatality or serious injuries, and includes data from crashes that resulted in over half a million injured people. The TSSI includes measures for how a vehicle protects the occupants of the car (crashworthiness) and injuries to other people involved in the crash (aggressivity). The TSSI adjusted for the influence of non-vehicle related factors such as age, gender, year and jurisdiction of crash, speed limit, and broad crash type.
- 57 ACC has applied MUARC's research to develop groups that split the passenger vehicle class based on vehicle safety. ACC then analysed how the severity of injuries changes across the four groups. Figure 5 shows that costs increase from the most safe group to the least safe group. This shows that some vehicle owners should pay more than other vehicle owners, instead of the status quo of a flat licence fee.

Figure 5: cost relativity of group of vehicles (severity without frequency)



12 Use of car crashes resulting in injuries to identify system weaknesses. Stigson H, Kullgren A, Krafft M. Downloaded 7 Sept 2013 from <http://www-nrd.nhtsa.dot.gov/pdf/esv/esv22/22ESV-000338.pdf>

13 The Impact of Changes in the Australian Light Vehicle Fleet on Crashworthiness and Crash Outcomes. Austroads. <https://www.onlinepublications.austroads.com.au/items/AP-428-13> downloaded 7 Sept 2013.

Proposal

- 58 ACC proposes to split the passenger vehicle fleet into four risk classes based on vehicle safety. The average weighted risk of the vehicles for each class indicates an increasing risk profile between the classes. Table 11 shows the total levy that owners of passenger vehicles are proposed to pay.

Table 11: levies for vehicle safety passenger vehicles classes

Passenger vehicle type	Estimated number	Current total levy (includes petrol levy)	ACC's recommended total levy includes petrol levy ¹⁴ (licence portion for petrol vehicles)	Size of reduction
Risk rating group 1	560,000	\$321.59	\$312.60 (\$188.92)	\$ 8.99
Risk rating group 2	480,000		\$297.60 (\$297.60)	\$23.99
Risk rating group 3	800,000		\$275.10 (\$151.42)	\$46.49
Risk rating group 4	750,000		\$230.30 (\$106.62)	\$91.29
Unrated group	30,000		\$274.40 (\$150.72)	\$47.19

- 59 The expected difference in risk, 42 percentage points, between safe and less safe vehicles is applied to the licence portion of the levy for petrol passenger vehicles – the most safe cars pay \$106.62 which is 44 percent¹⁵ less than the \$188.92 licence portion that least safe cars pay.
- 60 ACC has estimated that the proposal would redistribute the payment of levies from safer to less safe passenger vehicles, by around \$33 million.
- 61 Actuarial analysis indicates (see figure 5) that:
- it is appropriate to use vehicle safety to draw four homogenous groups for passenger vehicles
 - the slope for 'ACC claims cost' line is less steep than the 'vehicle safety research' line. This means the difference between groups' actual experience (ACC claims cost line) is not as large as the difference between groups' vehicle safety. Meaning using vehicle safety may overstate the difference in risk between the four groups. This is discussed further in Table 12.

Analysis of vehicle safety rating against key objectives

- 62 Risk rating passenger vehicles based on their crash safety is considered in the following table against some key objectives the Ministry views as important.

Table 12: analysis of vehicle safety rating against key objectives

Objectives	Assessment of vehicle safety as the basis of risk rating
Credibility	It is appropriate for ACC to use vehicle safety as a risk factor in setting the Motor Vehicle Account levy because vehicle design is one of the three key risks related to on-road injuries, along with road design and driver behaviour. MUARC research on vehicle type (by make, model and year) and crash outcomes shows a correlation between vehicle design and likelihood of serious injuries in a collision. This approach is consistent with insurance principles by introducing risk factors to draw homogenous groups. Some United States insurance companies use vehicle crash safety as a factor in setting premiums.
Proportionality	The proposed design uses vehicle safety as the only risk factor for varying the licence portion of levies for petrol vehicles, however, the actual degree of risk due

¹⁴ For petrol vehicles, the total levy includes an estimated amount ACC collects on average from these vehicle through the petrol levy of \$123.68. The remainder of the levy is collected from vehicle registration or the licence.

¹⁵ ACC has adjusted the differential from 42% to 44% for affordability reasons.

	<p>to vehicle safety is not known.</p> <p>The severity of ACC's claims costs shows a cost difference of 23 percentage points¹⁶ when splitting into groups based on vehicle safety groupings, compared to vehicle safety as a sole factor that suggests a higher difference of 44 percentage points¹⁷ – shown in figure 5. ACC's pricing may be more proportionate if the licence portion of the levy was adjusted by 23 percentage points rather than 44 percentage points because there are other factors that impact on claims costs, such as frequency, that have not been factored in. Due to data limitations in the matching process, the ACC claims cost line may not be a true indicator of actual claims cost and could be biased by other factors that are not controlled for. However this is the best estimate ACC has.</p> <p>Further investigation to improve proportionality is needed. This includes investigating the relationship between vehicle safety, frequency and severity so that ACC's pricing methodology reflects drivers of Motor Vehicle Account costs.</p>
Equity	<p>Given the compulsory nature of ACC levies, levy payers should pay levies that are appropriately aligned with their risk (or expected cost of claims) to achieve equity. Including vehicle safety could give a more accurate picture of underlying risk for passenger vehicles.</p> <p>Actuarial analysis matching claims cost and crash safety supports the approach if severity was the only factor in claims costs. We would also expect to achieve equity. However, ACC's costs depend on both the severity of claims and the number of claims made. Information on the number of claims made by the different vehicle risk groups is not available; without it we are unable to determine whether this would introduce new inequities.</p>
Implementation	<p>The Motor Vehicle Account levy is collected through New Zealand Transport Agency's (the NZTA) annual vehicle licensing system. System changes would be in place on 1 November 2014 at the earliest. Implementing vehicle safety rating for passenger vehicles in the 2014/15 levy year would require delaying start of the levy year from 1 July 2014 to 1 November 2014.</p> <p>The system change costs for the ACC to implement risk rating for passenger vehicles is a one off cost of \$4 million, with annual operational costs of around \$100,000.</p>
Durable	<p>We expect the Motor Vehicle Account levy to reduce to much lower levels as the Motor Vehicle Account's funding position improves. As levies fall, the differentiation of levies for safer and less safe vehicles would reduce to maintain proportionality.</p>

Impacts on passenger vehicle owners

- 63 The levy rates for passenger vehicles, using the methodology discussed above, would be based on the average passenger vehicle levy (100 per cent relativity). The four classes in order of least safest to safest, would have a relativity of 125.3 per cent, 115.4 per cent, 100.3 per cent and 70.7 per cent for levy rates. If there was no change to the average Motor Vehicle Account levy (Approach B), levy rates would need to be redistributed so that two of the four classes would see an increase to their levy, one (almost) no change, and only one class would see a decrease.
- 64 If the average Motor Vehicle Account levy were reduced under Approach A, some passenger vehicles would see a smaller reduction for 2014/15 than others compared to 2013/14 levies (see table 11). The least safe would see the smallest annual reduction of around \$9 and the safest would see the biggest annual reduction of around \$90.

16 Figure 5 shows a difference of 27% based on ACC claims cost (100% minus 89.1% divided by 116.1%).

17 Figure 5 shows a difference of 44% based on vehicle safety as the only factor (100% minus 72% divided by 128.2%).

65 The average 2013/14 passenger vehicle levy of \$321.59 represents about 7 per cent of the estimated \$4,600 annual operating cost for a vehicle.¹⁸ Implementing vehicle safety along with a levy reduction in Approach A, represents a saving of between 0.2 per cent to 2 per cent of annual operating costs for an individual passenger vehicle owner.

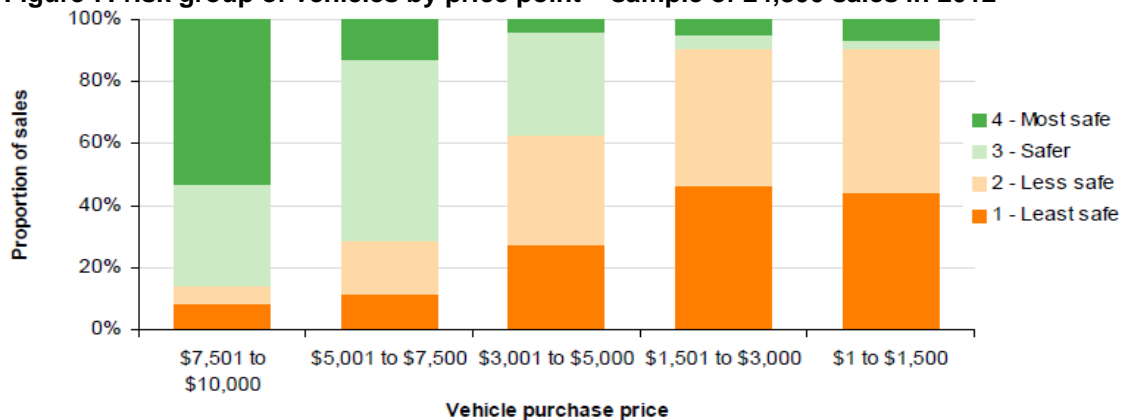
Implementation

- 66 A governance group has been established by ACC and the NZTA to allow system changes to be in place by 1 November 2014 (instead of 1 July when the levy year normally starts).
- 67 The introduction of Motor Vehicle levy changes in November 2014, rather than at the usual July introduction date, may result in some levy payers renewing their registration twice in 2014 rather than once. This would ensure they can receive maximum levy reductions by taking on shorter licensing periods prior to 1 November 2014 so that they can renew soon after 1 November 2014 at the lower levy rate.
- 68 The November 2014 implementation date would mean levy reductions for other vehicle classifications would be delayed for four months.

Risks

- 69 Some levy payers were concerned that this proposal represents a regressive tax, with people in lower socio-economic groups unable to take advantage of the lower levies attached to safer cars. In particular, pensioners had concerns that their vehicles, which tend to be older are unlikely to be rated as safe, and they would not see the same level of levy reductions.
- 70 ACC has noted that while there is a correlation between the price point of vehicles and their safety rating, there are cheaper vehicles available that are rated as most safe.

Figure 7: risk group of vehicles by price point – sample of 24,800 sales in 2012



71 There are some vehicles that ACC is unable to rate, such as collectors' items or high performance vehicles. As they are rare there is insufficient crash data to adjust levies for them. Some of these vehicles could be safe but would be unable to receive a lower levy. These vehicles would pay the average rate for the whole passenger vehicles classification.

18 Estimated by the Automobile Association.

Additional comments

- 72 The Ministry agrees with ACC's identification of vehicle safety as a risk across the passenger fleet, but further work on the proportionality between underlying risk and levies is required.
- 73 ACC is clear that the aim of this proposal is to improve equity. However, it is worth commenting on the safety impact for the fleet.
- 74 A net improvement in vehicle safety requires the importation of safer vehicles and/or the scrapping of less safe vehicles. This is unlikely to occur because the levy differential is likely to be too small to see vehicle owners scrapping unsafe vehicles in favour of selling them on. Because of this the proposal would have a limited impact on the overall safety of New Zealand's passenger vehicle fleet.
- 75 The proposal could raise awareness of vehicle safety, and may be a factor that contributes to a decision to buy a safer vehicle or scraping an unsafe vehicle. The information ACC proposes to use (crashworthiness and aggressivity) aligns with the methodology that determines the "Safe Picks" on the RightCar website. There is also safety information on cars through the ANCAP star rating. This allows consumers to choose vehicles that provide better protection to themselves and their passengers should they be involved in a crash. The impact that this information would have on consumer choice is unknown, but it is expected to help.
- 76 In order to have safety improvements across the fleet, it is necessary to influence the new fleet. This is unlikely to be achieved through these incentives, but it is still important for the purpose of awareness and messaging. To achieve this ACC would need to accurately risk-rate new vehicles to the fleet. However, the current approach does not place an accurate rating on the newest vehicle models entering the fleet. These vehicles would be levied at the average rate for the whole passenger vehicle class and there would be a two year lag for rating these new vehicle models. The Ministry would like to see further work on this.

Experience rating loading

Background

- 77 Experience rating is intended to create a financial incentive, through discounts or loadings on an employer's work levy. The programme is designed to:
- a reduce the number and severity of injuries in the workplace (e.g. through investing in risk management practices within their workplace)
 - b improve rehabilitation (return to work) outcomes (e.g. through engagement with employees and ACC during the rehabilitation process)
 - c improve risk differentials and equity, so that an employer pays a levy that better reflects their risk (in terms of number and cost of injuries) to the ACC Scheme, and employers are more aware of the cost and impact of the claims that occur within their workplace.

Problem definition

- 78 Levy rates are expected to reduce and this will reduce incentives. Currently there are cross-subsidies in the programme and these are accepted on the basis of affordability, as levies reduce, there is an opportunity to reconsider this balance.

- a As levies fall, this reduces the dollar size of the loading and therefore the financial incentive for businesses to improve their workplace safety performance with regards to preventing injuries, and when injuries do occur, returning injured workers as quickly and sustainably as possible to the workplace. The current portion of the Work Account would drop by 24 per cent under Approach A and by 19 per cent under Approach B. For example, a firm that has a current portion Work Account levy of \$1.00 and a 50 per cent experience rating loading, would pay \$1.50 for 2013/14 (\$0.50 loading). For 2014/15 the same firm would pay \$1.14 under Approach A (\$0.38 loading),¹⁹ or \$1.21 under Approach B (\$0.40 loading).²⁰
- b Poor performing firms in the experience rating programme are capped at a maximum 50 per cent loading, and do not pay a loading that accurately reflects their true risk to the Scheme. 315 employer groups are capped at the current mark, and as a result these firms are cross-subsidised by the rest of the experience rating programme. For example, the worst performer right now would require a loading of 645 per cent to reflect their risk to the Scheme, but they are currently capped at a 50 per cent loading.

Proposal

- 79 ACC proposes to increase the maximum loading from 50 per cent to 75 per cent.²¹ This means for 2014/15 the same firm above would now pay \$1.33 under Approach A, and \$1.42 under Approach B.

Maintains incentives for worker safety

- 80 As levies fall it is important to maintain incentive effects for poor performers. This proposal allows the dollar size of the loading to remain closer to current levels to maintain the incentives for firms to invest and focus on safety outcomes for employees, consistent with the purpose of experience rating (set out in paragraph 77).

Improving equity

- 81 Increasing the loading to 75 per cent, would improve equity because these firms pay a loading that is closer to their true costs and would reduce the cross-subsidies from uncapped firms to capped firms.

19 $[\$1 \times (1 - 24\%) \times (1 + 50\%)]$

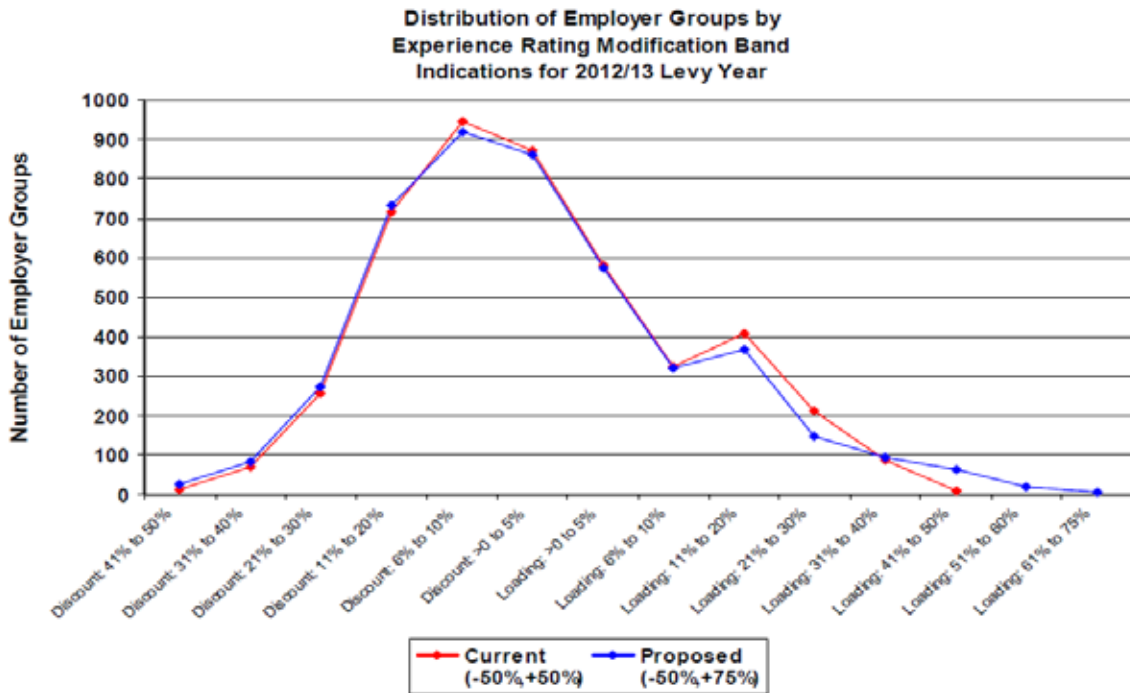
20 $[\$1 \times (1 - 19\%) \times (1 + 50\%)]$

21 The loading comprises a firm's industry's performance and a firm's performance within its industry, these equate to a 15 per cent and 35 per cent loading. This proposal would change the loading to 15 per cent and 60 per cent.

Impact

- 82 This change causes a small change to the distribution of loadings and discounts firms receive under experience rating (see figure 8). There would be a slightly wider spread, with the blue line (75 per cent) stretching further to the right than the red line (status quo of 50 per cent). This occurs because firms, that are currently capped at 50 per cent and should be paying more, would instead be capped at the higher level of 75 per cent.²²

Figure 8: distribution of employer groups by experience rating modification band



- 83 For individual firms, if there is no change to the average Work Account levy rate, they would see an increase to the dollar amount of their loading. The firm in the example above would see their levy rate move from \$1.50 to \$1.75.
- 84 With reduced levies, the proposal would result in some businesses receiving a larger percentage loading on their levy (and a greater loading in dollar terms), as discussed this maintains incentives, but the total levy falls because of the average levy reduction. Table 13 provides a breakdown of how this would work for the example firm.

Table 13: breakdown of the levy rate reduction and increase in experience rating loading for a firm that has \$1.00 Work Account levy (current portion) and a maximum loading

	2013/14	2014/15	
		Approach A (comparison to 2013/14)	Approach B (comparison to 2013/14)
Levy	\$1.00	\$0.76 (-\$0.24)	\$0.81 (-\$0.19)
Loading	\$0.50	\$0.57 (+\$0.07)	\$0.61 (+0.11)
Total	\$1.50	\$1.33 (-\$0.17)	\$1.42 (-\$0.08)

22 The distribution becomes flatter in some parts of the graph (blue line is lower than the red line) because the experience rating loading for an individual firm is based on a mix of the industry modification (15 per cent) and individual modification (35 per cent), and increasing the total loading has different effects on different firms. E.g. a firm may have a total 40% loading (5 percent for industry and 35% for individual) which becomes a 65% loading (5 percent for industry and 60% for individual), another firm may have a total loading 45% (10 percent for industry and 35% for individual) that becomes 50% (10 percent for industry and 40% for individual).

- 85 A firm's final rate would be subject to individual circumstances, specifically how they perform against their industry peers and any classification unit changes.
- 86 An evaluation of experience rating is underway for next year. The evaluation is focused on whether experience rating is achieving the objectives of the programme rather than the actuarial process underlying the experience rating Scheme. This change is not retrospective and it is not expected to impact on the data to be used for the evaluation.

Other proposals

Table 14: Other changes to levies policy

Proposed change consulted on	Ministry's comments	Notes
Work and Earners' Accounts		
Increasing the maximum and minimum liable earnings for the Work and Earners' Accounts	The Ministry supports this update for wage inflation so that levies match up with income-related benefits	Technical change in line with previous Cabinet decisions [CAB Min (12) 44/8]
Capping the impact of classification unit changes on Work Account levies + 25% or \$0.04 whichever is the greater, or -25%.	The Ministry supports no change to the current cap because this balances levy stability and charging the appropriate levy rate.	Current cap +25% or 0.04 cents, whichever is the greater, or -25%
Increasing the maximum liable earnings for the Workplace Safety Discount Programme	The Ministry supports this update for wage inflation.	Technical change in line with previous Cabinet decisions [CAB Min (12) 44/8]
Create a new classification unit in the Work Account	The Ministry supports these updates to improve risk pools.	Change as part of regular review of appropriateness of current risk pools
Merge two current classification unit and re-split them in the Work Account		
Changes to three classification unit descriptions in the Work Account		
Revising four levy risk group classifications in the Work Account		
Experience rating		
Increasing the minimum liable earnings for entry to the No-Claims Discount programme (under experience rating)	The Ministry supports this update for wage inflation.	Technical change in line with previous Cabinet decisions [CAB Min (12) 44/8]
Clarifying 'weekly compensation day' to include a part day	The Ministry supports this clarification because ACC systems are currently designed on this basis.	
Motor Vehicle Account		
Increase the motorcycle relativity	If the average Motor Vehicle Account levy per vehicle is reduced the Ministry would support keeping the dollar figure for motorcycles at current levels which would increase the relativity of motorcycles. This would more appropriately reflect injury costs.	Unlike other vehicle classes, the levy relativity for motorcycles was set largely due to affordability.

Proposed change consulted on	Ministry's comments	Notes
No change to the petrol levy rate of 9.9 cents per litre	The Ministry supports no change to the petrol levy.	
No change to the Motorcycle safety levy	The Ministry supports no change to the average Motorcycle safety levy.	
Expanding the Fleet Saver programme to rental fleets	Fleet rental companies cannot join Fleet Saver because they do not meet the requirements around driver behaviour. If they can demonstrate they meet new safety management practices tailored for these companies, rental fleets would receive reductions of 10 per cent or 25 per cent, but not 40 per cent, because they do not have control over the drivers of rental vehicles. The Ministry supports the expansion of the Fleet Saver programme to rental fleets. This is expected to have a positive but minor impact on the \$15 million benefit that Fleet Saver is expected to deliver to the Scheme over 10 years.	The Fleet Saver programme that Cabinet agreed to introduce [CAB Min (12) 44/8].

Results of public consultation

87 Section 331 of the AC Act requires ACC to consult on levy changes with levy payers. Public consultation was carried out from 17 September 2013 to 15 October 2013.

88 Levy submissions were received from all the major parties who contribute regularly during consultation.

ACC's analysis of public consultation

89 The number of submissions received this year and last year for each account are set out in Table 15:

Table 15: number of submissions received during public consultation

	2013/14	2014/15
Work Account	69	100
Motor Vehicle Account	32	126
Earners' Account	8	46

90 Key themes in the Work Account submissions were:

- a general support for the proposed reduction in the Work Account levy
- b concern from several major stakeholders that the current funding policy will produce excessive levels of reserves, taking account of the unique position of ACC as a Crown Entity
- c support for the increased expenditure on Injury Prevention programmes
- d requests from members of the digital visual effects sector of the film industry that their work be classified as computer work, rather than as part of film production
- e requests from members of the picture framing, hospitality labour supply and used book retailing industries that their classifications be reviewed

- f queries around the effect of the ACC policy of counting part days of weekly compensation payment as full days for Experience Rating purposes
 - g several industries have reported positive working relationships with ACC
 - h minimal response to the proposals for changes to the classification structure and Levy Risk Group composition.
- 91 Significant matters raised Earners' Account submissions were:
- a general support for the proposed reduction in the levy rate
 - b several major stakeholders suggested structural changes to the Account and the levy setting process, all of which are government policy matters outside the considerations of the levy consultation
 - c a number of requests that cyclists, sports people and clubs, and participants in outdoor recreational activities be levied to pay for their injury costs. These submitters assumed that motorcyclists, motorists and employers were covering these costs.
- 92 Key themes raised in the Motor Vehicle Account submissions were:
- a general support for the introduction of risk rating into the passenger vehicle class, particularly from major stakeholders. However many of the individual submitters consider the proposals flawed because they do not contain an element relating to driver/owner personal driving history
 - b motorcyclists reject the proposal that their levies should not reduce. Officials disagree with the views presented in submissions – that motorcyclists are subsidising other road users, or other sectors of the community, e.g. outdoor recreation. Within this group the basis for levy setting for motorcycles is disputed, and they do not recognise that ACC information shows that motorcyclists continue to be subsidised by other motorists. Safety improvements within the motorcycling community are seen as undervalued by ACC
 - c some preference for collecting a higher proportion, or all, of the total levies on a mileage basis.

Consultation

- 93 The Ministry consulted ACC on this Regulatory Impact statement and their feedback has been incorporated. The Treasury were informed.

Recommendations

Levy rates for 2014/15

- 94 As discussed above, setting the ACC levy rate involves balancing a range of objectives and factors including levy stability, full funding, uncertainty in forecasting, and the public interest.
- 95 The analysis of available options for levy rates show that Approach A (ACC's recommendations) achieves more of the objectives than Approach B. However, Approach B would better support the Government's fiscal strategy of reaching surplus in 2014/15 which would be in the public interest.

- 96 We support Approach A, as the benefits outweigh the economic and fiscal implications of relatively higher levy rates associated with Approach B.

Table 16: Ministry's recommended rates

	Work Account Average levy per \$100 liable earnings	Earners' Account Levy per \$100 liable earnings (incl GST)	Motor Vehicle Account Average levy per vehicle
The Ministry's recommended 2013/14 rate	\$0.95	\$1.45	\$280.00

Vehicle safety rating

- 97 The Ministry supports the concept of risk rating for passenger vehicles because existing evidence shows that there is a difference in risk across the passenger vehicles with less safe vehicles expected to have higher costs than safer vehicles.
- 98 We recommend deferring this proposal for further work to clarify the proportionality of vehicle safety as a risk within the pricing methodology and investigating how new vehicles can be rated. We believe refinement to these two issues would improve equity.
- 99 It should be noted that this could be a first step to improving safety for the New Zealand fleet and creates a platform for ACC to play a larger role in road safety. While this proposed programme may raise awareness of vehicle safety, the current design is unlikely to directly lead to improvements in the overall safety level of New Zealand's passenger vehicle fleet, and requires more work.
- 100 If levy rates do not reduce for the Motor Vehicle Account, as under Approach B, this proposal would not be possible without increasing levies for the least safe vehicle owners.

Experience rating loading

- 101 The Ministry supports increasing the experience rating loading to maintain incentive effects for poor performers.

Implementation

- 102 New levy regulations are required to be set by 31 March 2014 for the Work and Earners' Accounts. Otherwise the 2013/14 levy rates will remain in place from 1 April 2014. New levy rates have historically been set by 30 June 2014 for the Motor Vehicle Account. Otherwise the existing levy rates will remain in place from 1 July 2014.
- 103 If changes to the Earners' Account levy rates are to be in place on 1 April 2014 the Inland Revenue processes would require notification of approved Earners' Account rates by mid-December 2013 so that payroll software developers can update, test, and distribute their systems updates.
- 104 There are no proposals that would significantly change levy collection mechanisms, so implementation of these changes would be business as usual for ACC.
- 105 If risk rating of passenger vehicles is introduced for 2014/15, ACC will work with NZTA on the implementation and expects the programme to be available from 1 November 2014. This would require delaying the levy year from 1 July 2014 to 1 November 2014.

Monitoring, evaluation, and review

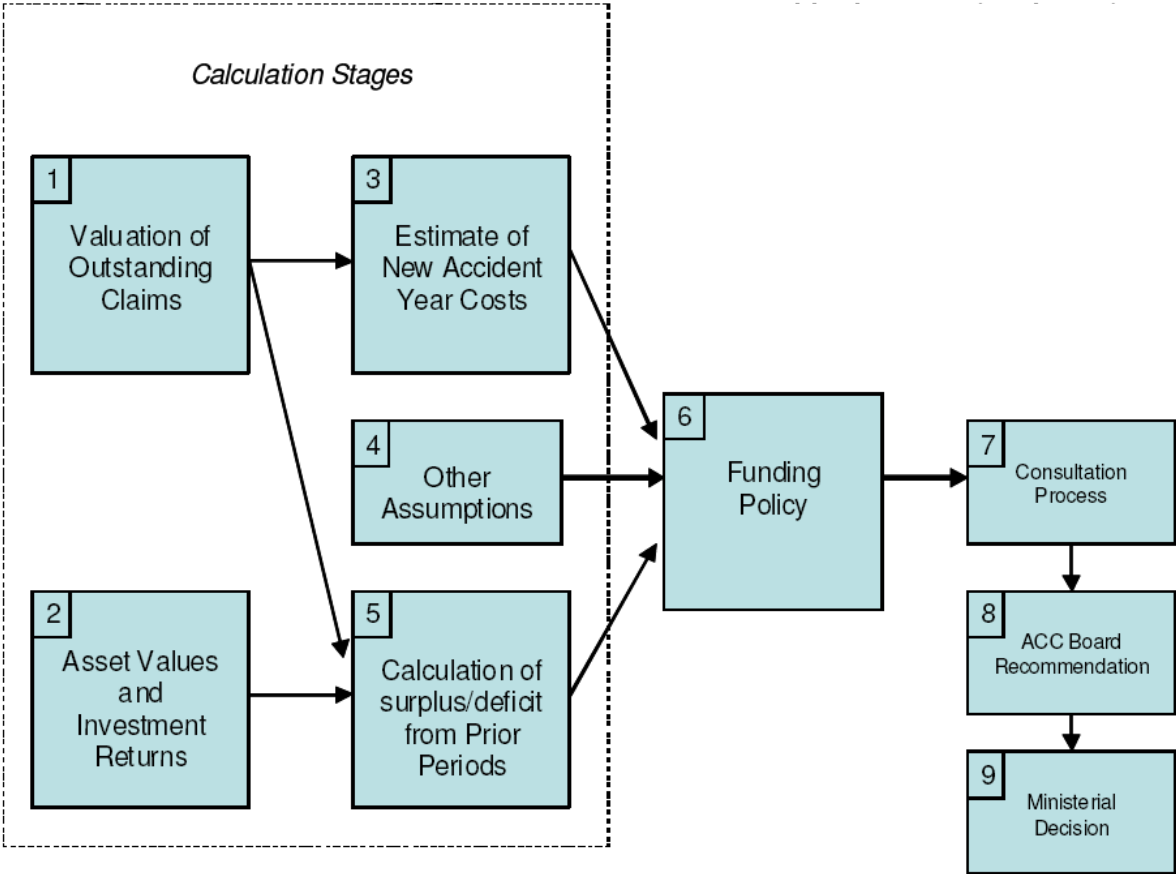
106 Monitoring, evaluation and review is built into the annual review of the ACC levies. The process for the review is as follows:

- The review of levies begins with the ACC commissioned independent actuarial assessment of ACC's liabilities as at 30 June. This assessment is then reviewed by the Treasury's independent actuaries.
- ACC's internal actuaries then apply the assumptions and methodologies used in the independent actuarial review, along with other material, to make assumptions about claims costs for the upcoming year.
- The ACC Board reviews its funding policies, with the key goal of ensuring that the levies set will mean that ACC is fully-funded (or on the right path to achieving full-funding).
- ACC then publicly consults on proposals and provides 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 Ministry commissions an independent actuarial review of the recommended levy rates and provides advice to the Minister for ACC.
- The Minister for ACC presents her recommendations to Cabinet.

Appendix A: levy setting process

1. The following diagram explains the steps in the ACC levies process.

Figure 3: ACC levies process



2. The key stages of the process are as follows:

- [Box 1]: Independent actuaries (currently PricewaterhouseCoopers Actuarial (PwC)) are engaged by ACC to estimate its outstanding claims liabilities. PwC does not estimate liabilities for certain types of gradual process claims. These estimates are produced by ACC.
- [Boxes 2 and 5]: The estimated outstanding claims liability is subtracted from the value of the assets to obtain the starting funding position (the deficit or surplus from prior periods).
- [Box 3]: New accident year claims costs are estimated using historical claim frequency and severity derived from actual historical claim numbers and payments, and projected future claims payments for prior accident dates. ACC applies these estimates (including any assumed favourable or unfavourable trends) to projected exposure. The exposure measure varies by Account, for example, number of motor vehicles for the Motor Vehicle Account. The timing of the future claim payments for new accident years is then calculated after applying an assumed payment pattern.
- [Box 4]: Other components required to be funded by the proposed levy are:
 - claim management expenses, which are estimated directly by ACC

- the cost of Public Health Acute Services, which is estimated by the Ministry of Health
- the potential for bad debt (that is, non-payment of levies).
- [Box 6]: At this stage of the process, ACC has now estimated new year costs [Box 3], other assumptions such as expenses [Box 4], and the amount of surplus/deficit for prior periods [Box 5]. All these amounts must eventually be covered by levies, but ACC has discretion over the period in which full-funding is achieved. The key decision is the period over which any surplus or deficit from prior periods will be smoothed out.
- ACC estimates its future funding position based on current asset and liability balances, and expected future cash flows. The relevant cash flows are the projected investment return, future levies, and claim payments. Future levy rates are set in line with the funding policy objectives.
- [Box 7]: ACC proposes levy rates for public consultation.
- [Box 8]: Following consultation ACC recommends rates to the Minister for ACC.
- [Box 9]: The Minister for ACC decides the levy rates to be adopted. If approved by Cabinet the rates can be passed into legislation.