Regulatory Impact Statement

ACC levies for 2015/16

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by the Ministry of Business, Innovation and Employment (the Ministry). This RIS has three distinct but related parts that provide analysis of:

– options for setting the Accident Compensation Corporation (ACC) levies for 2015/16;

– a policy proposal to introduce risk rating into the Motor Vehicle Account; and

– technical updates to factors used for calculating levies.

ACC levies are based on forecasts of a number of factors including injury rates, ACC's rehabilitation 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 these factors from year to year will change the level of funding that ACC requires (which is why ACC levies are updated annually).

A full independent actuarial review of ACC's liabilities and costs used in levy setting was completed by Finity Consulting Pty Limited. This review found the inputs and analysis used by ACC 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. In addition to the factors already considered by ACC, the Minister must also consider the public interest, as required under Section 300 of the *Accident Compensation Act 2001* (*the AC Act*).[1] The Government has identified the importance of the public interest in the fiscal strategy to return to surplus in 2014/15. When this factor is weighted more highly in the public interest test, alternatives to ACC's recommended levy rates for 2015/16 arise.

Levy proposals in respect of introducing the risk rating of passenger vehicle levies to better reflect the cost of different cars to the Scheme are considered. Finally, annual technical updates for levy calculations are considered to reflect wage inflation and other levy changes that allow ACC to implement the Scheme.

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Kirstie Hewlett

General Manager,

Labour Environment

1 In exercising any functions or powers under the *AC 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.

Summary

1. ACC's financial position has significantly strengthened since 2009, and this trend has continued over the last year, mainly due to economic factors. The most important factor to consider this year, and potentially for a number of years to come, is that levies have to return any surpluses in the funding position either in the short or medium term. We must consider managing how fast to reduce a surplus through the levy rates – some options reduce the funding position slowly, while others change it faster.

2. Current decisions on how to set levy rates will have implications for future decisions on how to approach reducing the surplus funding across Accounts. It is important to note that not making reductions now increases future instability by creating the need for significant changes in the future. These decisions around the size and speed of collection can create intergenerational transfers and may distort pricing signals. We must also recognise that levy rates have an impact on the Crown accounts which may not be in the public interest.

3. We discuss the options for 2015/16 levy rates below, and after considering the factors outlined above we support ACC's recommended levy rates, the introduction of risk rating of passenger vehicles, and the technical changes.

Background

What is ACC?

4. ACC is a Crown agent providing comprehensive, no-fault personal injury cover to all New Zealand residents and visitors to New Zealand. ACC coverage is managed under five separate Accounts. The following table outlines the five Accounts:

Table 1: Summary of the ACC Accounts

Account		**How it is funded**	**Entitlements it pays for**
Levied Accounts	Earners' Account	Levies on earners through PAYE (or invoiced directly by ACC for self-employed people)	Earners' non-work injuries (not including motor and treatment injuries)
	Work Account	Levies on employers and self-employed	Work-related personal injuries
	Motor Vehicle Account	Levies on motor vehicle owners (registration and through petrol)	Motor vehicle injuries
	Treatment Injury Account	Contributions from the Earners' and Non-Earners' Accounts	Treatment injuries
Non-Levied Accounts	Non-Earners' Account	Government appropriation	Non-earners' personal injuries

The levy setting process

5. The *Accident Compensation Act 2001* (*the AC Act*) requires levy rates to fully fund each Account having regard to uncertainty in forecasting and levy stability.

6. Each year the Minister for ACC, in consultation with Cabinet, is asked to review the funding needs of the levied Accounts to cover entitlements for injuries related to the Work, Earners' and Motor Vehicle Accounts, and to set levy rates consistent with the

full funding requirement. The Earners' Account levy includes a portion for the Treatment Injury Account. The rates are set through regulations.

7. The *AC Act* requires ACC to develop a funding policy that considers levy stability and forecast uncertainty, use this to develop levy rates to consult on[2], and finally to make recommendations on levy rates to the Minister for ACC. It should be noted that decisions are being made on a new Government funding policy and this is discussed from paragraph 15.

8. There is no formal definition of 'fully funding' in the AC Act, ACC's interpretation of this is through setting a funding target that it considers is appropriate to ensure funding for both the upcoming year and historical claims costs. This aims to balance the need for financial sustainability of the Scheme and levy stability over time. ACC's recommended levy rates are based on:

   - the expected lifetime cost of claims for each Account for the upcoming levy year, in this case the 2015/16 levy year
   - consideration of ACC's financial position for the lifetime cost of historical claims (prior to the 2015/16 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.

9. The Ministry of Business, Innovation and Employment (the Ministry) commissioned Finity Consulting Pty Limited (Finity) to carry out an independent actuarial review of ACC claims' cost forecasts in relation to 2015/16 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.[3]

10. The Ministry provides the Minister for ACC with advice on the proposed levy rates and related policies, using the independent actuarial review along with the consideration of levy setting objectives (set out in paragraphs 57).

11. The Minister for ACC, in consultation with Cabinet, considers ACC's recommended funding needs for the levied Accounts. In addition to the factors already considered by ACC, the Minister must also consider the public interest, as required under Section 300 of the *AC Act*[4] when carrying out the functions and powers under the *AC Act*. An overview of the funding process is set out in Appendix A.

12. All rates discussed in this paper for the Work and Earners' Accounts are per $100 of liable earnings and exclude GST. All rates for the Motor Vehicle Account are per vehicle and exclude GST.

13. The financial information given in this RIS, including that of the funding positions, reflect estimates and forecasts based on 31 December 2013 data and is consistent with the modelling undertaken for the consultation. These have not been updated for the most recent financial information. Information on Crown Accounts uses the Operating Balance Excluding Gains and Losses (OBEGAL) as it was reported in the Budget and Economic and Fiscal Update (BEFU) in May 2014.

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2 ACC carried out public consultation from 20 May 2014 to 17 June 2014 (summarised in paragraphs 120 to 126 below). Consultation and analysis of submissions has been completed, and the ACC Board provided its recommendations to the Minister for ACC on 16 July 2014 [ACC BP 14-032 refers].

3 This work is limited to the reasonableness of ACC's recommendations and is not an independent estimate of levy rates. This may increase the confidence in the judgments made by ACC in selecting assumptions, but it does not reduce the inherent uncertainty of the eventual outcome.

4 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.

2015/16 expected cost of claims

14. The current year's costs have been through actuarial analysis, and the Ministry considers the figures to be as robust as current information allows. The 2015/16 expected cost of claims (including Scheme costs) for each Account are set out in Table 2. More detailed analysis of this is provided in Appendix B.

Table 2: Expected cost of claims for injuries occurring in 2015/16[5]

Earners' Account	Work Account	Motor Vehicle Account
$1.24	$0.78	$140.00

Development of a government funding policy

15. On 28 May 2014 the Cabinet Economic Growth and Infrastructure Committee agreed to set a Government funding policy to direct how ACC sets the proposals for its levied Accounts.

16. The Government funding policy requires ACC to administer the levied Accounts and recommend levies according to set parameters, which will improve the ACC levy setting process, encourage more transparency of the Government's funding preferences and improve the alignment of ACC's levy recommendations with the Government's expectations.

17. This would better reflect the Government's risk preference for ACC as a Crown agent and targets a much lower funding level than the current ACC funding policy. This is in recognition of the consequences associated with overfunding (some of these are outlined in paragraph 27).

18. The Accounts are significantly overfunded compared to the new agreed funding band. Work is underway on the details of how to transition to the new funding band. We consider the new funding policy and any transitional arrangements will address the issues associated with overfunding.

19. The new funding policy will not come into effect until the 2016/17 levy round. However, the new policy is relevant to setting the 2015/16 levies, as 2015/16 levy rates should consider any effect they have on the transitional phase, or whether 2015/16 rates lead to a stable levy path related to the transitional phase. Generally any rate that reduces (or does not increase) each Account's funding position is a good first step to bring levies to a sustainable level.

The status quo

20. The current average levy rates are set out in Table 3:

Table 3: 2015/16 levy rates

Earners' Account	Work Account	Motor Vehicle Account
$1.26	$0.95	$330.68

Problem definition

21. The purpose of levies (and the full funding approach), as set out under the *AC Act*, is to ensure that there is enough money now and in the future to pay for the lifetime cost of injuries that have occurred in the past, and are forecast to occur in the upcoming levy year. Good ACC claims' management, high investment returns, and positive economic factors have all lead to the three Accounts being full funded (and two Accounts with a high funding position), and we must consider how to manage this.

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

22. Claims' performance, investment returns, and economic factors lead to changes in ACC's claims costs, assets, and liabilities. As a result we review the impact of these factors on the lifetime cost of injuries for the upcoming year and the funding position, and update levies to ensure that the Accounts would be fully funded under the *AC Act* for the purpose of paying for entitlements.[6]

23. Over the last year we have seen emerging evidence of negative, but minor, claims' experience in a few areas, which is a departure from consistent positive claims performance since 2009. Short term rehabilitation rates have deteriorated with more people staying on the Scheme for longer. Care package size for social rehabilitation of serious injuries has been higher than expected because of the increase in the average number of care hours.

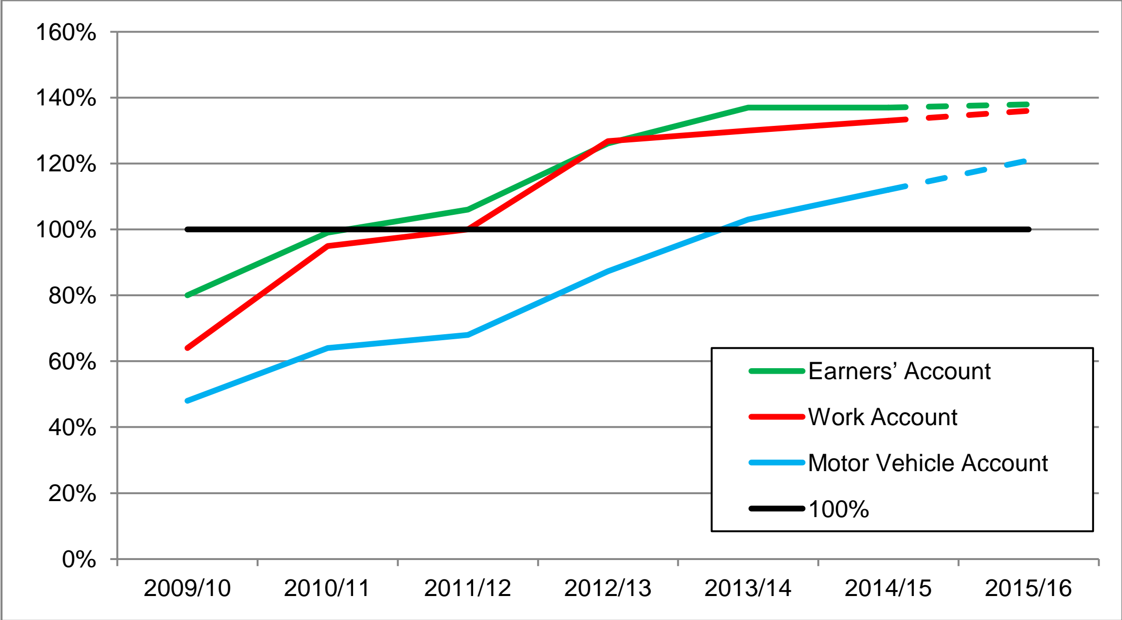
24. ACC has indicated that the deterioration in these areas will be actively managed. ACC expects that management would bring these costs under control, and therefore have not factored the current deterioration into their forecasts at this stage. This is financially responsible, and it is appropriate for ACC as forecasts should be based on demonstrated and consistent trends.

25. If ACC is unsuccessful, and we see continued deterioration, ACC may forecast higher claims' costs in the future and the current surplus we see for historical claims may decrease as a result.

26. ACC's financial position for historical claims has improved over recent years. Over the last year this trend has continued, and has been due to the positive impact of economic factors such as higher investment returns and movement in discount rates. These have outweighed the negative impacts of recent deteriorating claims' performance. Figure 1 shows that:

    - by the start of the 2015/16 levy year all Accounts are fully funded as per ACC's interpretation, and
    - keeping the 2014/15 levy rates in place for another year would see all Accounts continuing to increase.

Figure 1: Expected funding position of levied Accounts by start of 2015/16 levy year



6 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.

27. Retaining the current 2014/15 rates, 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 issues with this are:

    a. ACC collecting more than is necessary

    b. the funding position continuing to increase

    c. larger levy reductions in the future to return excess collection from this year

    d. intergenerational transfers where today's levy payers cross-subsidising future levy payers

    e. levy rates would be further from the true cost of injuries today and in the future

    f. more is removed from the economy and negatively impacts the economy (this is not entirely lost because ACC has a significant investment role in New Zealand).

Regulatory impact analysis

2015/16 average levy rates

Approaches to levy setting

28. A range of levy rates would be consistent with the *AC Act's* requirement for the levies to fully fund the Accounts. Some levy rates see the funding position change slowly, while others see it change faster. 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 recommendations due to their responsibility to also consider the public interest. This may lead Ministers to decide on a levy rate that is different to ACC's recommendation but still consistent with the AC Act's requirements.

Factors taken into account

29. The cost for the upcoming levy year is covered in paragraph 14, and this is set out in more detail in Appendix B.

30. 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.

31. 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 surplus would require larger adjustments at some point in the future to return the surplus. These decisions around the size and speed of collection can create intergenerational transfers and may distort pricing signals.

32. When dealing with the surplus or deficits for historical costs there are two broad approaches we can take to adjust the expected cost of claims for the upcoming year when setting levy rates:

    a. ACC takes an actuarial approach, and applies its current funding policy. The funding policy is based on ACC's risk preferences in managing its funding position towards its selected funding target over a period of time in the interest of levy payers.

    b. Ministers are required to balance the above considerations against the public interest and, in particular, the interests of taxpayers, levy payers, claimants, and potential claimants.

33. The Ministry has considered the Government's risk preferences, along with objectives related to the economic and social goals for setting levy rates (including the selected funding target and how fast this is achieved) in our analysis of the two broad approaches.

Option 1 (ACC's approach)

34. ACC has proposed levy rates based on adjustments to the 2015/16 expected cost of claims. This considers what size the change to the funding adjustment should be. ACC considered these factors:

    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 we change the funding adjustment to collect an appropriate amount based on ACC's risk preference.

35. ACC's proposed rates reflect their judgement on levy stability in the interest of levy payers.

Earners' and Work Accounts

36. Last year the Government reduced the levy rates for the Earners' Account by 17 per cent and the Work Account by 15 per cent. Strong investment performance and the positive impact of changes to the long term discount rate have seen the funding position of each Account remain strong.

37. The Earners' and Work Accounts are expected to be at 137 per cent and 133 per cent respectively at the end of the 2014/15 levy year. In dollar terms the Accounts are $1.977 billion and $1.867 billion respectively above ACC's declared liabilities.

38. The highly funded nature of the two Accounts means for 2015/16 ACC has proposed to reduce the levy rates from existing levels. Consistent with ACC's risk preferences, this would continue to bring the Earners' Account back within ACC's band, and maintain the Work Account within ACC's funding band in the medium term.

Motor Vehicle Account

39. The Motor Vehicle Account is not as well funded as the Work and Earners' Accounts. It is projected to enter ACC's target funding band during the 2014/15 levy year, and it is growing at a much higher rate than the other two Accounts. This Account had a significant deficit historically, and therefore had a much higher funding adjustment to make up the deficit for historical claims. For 2014/15, the average levy is over twice the expected cost of claims, and we expect a nine percentage point movement from 103 per cent at the start of July 2014 to 112 per cent at the end of June 2015.[7]

40. Given the Account is within ACC's band and is fully funded (as per ACC's definition), ACC recommends reducing the levy, which will reduce the difference between the levy and the expected cost of claims, and also the rate at which the funding position increases.

ACC's proposed funding adjustment for each Account

41. The expected cost of injuries for 2015/16 is expected to remain largely similar to 2014/15. The funding adjustments, however, have been reduced to reflect the improvement to the funding position for all three Accounts over the last year, and to deal with surpluses for historical claims.

42. The following table shows a small adjustment to the 2015/16 expected cost of claims leads to the expected 2015/16 funding position for the Earners' Accounts reducing, and the Work and Motor Vehicle Accounts increase at a slower rate. It should be noted that

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7 The Motor Vehicle Account will be $0.90 billion above ACC's declared liabilities at the start of the 2015/16 levy year.

setting the Work Account levy $0.03 below expected cost of claims still leads to the funding position increasing. This is because investment returns on the assets over and above 100 per cent funding and the 2014/15 levy rates result in an increase to the funding ratio.

Table 4: ACC's funding adjustment for 2015/16 and the impact on funding position

	Earners' Account	Work Account	Motor Vehicle Account
Expected cost of claims for 2015/16[8]	$1.24	$0.78	$140
Proposed average levy rate for 2015/16	$1.20	$0.75	$200
2015/16 adjustment[9]	-$0.04	-$0.03	+$60
Expected 2015/16 funding position	135%	134%	115%
Change from 2014/15 funding position[10]	**-1.2%**	**+1.0%**	**+2.9%**

43. ACC's proposals are consistent with their funding policy, which aims to fully fund each Account according to ACC's risk preferences and consideration of levy payer interests. Finity considers ACC's recommendations to be reasonable under ACC's current funding policy.

Option 2a (Considering the fiscal strategy in the public interest)

44. Option 2a takes into consideration ACC's advice, but the public interest test places more weight on the public interest of the Government's fiscal strategy to balance the books by the end of 2014/15, over the public interest of additional funds being left in the economy.

45. As mentioned earlier, 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. When applying the public interest test the Government needs to balance the benefits of cuts for levy payers, while bearing in mind reductions to ACC levies impact on the Government's fiscal strategy to balance the books and the public interest of doing so.

46. In the *Budget 2012 Fiscal Strategy Report*, the Government identified that the fiscal strategy to balance the books was in the public interest, and stated that "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".

47. Key benefits of the fiscal strategy are:[11]

    a. "repaying debt also helps to raise national savings, maintain credibility with international lenders, reduce finance costs and allow the internationally competitive sectors of the economy to grow."

    b. "carrying substantial debt is neither comfortable nor financially prudent…a sizeable level of debt and reduces the Government's ability to borrow in [the] future if New Zealand were to experience another economic shock or natural disaster…"

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8 Includes incentive programmes and the motor cycle safety levy.

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.

10 Percentage point.

11 The *Budget 2014 Fiscal Strategy Report.*

48. The funding adjustment leads to the expected 2015/16 funding position increasing for the Earners' Accounts, and the Work and Motor Vehicle Accounts increasing at a slower rate.

Table 5: Funding adjustment for 2015/16 and the impact on funding position based on Option 2a

	Earners' Account	Work Account	Motor Vehicle Account
Expected cost of claims for 2015/16[12]	$1.24	$0.78	$140
Proposed average levy rate for 2015/16	$1.26	$0.90	$195
2015/16 adjustment[13]	**+ $0.02**	**+$0.12**	**+$55**
Expected 2015/16 funding position	137%	136%	114%
Change from 2014/15 funding position[14]	**+0.1%**	**+3.2%**	**+2.7%**

49. Option 2a rates have been included in the forecast for Budget 2014. Options other than 2 have a different impact on 2014/15 OBEGAL. Option 1 has a $119 million negative impact on 2014/15 OBEGAL compared to Option 2a.

50. Under Option 2a, higher levy rates in the Work and Earners' Account compared to Option 1, would result in:

    a. the funding position increasing marginally for the Earners' Account, and not reducing as it does under Option 1, and

    b. the funding position for the Work Account increases at a higher rate than under Option 1.

51. The Motor Vehicle Account funding position would increase at a slower rate under Option 2a compared to Option 1.

52. Two other options arise under the approach that weights the public interest of balancing the books more highly than Option 1 does. These reflect that on 8 July 2014 The Treasury released the Financial Statements of the Government of New Zealand for the 11 months ending 31 May 2014, which showed that the Government's financial position was $332 million more in deficit than forecast in Budget 2014.

53. Option 2b has a different balance between levy payer and public interest, and places more weight on the public interest of balancing the books. This approach would further minimise the impact on 2014/15 OBEGAL by making a smaller total levy reduction. This would involve reducing the Motor Vehicle Account levy by the same amount as under Option 2a but leaving the levies for the Work and Earners' Accounts unchanged for 2015/16.

54. Option 2c addresses levy payer and public interest in a different way. This would balance the impact on the fiscal strategy by focusing a large levy reduction to the Account that has the smallest impact on 2014/15 OBEGAL. This involves reducing the Motor Vehicle Account levy by $480 million. This is a significantly larger reduction to the Motor Vehicle Account than Options 1, 2a and 2b, but leaves the levies for the Work and Earners' Accounts unchanged for 2015/16. While it is growing fastest, the Motor Vehicle Account is the lowest funded of the three Accounts, and this may result in levy instability in the Work and Earners' Account in subsequent years.

12 Includes incentive programmes and the motor cycle safety levy.

13 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.

14 Percentage point.

*Table 6: Comparing levy rates under Option 2a, 2b, and 2c (changes from Option 2a in **bold**)*

	Earners' Account	Work Account	Motor Vehicle Account
Option 2a	$1.26	$0.90	$195
Option 2b	$1.26	**$0.95**	$195
Option 2c	$1.26	**$0.95**	**$184**

55. The impacts of Options 2a, 2b, and 2c are largely similar, therefore comparisons in this paper are made between Options 1 and 2a. Differences that occur between Options 2a, 2b, and 2c are indicated where appropriate.

Comparison of main options

Objectives

56. 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 7, 8 and 11 highlight the respective factors that the Minister for ACC and ACC must consider.

57. The Ministry considers that the following objectives are important to levy setting:

- providing claimants with certainty that funds will be available to meet their ongoing 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 interest[15], including whether there is appropriate revenue transfer, any detrimental effects on the Crown accounts and encouraging the wider economic goals of the Government, especially economic growth.

58. The following criteria are fundamental trade-offs in levy setting and underpin the objectives we have set out. We discuss how the trade-offs apply, which will assist our assessment of the options against our objectives.

- keeping levies stable
- tolerance for the funding position not being at target, and
- how close levies are to expected cost of claims.

59. The full funding approach means ACC holds significant assets, and allows ACC to post-fund deficits (or return any surpluses). This means ACC holds enough assets to cover the cost of entitlements and be able to deal with financial volatility in the short term. Any deficits can be dealt with over the longer term, and does not need to be corrected immediately. The long term nature of the Scheme means ACC must also manage the impact of economic factors and cycles.

60. There is an important trade-off between stability of levies and stability in ACC's funding position. Given the full funding approach to levies, there is a high degree of flexibility in how we manage the inherent volatilities (changes to claims' performance, investment returns and economic assumptions) that can negatively impact ACC. Our preference is

15 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.*

to focus on levy stability to reduce uncertainty for levy payers, and to shift the management of volatility onto ACC's financial position. The key question is how quickly we want to manage the risk and whether we:

a. make smaller adjustments to levy rates that have a smaller impact on ACC's financial position, or

b. make larger adjustments to levy rates that have larger impacts on ACC's financial position.

61. It is important to note that not making reductions when they are needed now increases future instability. This would create the need for significant changes in the future.

62. Having levies close to the expected cost of claims is an important consideration as well. Levy rates should reflect claims' performance (of the industry/classification unit and the individual) rather than being distorted by adjustments for historical funding changes. This is important for all stakeholders to make decisions based on accurate information that appropriately reflects underlying cost. This is very relevant to the incentive programmes that are in place, because the Government should send accurate pricing signals for levy payers to base their decisions and behaviour on.

63. The following table sets out the how the trade-offs apply to the two overarching approaches to 2015/16 levies.

Table 7: Key trade-offs for each approach

	Option 1	Option 2a
Earners' Account	**Change from $1.26 to $1.20.** ACC has recognised the high funding position of the Earners' Accounts and has recommended setting this Account marginally below expected cost of claims by $0.04. **Expected cost**R ACC has recognised the high funding position of the Earners' Accounts and has recommended setting this Account marginally below expected cost of claims by $0.04. This provides more accurate information than lower levies that would be further away from expected cost. **Funding position**R This is a way to manage this Account toward ACC's target based on its risk preferences. We expect the Earners' Account funding position to reduce by 1.2 percentage points. This moves the funding position towards their target funding position more slowly (and over a longer term), than otherwise possible. Setting rates further below expected cost over the same period would see the funding reduce faster. **Levy stability**R The recommendation for this Account is consistent with levy stability because it reduces the need for significant reductions to the levy in the future, and is more likely to create a stable levy path in the management of the funding position. Rates would be less distorted by adjustments related to historical funding both now and in the future. **Comment** ACC's recommendation is based on ACC's existing funding policy,	The Government has indicated **no change** to the Earners' Account in Budget 2014. This is based on the need to have regard to the surplus target which is in the public interest, and manages the reduction of the funding position of the Accounts over a longer period in comparison to ACC's approach. **Expected cost**R The option makes no change to the Earners' Account levy. This would be $0.02 above the expected cost of claims. This provides relatively accurate information. **Funding position** This would see the Account collect more than necessary, but we do not expect the funding position to increase significantly (0.1 percentage points). This is because the Earners' Account levy is close to the expected cost of claims. This would not take the Account further away from the Government's preferred funding position. Collecting slightly more now means a marginal increase to the funds above the preferred funding position that must be returned later. **Levy stability** Collecting more than needed in the Accounts now has a negative impact on levy stability by increasing future instability and may lead to the need for significant changes in the future. **Comment** Options 2b and 2c would have the same impact on the Earners' Account as Option 2a.

	Option 1	Option 2a
	and represents a moderate move in the direction of the Government's preferred funding position over a longer period.	
Work Account	**Change from $0.95 to $0.75.** ACC has recognised the high funding position and the high rate of increase of the Work Account and has recommended setting this Account below expected cost of claims by $0.03. **Expected cost**R The reduction will take the rate to $0.03 below the expected cost of claims. This provides more accurate information than levies that are lower. However, the funding position would increase more at this level. **Funding position**R This is a way to manage the rate of increase for this Account, and manage it towards ACC's target, based on their risk preferences over a period of time. Even though the rate is below expected cost of claims this option would still increase the funding position through investment gains. However, it reduces the growth in the funding position from 3.9 (if kept at current rates) to 1.0 percentage point. Setting rates further below expected cost over the same period would see an even smaller rate of growth, or a reduction of the funding position. **Levy stability**R This is consistent with levy stability because it reduces the need for significant reductions to the levy in the future, and is more likely to create a stable levy path in the management of the funding position. Rates would be less distorted by adjustments related to historical funding both now and in the future. This option is based on ACC's existing funding policy, and represents	**Change from $0.95 to $0.90**. Option 2a makes a minor reduction to the Work Account. This is based on the need to have regard to the surplus target which is in the public interest, and manages the reduction of the funding position of the Accounts over a longer period in comparison to ACC's approach. **Expected cost** This smaller reduction would put the Work Account levy $0.12 above cost of claims. This account would collect more funds than necessary now, which means additional funds above the preferred funding position that must be returned later. **Funding position** The funding position would increase, but the rate of increase is reduced from 3.9 (if 2014/15 rate was used for 2015/16) to 3.2 percentage points. However the rate of increase will be significantly higher than ACC's recommendation which only increases by 1.0 percentage points. Having regard to the surplus target in the public interest would see the funding position increase at a higher rate for the 2015/16 levy year. This would take the Account further away from the Government's preferred funding position. **Levy stability** Collecting more than needed in the Accounts now has a negative impact on levy stability by increasing future instability and may lead to the need for significant changes in the future. **Comment** Options 2b and 2c would hold the Work Account levy constant at $0.95. The

	Option 1	Option 2a
	a moderate move in the direction of the Government's preferred funding position over a longer period. A larger reduction to the Work Account would be consistent with the principles of the funding policy review.	levy would be $0.17 above the cost of claims and result in the funding position growing by a further 0.7 of a percentage point more than Option 2a. This would mean additional funds above the preferred funding position that must be returned later.

<table>
<tr><th></th><th>Option 1</th><th>Option 2a</th></tr>
<tr><td rowspan="2">Motor Vehicle Account</td><td colspan="2">Historical underfunding has meant that past levies have been set at rates to move this Account towards the funding target quickly. This Account is expected to be fully funded at the start of the 2015/16 levy year, both under ACC’s and the Government’s risk preferences. Over the last few years, agencies have recommended reducing rates in this Account to manage the funding position. However the Motor Vehicle Account levy was not reduced, and led to the Motor Vehicle Account projected to be at a higher funding position than is needed. It is appropriate to rebalance the priorities in this Account now to keep the funding at a sustainable level.

Option 1 (40 per cent reduction) and Option 2a (41 per cent reduction) propose similar rates for the Motor Vehicle Account but are based on different reasons.</td></tr>
<tr><td>Change from $330.68 to $200.00

Expected cost

Option 1 would reduce the Motor Vehicle Account from $191 to $60 above the expected cost of claims. This provides more accurate information than the current 2014/15 levy rates. For 2015/16 the rate is still significantly above expected cost of claims which means less accurate information. But this is needed for ACC to manage the funding position and is discussed below.

Funding positionR

Prior to the 2015/16 year, having a large amount above the expected cost of claims aimed to address historical underfunding in the Motor Vehicle Account. This meant collecting more to improve the funding position at a higher rate and reaching the desired funding as soon as possible. This option reflects ACC’s view that the Account is now fully funded, and no longer needs to collect significantly more for historical deficits.

However, this option is still $60 above expected cost of claims which represents $120 million per annum. This manages the funding position from 112 per cent at the start of the 2015/16 levy year to 115 per cent at the end of the 2015/16 levy year, a 2.9 percentage point increase. ACC’s risk preferences aim for 116 per cent funding to meet the</td><td>Change from $330.68 to $195.00

Expected costR

The Government indicated a Motor Vehicle Account levy $55 above the expected cost of claims. This provides more accurate information than the current 2014/15 levy rates.

Funding positionR

The Government’s target funding position for this Account is lower than ACC’s, and their indications represent management of the funding position downwards in the medium term, while ACC is managing the funding position’s rate of increase towards a target point that is above the current level.

This option is above the cost of claims which would see the funding position increase, but reduces the rate of increase. Being $5 less than Option 1, this option would collect less for 2015/16 and reduce the funding position’s rate of increase slightly more than ACC’s recommendation. The rate of increase is reduced from 8.2 (if 2014/15 rate was used for 2015/16) to 2.7 percentage points, and is 0.2 percentage points less than under Option 1.

This also recognises that reductions have not been made to the Motor Vehicle Account in recent years.</td></tr>
</table>

<table>
<tr><th></th><th>Option 1</th><th>Option 2a</th></tr>
<tr><td></td><td>requirements of full funding.

Instead of having a large drop over one year, ACC could have recommended smaller successive drops over the next few years. However, this would have seen ACC collecting more than needed and the funding position increasing at a higher rate, this means excess funds collected now would need to be returned in the future.

Levy stabilityR

This option is consistent with levy stability because it reduces the need for significant reductions to the levy in the future. It is more likely to create a stable levy path in the management of the funding position. Rates would be less distorted by adjustments related to historical funding both now and in the future.</td><td>Levy stabilityR

This would marginally improve levy stability over ACC, because collecting a bit less now would avoid larger reductions in the future. This means the Government’s approach is a different balance between a stable levy path and managing the funding position downwards.

Comment

Option 2b would have the same impact as Option 2a. Option 2c proposes a 44 per cent decrease to $184. This is closer to the expected cost of claims ($44 above) and would reduce the growth of the Account by a further 0.5 of a percentage point than Option 2a. This would reduce the amount that needs to be returned to levy payers. A $480 million reduction in the Motor Vehicle Account will have the greatest impact (out of Option 2a, 2b and 2c) on reductions that are possible in the 2016/17 year.</td></tr>
<tr><td></td><td colspan="2">Comment

The Government’s risk preferences target a lower funding position. Minimising the increases in the funding position now supports reaching this target funding position.

The new funding policy focuses on keeping levies closer to expected cost of claims as the way to maintain levy stability over a period of time. Having a large reduction now is consistent with the new funding policy that would come into place. Applying the funding policy to this Account now is likely to require an adjustment from current rates, down to expected cost to manage the funding position. This is because keeping 2014/15 levy rates in place for 2015/16 means the Account could be: a) within the band and is likely to move outside of it; or b) it is outside of the band and needs to move into the band.</td></tr>
</table>

64. The following assesses the two main options against our stated objectives for 2015/16 levies. A more detailed discussion of this is set out in Appendix C.

Table 8: Overall assessment of each approach against objectives

Objectives	Option 1	Option 2a[16]
Funding certainty	P	P
Collect the minimum necessary	P	
Appropriate incentives	P	
Levy stability	P	
Minimise inter-generational transfers	P	
Public interest	**This would reduce levy rates and minimises any opportunity cost and revenue transfer by leaving more in the pockets of levy payers for the 2015/16 levy year.**	**Would represent higher revenue in Crown accounts. This is consistent with the Government's fiscal strategy to balance the books.**

Implications of each approach on the economy

65. Higher levies under Option 2a would be expected to take around $178 million more from levy payers over 2015/16, as summarised in Table 9. 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 the economy, because ACC plays a significant role in the New Zealand economy through its investment portfolio.

Table 9: Total levy reductions under the Options for each Account

	Earners' Account	Work Account	Motor Vehicle Account	Total
Option 1	$69 million	$162 million	$427 million	$658 million
Option 2a	$0 million	$42 Million	$438 million	$480 million
Option 2b	$0 million	$0 million	$438 million	$438 million
Option 2c	$0 million	$0 million	$480 million	$480 million

66. Option 1's recommendation for the Work and Earners' Accounts are 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.

67. The two broad approaches for the Motor Vehicle Account are very similar, with Options 2a and 2b having a marginally larger positive impact than Option 1. Option 2c would have the largest impact of the four on reducing headline inflation through the reduction in the Motor Vehicle Account levy, although this would not be expected to have much impact on monetary policy.

[16] Comparisons are consistent for Options 2a, 2b, and 2c.

Impact of changes to levies on individual levy payers

68. Table 10 below shows the impact of the different levy options on different levy payers. The greater decrease in the average Motor Vehicle Account levy in Option 2a is more than offset by the reductions in the Earners' Account levy.

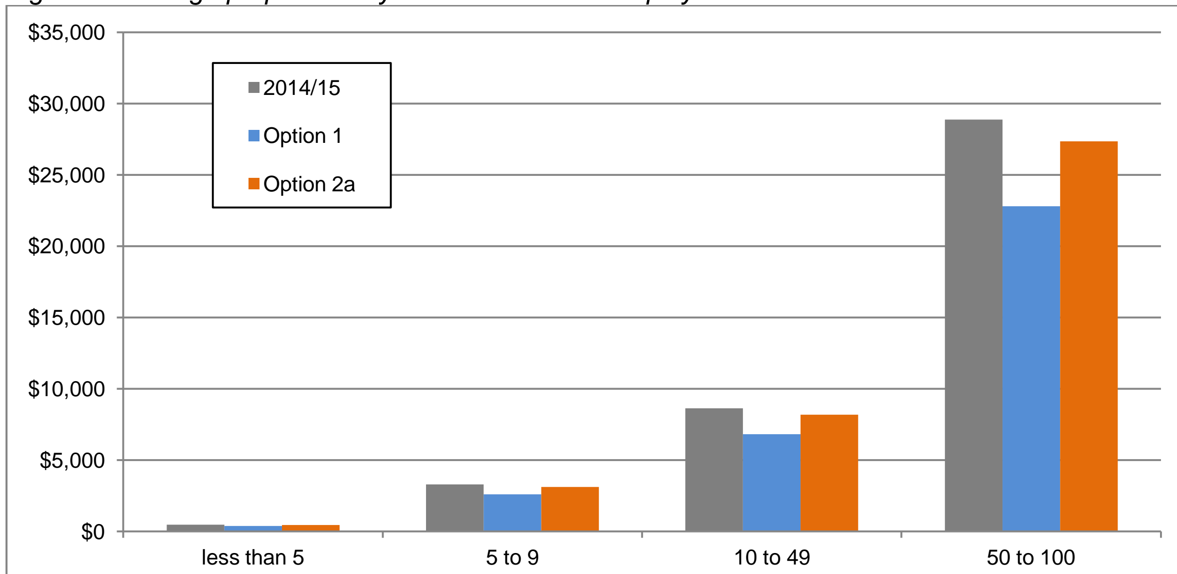
Table 10: Impact of levy rate options on different levy payers

<table>
<tr><th></th><th>Household with average income and two cars</th><th>Household with average income and one cars</th><th>Two minimum wage earners and one car</th><th>One average income earner with one car</th></tr>
<tr><td>Current levy rates</td><td>$1,886.06</td><td>$1,555.38</td><td>$1190.24</td><td>$1,036.47</td></tr>
<tr><td>Option 1</td><td>-$320.48</td><td>-$189.80</td><td>-$172.18</td><td>-$164.75</td></tr>
<tr><td>Option 2a</td><td>-$271.36</td><td colspan="3" rowspan="2">-$135.68</td></tr>
<tr><td>Option 2b</td><td>-$271.36</td></tr>
<tr><td>Option 2c</td><td>-$290.36</td><td colspan="3">-$146.68</td></tr>
</table>

69. Figure 2 gives an indication of the average Work Account levy firms of various sizes would pay under Options 1 and 2a. Options 2b and 2c are not included as they make no change from the 2014/15 levy rates for the Work Account. 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.

70. The average Work Account levy for businesses with 100 or more employees for 2014/15 is $285,000. This would fall by $60,000 to $225,000 under Option 1, and by $15,000 to $270,000 under Option 2a. Actual levy rates depend on the firm's classification unit, liable earnings, experience rating adjustments, and work safety management practices.

Figure 2: Average proposed levy rates for different employers



Other levy policy proposals

Risk rating light passenger vehicles (cars)

71. On 2 December 2013, Cabinet agreed in principle to differentiate levies paid by light passenger vehicles, based on crash safety ratings from 1 July 2015 [CAB Min (13)42/6].

72. It is consistent with insurance practice to use a range of factors to identify different risks, to create more homogenous groups that improve the accuracy of risk profiling.

73. It is proposed that crash safety ratings are used to create more homogenous pools of risk that better align pricing with underlying risk. This would improve equity in the Motor Vehicle Account compared with the status quo. This involves four new light passenger vehicle classes (called bands).

74. Cabinet is asked to approve the final design of this proposal. Since Cabinet's 2 December 2013 decisions, further work has focused on ensuring ACC's pricing methodology better reflects the drivers of Motor Vehicle Account costs.

Status quo

75. The ACC Motor Vehicle Account provides entitlements for injuries involving motor vehicles that occur on public roads. There are 2.6 million cars in New Zealand that pay ACC levies. Owners of petrol vehicles pay an average of $119.07 of their total levy through the petrol levy for 2015/16, this is a proxy for exposure to on road injury risk. Licence fees for petrol cars are reduced by this amount so that the average levy paid by petrol and diesel cars is the same.

Problem definition

76. 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. The US National Highway Traffic Safety Administration (2013) found that vehicle crash safety was "the most important component to reduce serious injury outcomes and injuries leading to permanent medical impairment".[17] Looking at the result of crashes shows that the design of the vehicle and its safety features can impact the outcome of injury severity, and therefore cost to the Motor Vehicle Account.

77. As an example of safety features, 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. An *Austroads Report* found drivers of older vehicles were twice as likely to be fatally injured when they crash as drivers of new vehicles, and the most likely reason is the improved secondary safety of the newer vehicles.[18] Research also shows safety features such as electronic stability control and side curtain airbags dramatically reduce the severity of injury in a crash.

78. 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 injury, and includes New Zealand and Australian data from crashes covering 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 is adjusted to remove the influence of non-vehicle related factors such as age, gender, year and jurisdiction of crash, speed limit, and broad crash type.

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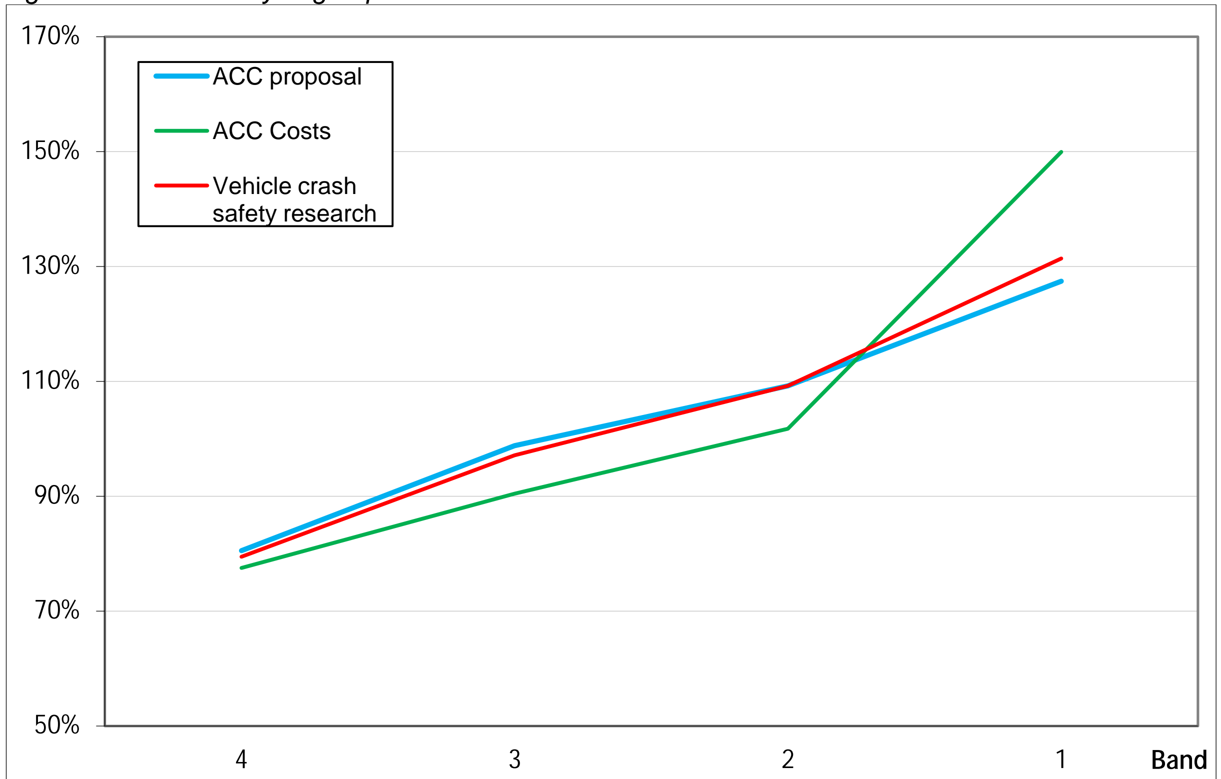
17 Use of car crashes resulting in injuries to identify system weaknesses. Stigson H, Kullgren A, Krafft M. Downloaded 7 Sept 2013 from http://www-nrd.nhtsa.dot.gov/pdf/esv/esv22/22ESV-000338.pdf

18 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.

79. ACC has adjusted crash research relativities to reflect the composition of the New Zealand vehicle fleet.

80. ACC has applied MUARC's research to develop groups based on vehicle crash safety that splits the current passenger vehicle class into four bands. ACC then analysed how the injury costs (severity and frequency) changed across the four groups. Figure 3 shows how costs increase from the most safe group to the least safe group. This shows that it would be more equitable for some car owners to pay more than other car owners, instead of the status quo of a standard licence fee for all cars.

Figure 3: Cost relativity of group of vehicles[19]



Design of the proposal

81. ACC would split the car fleet into four bands, based on vehicle crash safety as a risk factor, and calculate the average weighted risk of the cars for each band which gives the expected cost for that band. Using this they can produce relativities for pricing. A 100 per cent relativity is the average risk of the whole fleet (all four bands combined). In order of safest to least safe, the relativities are 80 per cent, 99 per cent, 109 per cent and 127 per cent. This indicates an increasing risk profile from the safest to least safe. This means a car from the band at 127 per cent is expected to have costs that are 27 percentage points more than the average of the fleet. The figures below assume an average Motor Vehicle Account levy under Option 1, if Option 2a or 2b is chosen the same relativities will be applied to the lower average levy rate.

82. Table 11 shows the total levy that ACC has recommended for the owners of a car to pay. These total levy rates (for petrol passenger vehicles this includes the petrol portion) are based on the relativities mentioned above. The expected risk difference between the safest and least safe bands is 47 percentage points. This equates to the most safe cars paying $154.29 which is $90 less than the $244.29 ACC has recommended the least safe cars to pay.

19 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.

Table 11: Levies for vehicle crash safety passenger vehicles classes

Car	Estimated number	Current total levy (includes petrol levy)	ACC's recommended total levy includes petrol levy[20] (licence portion for petrol vehicles)	Size of reduction
Band 1	540,000	$321.59	$244.29 ($149.64)	$ 77.30
Band 2	470,000		$209.29 ($114.64)	$112.30
Band 3	700,000		$189.29 ($94.64)	$132.30
Band 4	940,000		$154.29 ($59.64)	$167.07

83. ACC has applied rules to ensure the statistical credibility of the risk rating methodology. This has an impact on individual cars that are the same model but manufactured across different years, which we would expect as vehicle design changes throughout time, to lead to different crash outcomes. Vehicle years are grouped together and allocated into a band to reflect their expect risk. In relation to data, ACC has also applied rules to ensure that the vehicle fleet can be appropriately linked to a band.

Analysis of risk rating light passenger vehicles, based on vehicle crash safety

84. ACC has estimated that the proposal would redistribute the payment of levies from safer to less safe passenger vehicles, by around $37 million.

85. Actuarial analysis indicates (see figure 3) that:

- vehicle crash safety can be used to draw four relatively homogenous groups for passenger vehicles, and
- analysing ACC costs against the four bands supports the use of vehicle crash safety as a risk rating factor and supports the expected risk profile across the four bands.

86. 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 crash safety rating against key objectives

Objectives	**Assessment of vehicle crash safety as the basis of risk rating**
Credibility	Vehicle crash safety has been identified as a risk factor and is one of the three key risks related to severity of on-road injuries, along with road design and driver behaviour. Internationally recognised 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. Including these factors into levies 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	Vehicle crash safety data is correlated with ACC costs for the four vehicle bands. ACC has investigated ACC costs by looking at both severity and frequency, and the relationship with vehicle crash safety. ACC analysis shows a cost profile that increases from the most safe to least safe band. This is supported by figure 3 showing 'ACC costs' and 'vehicle crash safety research' lines having the same upward trend. ACC's analysis also shows that the expected risk for each band is consistent with ACC costs. This is supported by the 'vehicle crash safety research' line being less steep than the 'ACC costs' line (which includes effects on severity and frequency). We are satisfied that proposed relativity for each band is a conservative measure of risk that aligns with ACC claims costs, is an appropriate proxy for other factors, and is therefore appropriate for levy setting. ACC's pricing methodology reflects the

20 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.

	drivers of Motor Vehicle Account costs. This methodology assumes that driver profile is consistent across the four bands. The petrol levy is a proxy for exposure and is also assumed to be consistent across the petrol passenger vehicle fleet. It is therefore appropriate that ACC's proposed relativity/risk calculation to apply to the whole levy.
Equity	Given the compulsory nature of ACC levies, levy payers should pay equitable levies that are better aligned with their risk (or expected cost of claims). Including vehicle crash safety in levies gives a more accurate picture of underlying risk for cars. Actuarial analysis matching claims cost and crash safety supports this approach. We expect this to better align risk and levies which would improve equity. This view focuses on financial equity.
Implementation	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 July 2015 when the levy year starts. ACC spent $4.1 million on system change costs to implement risk rating for passenger vehicles last year. Annual operating costs for this system are around $100,000. Administration costs for the Motor Vehicle Account this year are expected at around $64 million, this equates to a 0.15 per cent increase for 2015/16.
Durable	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 dollar differentiation of levies for safer and less safe vehicles would reduce to maintain relative proportionality. MUARC will be providing ACC with updated crash data each year so that ACC's bands reflect the most up-to-date risk information that is available.

Impacts on passenger vehicle owners

87. Table 11 shows that there are levy reductions for each band. The average 2014/15 car levy of $321.59 represents about 7 per cent of the estimated $4,600 annual operating cost for a vehicle.[21] If average levies were reduced as recommended by ACC, car owners would save between 1.7 per cent to 3.6 per cent of annual operating costs.

88. The Vehicle Safety Rating is consistent with the Ministry of Transport's focus on reducing the compliance costs to in this area. Since no levies will go up, and this is being implemented together with a levy reduction it is unlikely to negatively impact compliance rates.

Implementation

89. A governance group has been established by ACC and the NZTA to ensure system changes will be in place by 1 July 2015.

Risks

90. The NZTA, and the Ministry of Transport has indicated that ACC's rating system generally aligns with ANCAP and the RightCar website. But does not do so in every case. ACC has chosen their system because real world crash outcome data allows them to cover the majority of New Zealand's vehicle fleet. ACC can more reliably predict expected cost to the Scheme, by looking at real world crash outcome data, rather than ANCAP based on crash testing in controlled situations. Both ACC and our independent actuaries consider the proposed methodology to be statistically robust. While in most cases there is consistency, some individual vehicles might see different ratings in the two systems. ACC will need to manage the messaging risks and be clear that their information is based on the expected cost to ACC, rather than a determinant of safety.

21 Estimated by the Automobile Association.

91. Stakeholders have also raised some concerns and limitations of this approach which were also identified by Finity. This may have risks, however ACC is confident that their approach balances statistical credibility against individual accuracy.

a. A single year of manufacture may contain a vehicle which has undergone a model update mid-year. However, both vehicles sold in the same year would be charged the same levy whether or not there were safety differences.

b. Some manufacturers sell a number of variants of each model, or offer a range of options that enhance safety or increase risk. However, again all vehicles registered in the same year are allocated a single class.

c. There are a number of models with unusual changes in levy category from one year to the next, or across a number of years, and we suggest ACC investigates whether these variations are appropriate.

92. 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. While this may be less fair it does not increase the burden on levy payers under the status quo. The average reduction in the levy means all car owners would see a reduction from their current 2014/15 levy rate.

93. 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. A recent survey carried out by the Ministry of Transport gives us an insight into car purchasing behaviour. Around 20 per cent of survey participants were willing to spend up to $4,000, 25 per cent between $4,000 to $10,000, 25 per cent between $10,000 to $20,000, and 25 per cent more than $20,000. These results were roughly consistent when this was broken down in to household income (up to $40,000, $40,000 - $75,000, and more than $75,000).

Figure 4: Risk group of vehicles by price point – sample of 24,800 sales in 2012

94. There are some vehicles that ACC is unable to rate.

a. Vintage vehicles (older than 40 years) are not included within this proposal. Their total levy rate would reduce along with the average reduction proposed, going from a total levy of $113.43 for 2014/15 to $67.60 for 2015/16.

b. Heavy passenger vehicles will now be separated from light passenger vehicles. This class includes buses. Even though ACC has insufficient data, the size and weight of these vehicles can cause significant damage. ACC recommends charging these vehicles the same rate as the least safe band.

c. Other cars such as collectors' items or high performance vehicles are rare and may have insufficient crash data for adjusting levies. Some of these vehicles could be safe, but their levy would be based on the year of manufacture. ACC

would presume vehicles before 2003 are in the least safe band and vehicles after 2003 are in the safest band. This reflects the general trend across the fleet.

Additional comments

95. The Ministry agrees with ACC's identification of vehicle crash safety as a risk across the passenger fleet, and is satisfied with their further work on the proportionality between underlying risk and levies. 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.

96. A net improvement in vehicle crash safety requires the importation of safer vehicles and/or the scrapping of less safe vehicles. This is unlikely to occur as a result of this programme because financially, the levy differential is likely to be too small to see vehicle owners scrapping unsafe vehicles rather than selling them on.

97. This proposal could contribute to awareness of vehicle crash safety, and through signalling it may be a factor that contributes to decisions to buy a safer vehicle or scraping an unsafe vehicle. The information ACC proposes to use (crashworthiness and aggressivity) largely 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. However, there are risks of confusion for car owners, which are discussed at paragraph 90.

98. A recent survey carried out by the Ministry of Transport gives us an insight into car purchasing behaviour. Safety feature was one of the top three factors that people consider when replacing a previous vehicle. Out of eight factors safety features and safety rating were the fifth and sixth most important, with price being the most important.

99. It should be noted that the manufacturer's reputation for a vehicle was second. Of those surveyed 70 per cent rated safety features a four or five out of five, and 65 per cent rated safety rating a four or five. These results were roughly consistent when this was broken down in to household income (up to $40,000, $40,000 - $75,000, and more than $75,000).

Rating the newest vehicles

100. The current approach does not accurately rate the newest vehicle models because real crash data is not available (paragraph 91 mentions some of the concerns raised by stakeholders). There would be a two-year lag before information is available to rate these new vehicle models. It is important for the purpose of awareness and messaging to be able to do this.

101. ACC proposes rules to deal with this:
    a. A new model of a vehicle is expected to be at least as safe as the previous model and have similar costs, eg; a 2014 Toyota Camry would have the same rating as the 2013 Toyota Camry.
    b. If a previous model is not available, ACC presumes that the newest vehicles are likely to incorporate the latest technology and would likely lead to lower costs for ACC, eg; if Toyota introduced a new model then they would be placed in the most safe band.

102. Alternatively ACC could use ratings such as ANCAP which the car industry considers to be robust and credible for the first few years, until real crash data is available. Stakeholders including the New Zealand Automobile Association, the Motor Trade Association, and the Motor Industry Association strongly support this approach over that outlined above.

103. Importers generally pay for the registration costs for a vehicle for the first six months. This means that any incentive is unlikely to influence the point of sale, and it is less important for ACC to accurately rate new vehicles. However, being able to do so could better support the safety messaging, including how importers position vehicles in the market.

104. Further work is needed to investigate the benefits of using ANCAP for the newest vehicles. This design issue does not impact the ability to improve equity in the Motor Vehicle Account. This issue will need to be resolved before implementation.

Petrol levy

Status quo

105. The Motor Vehicle Account levy is collected from petrol vehicle owners through two sources, vehicle licence and the petrol levy. Petrol vehicle owners currently pay a petrol levy of 9.9 cents per litre.

106. On average, petrol cars pay around 38 per cent through the petrol levy and 62 per cent through the licence levy.

107. Collecting Motor Vehicle Account levies through petrol is a form of risk rating: the longer a vehicle is used on public roads, the more petrol that vehicle consumes, and the longer that vehicle is exposed to risk of accident. However, length of time on the road is only one factor which contributes to the risk of each vehicle; vehicle type is also an important factor. Collecting levies entirely through petrol would not account for different levels of risk by vehicle type or different fuel efficiencies. Because distance travelled is only one of several factors which influence the risk of accidents, it is appropriate to collect only part of the levy from petrol.

Problem definition

108. ACC estimates that distance travelled accounts for up to 30 per cent of the risk of a crash. If the total average levy reduction of around $130 was to only come out of the licence portion for petrol vehicles, the petrol levy would constitute around 62 per cent of the total average levy, more than double the risk ACC can reliably demonstrate.

Comments

109. ACC recommends reducing the petrol levy from 9.9 cents per litre to 7.9 cents per litre. This is a 20 per cent reduction, and is half the 40 per cent change in the overall average levy.

110. The Ministry supports the reduction of the petrol levy as part of the reduction to the average levy because having the petrol levy cover 62 per cent of the average levy does not appropriately reflect exposure as a risk factor. Reducing the levy to 7.9 cents per litre reduces the petrol levy for a passenger vehicle to around 50 per cent of the total average levy.

111. ACC considers the reduction to 7.9 cents per litre to be appropriate after consultation feedback that indicated reducing the petrol levy to 5.9 cents per litre would disadvantage low mileage vehicles (such as those owned by the elderly), reduce the effective levy charged to motorcyclists (the licence levy was not increased to offset the lower petrol levy), and lower the extent to which the levy reduction was visible to levy payers through their vehicle licence payment.

112. Over recent years, ACC has also collected less through petrol levies than budgeted. This is because petrol consumption has fallen, and it most likely due to improvement in fuel efficiency of vehicles. This has not adversely affected ACC’s funding needs so far, however reducing the proportion from 62 per cent this year would mitigate this risk.

Impact

113. The reduction of the petrol levy from 9.9 cents per litre to 7.9 cents per litre is an average amount of $28.20 per car.[22] This would be included in the reduction to the average Motor Vehicle Account levy of around $130 to $135 per passenger vehicle.

Risks

114. Petrol vehicles pay their total levy through the licence levy and when they purchase petrol. This means petrol vehicle owners often associate their relative risk with the licence portion only. This means for vehicle safety rating, that people would misinterpret the relative risk. The most safe (Band 4) would pay $59.64 and the least safe class (Band 1) would pay $149.64. This appears to indicate Band 1 is around three times as risky as Band 4, and overstates the risk when the same comparison is done for the total levy. Band 1 is 58 per cent more risky.

Table 13: Licence fee for 2015/16 under petrol levy options

	Total levy for 2015/16	Licence levy (7.9 c/L = $94.65)
Band 1	$244.29	$149.64
Band 2	$209.29	$114.64
Band 3	$189.29	$94.64
Band 4	$154.29	$59.64

115. The issue also exists between petrol and non-petrol vehicles. However, the total levy estimated is the same. The difference reflects petrol vehicles paying some of the levy through the petrol levy.

Motorcycle relativity and levies

116. Levy relativities in the Motor Vehicle Account are generally based on the expected cost of claims for vehicles in each group. The levy relativity for motorcycles has been set at a significantly lower level than claims costs would justify.

117. Updated information shows the true cost of injuries for motorcycles would require levies between $1,200 and $1,900 depending on engine capacity.

118. ACC estimates that motorcycle and moped injuries cost $104 million a year. ACC's recommended rate collects $27 million of this cost from owners of motorcycles and mopeds. The rest is collected from other vehicle owners in the Motor Vehicle Account and is a large cross-subsidy annually.

119. For this reason, the Ministry agrees with ACC's recommendation to leave the levy for motorcycles at current levels while the average Motor Vehicle Account levy is reduced. This would increase the relativity of motorcycles against other motor vehicles and better aligns levies for motorcycle owners with the true cost of injuries to the Scheme.

Table 14: Relativities for mopeds and motorcycles

	Keeping the total 2014/15 levy for 2015/16[23]	2014/15 relativity	2015/16 relativity
Mopeds	$165.85	55%	86%
Motorcycles (600 cc or less)	$364.42	117%	190%
Motorcycles (over 600 cc)	$463.69	148%	242%

22 This includes an adjustment for petrol consumption, keeping the petrol levy at 9.9 cents per litre would have seen the average per vehicle reduce from $122.85 to $119.07.

23 Retains the 2015/16 rates (which include the Motorcycle levy) and has been adjusted downward to reflect changes to the petrol levy.

Other proposals

Table 15: 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 (13) 42/6]
Increasing the maximum liable earnings for the Workplace Safety Discount Programme	The Ministry supports this update for wage inflation.	
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%
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 (13) 42/6]
Motor Vehicle Account		
Reducing the residual portion from $77.07 to $58.30	The Ministry supports this change. The rates set in the regulations did not impact the overall amount that was collected and needed to be collected. The residual and the current portions in the Motor Vehicle Account are for accounting purposes. This change is consistent with the purpose of the residual portion for this Account.	
Creating a new vehicle category for heavy passenger vehicles	There is insufficient data to include heavy passenger vehicles in the risk rating analysis. This category covers buses, which in other jurisdictions are charged significantly higher rates than cars. We consider it appropriate to separate this levy class and to be charged the same rate as band 1 (least safe) cars.	
No change to the Motorcycle safety levy	The Ministry supports no change to the average Motorcycle safety levy.	
Heavy Goods Service Vehicles (GSV)	Cabinet agreed to differentiate between light GSVs and heavy GSVs to better reflect injury cost [Cab Min (12) 44/8 refers]. Cabinet also agreed to set the maximum levy at the same level as 2012/13 [Cab Min (13) 31/10 refers]. The claims experience for heavy GSVs has not improved. The Ministry supports ACC's recommended to maintain the current levy (which increases the relativity) to better reflect risk and cost to the Scheme. A minor adjustment has been made to reflect the petrol levy change.	

Results of public consultation

120. Section 331 of the *AC Act* requires ACC to consult on levy changes with levy payers. Public consultation was carried out from 20 May to 17 June 2014.

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

ACC's analysis of public consultation

122. The number of submissions received this year and last year for each account are set out in table 16:

Table 16: Number of submissions received during public consultation

	2014/15	2015/16
Earners' Account	46	30
Work Account	100	49
Motor Vehicle Account	126	419

123. Key themes in the Earners' Account were:
    a. General support for the proposed reduction in the levy rate.
    b. Concerns relating to the coverage of the over-65 group specifically that they pay full levies but do not receive weekly compensation.

124. Key themes in the Work Account were:
    a. There was general support for the proposed reduction in the Work levy.
    b. Support for increasing expenditure on Injury Prevention (IP) programmes.
    c. Increased concern about the appropriateness and attractiveness of Accredited Employer Programme (AEP). This is heightened as the residual levy (which does not factor in the AEP discount) becomes a larger proportion of the total levy.
    d. Structural changes to the Account (particularly concerning the residual portion) and the levy setting process, all of which are government policy matters outside the considerations of this consultation.

125. Key themes in the Motor Vehicle Account were:
    a. A large number of the submissions on this Account were objections to risk rating and increasing the levies on vintage and veteran motor vehicles. However this was a misunderstanding and these were not proposed.
    b. Continued support for the introduction of risk rating into the light passenger vehicle fleet, particularly from major stakeholders. However, there were reservations from individuals and at least one significant stakeholder in the motor industry concerning the band assigned to particular models of light passenger vehicles.
    c. Support for the use of new vehicle crash test star ratings as the basis for the initial banding of new vehicles.
    d. Suggestions that the licence levy should be calculated based on factors more closely linked to the driver, such as driver experience, crash history and age for all vehicles, including motorcycles.
    e. Some preference for collecting a higher proportion, or all, of the total levies on a mileage basis.
    f. 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.

g. Some suggestions on how to spend the Motorcycle Safety Levy.

Consultation

126. The Ministry consulted ACC on this RIS and their feedback has been incorporated. The Treasury were informed.

Recommendations

Levy rates for 2015/16

127. 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.

128. The analysis of available levy options show that Option 1 achieves more of the objectives than the other options. However, the rates indicated in Option 2a (as well as Option 2b and 2c) would better support the Government's fiscal strategy of reaching surplus in 2014/15 which would be in the public interest.

129. We support Option 1, as the benefits outweigh the economic and fiscal implications associated with relatively higher levy rates associated with Options 2a, 2b, and 2c. While the Ministry supports the reduction proposed in Option 1 for the Motor Vehicle Account, we think a further reduction would be appropriate to manage the rate of increase to the Account's funding position. A reduction to the Motor Vehicle Account of the scale under Option 2c would have the largest impact on the ability to reduce the more highly funded Accounts next levy round out of Options 2a, 2b and 2c.

Table 17: Ministry's recommended rates

	Earners' Account[24]	Work Account	Motor Vehicle Account
The Ministry's recommended 2015/16 rate	$1.20	$0.75	$200.00

Risk rating cars using vehicle crash safety rating

130. The Ministry supports the risk rating of light passenger vehicles as a way to improve financial equity in the Motor Vehicle Account 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.

131. It should be noted that we do not expect this to incentivise safety outcomes, but it would support the messaging and awareness of safety.

Implementation

132. New levy regulations need to be set by 31 March 2015 for the Work and Earners' Accounts. Otherwise, the 2014/15 levy rates will remain in place from 1 April 2015. New levy rates have historically been set by 30 June 2015 for the Motor Vehicle Account. Otherwise, the existing levy rates will remain in place from 1 July 2015.

24 The GST inclusive rate is $1.38.

133. If changes to the Earners' Account levy rates are to be in place on 1 April 2015 Inland Revenue would require notification of the approved Earners' Account rates by mid-December 2014 so that payroll software developers can update, test, and distribute their systems updates.

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

135. ACC and NZTA are working on the implementation of risk rating of cars and expect the programme to be available on 1 July 2015 when the Motor Vehicle Account levy year starts.

Monitoring, evaluation, and review

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

    a. 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.

    b. 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.

    c. 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).

    d. 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).

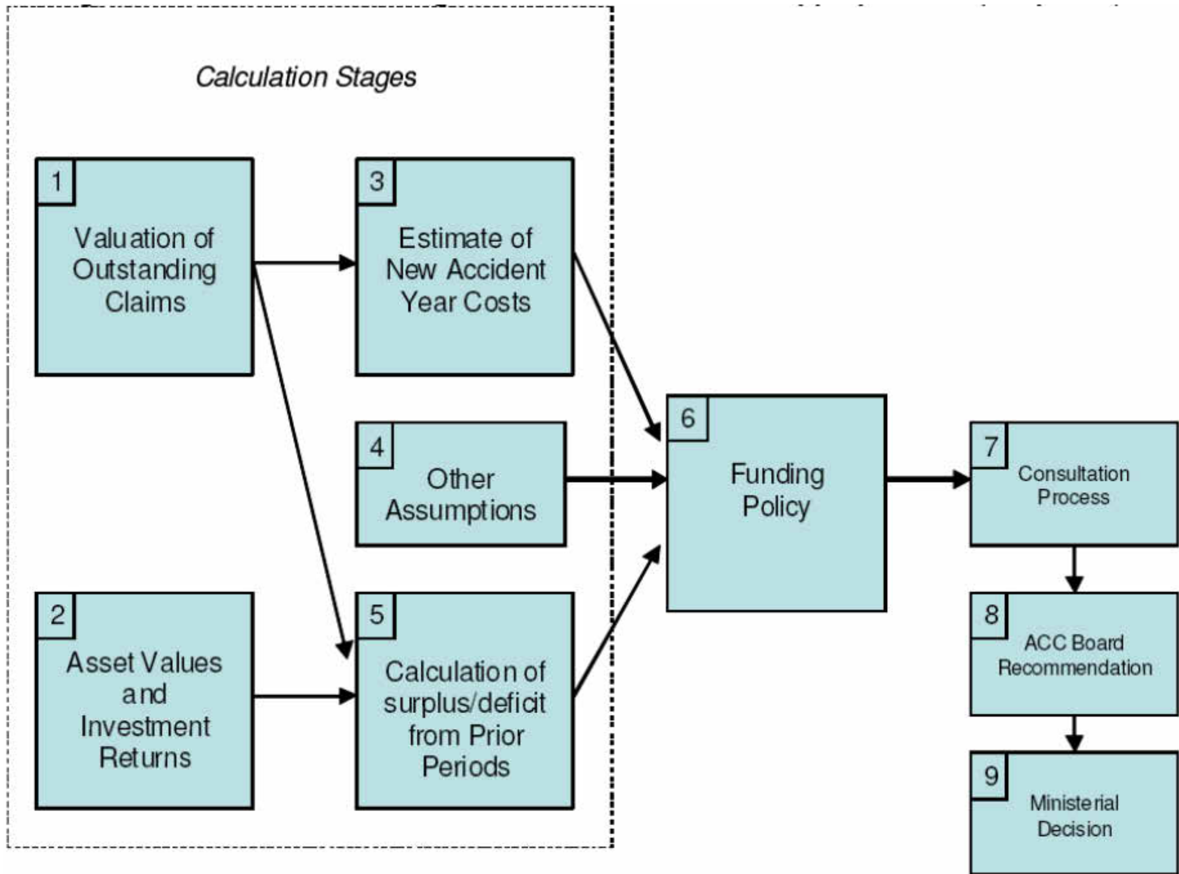
    e. The Ministry commissions an independent actuarial review of the recommended levy rates and provides advice to the Minister for ACC.

    f. 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 1: 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.

Appendix B: expected cost of claims for 2015/16 injuries

How much is needed for injuries occurring next year?

1. The 2015/16 expected cost of claims (including Scheme costs) for each Account are set out in table 1.

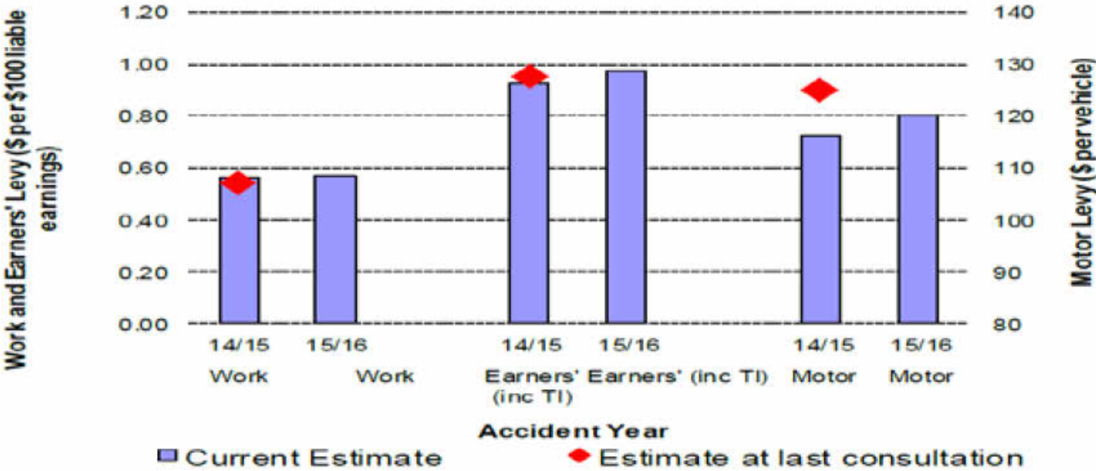
Table 1: expected cost of claims for injuries occurring in 2014/15[25]

Earners' Account	Work Account	Motor Vehicle Account
$1.24	$0.78	$140.00

2. The portion of the 2015/16 levy rates which fully fund the expected cost of claims (or injuries occurring) for the 2015/16 year have been set based on an actuarial review by ACC. This has also been through an independent quality assurance process by Finity.

3. Firstly, ACC updates their previous forecast of 2014/15 claims cost by using updated claims experience, called the revised 2014/15 costs. This is shown in figure 1 between the red diamond and the '14/15' bars. Secondly ACC applies growth assumptions (also reflecting updated experience) to forecast 2015/16 expected cost of claims. This is shown by the '15/16' bars in the same figure.

Figure 1: Comparison of Actual and Expected Claims Costs[26]



4. ACC has revised their 2014/15 costs from their expectation last year. Over the recent period there have been two trends a) poorer claims experience that increased costs, and b) more positive economic factors that reduced costs. Depending on the Account, the updated experience means one impact is larger than the other:

   a. in the Earners' and Motor Vehicle Accounts 2014/15 costs have reduced because economic factors have outweighed poor claims experience

   b. for the Work Account 2014/15 costs have increased because poor claims experience has outweighed economic factors.

5. 2015/16 expected cost of claims is higher than the revised 2014/15 costs reflecting growth assumptions in claims frequency and average cost of claims. Across all three Accounts it is appropriate to assume that average costs increase in line with inflation,

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25 These figures include Scheme costs. The figures discussed below only includes injury costs.

26 Figure 1 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.

including medical inflation which is higher than the wage inflation ACC has continued to apply the same projected trend for the frequency of claims.

6. Deterioration of ACC rehabilitation rates over the most recent period has impacted on 2014/15 costs, but this experience has not been included in cost forecasts for 2015/16. This is because ACC will focus on managing costs in this area. As an actuarial principle it is reasonable to see whether they are successful, and to exclude these trends for now. If rehabilitation rates continue to deteriorate these would need to be included in future levy reviews.

7. Finity considers that these assumptions are reasonable. The following table provides a breakdown, according to the levy rate, to show how the different factors impact on the 2014/15 claims' cost and the 2015/16 claims' cost:

Table 2: breakdown of changes

Break down of changes	Earners'	Work	Motor Vehicle
2014/15 expected cost (2013 review)	**$0.95**	**$0.54**	**$125**
Updated experience	-$0.02	+0.02	-$9
Claims experience	+$0.04	+$0.06	+$3
Discount rate	-$0.06	-$0.04	-$12
2014/15 expected cost (2014 review)	**$0.93**	**$0.56**	**$116**
Cost growth assumptions	+$0.04	+$0.01	+$4
2015/16 expected cost	**$0.97**	**$0.57**	**$120**

8. Table 3 details ACC's revised expectation of 2014/15 cost structure and estimated 2015/16 costs after updated experience.

Table 3: updated 2013/14 expected cost and estimate of 2014/15 costs

Account	2014/15 experience	2015/16 estimate
Earners' Account	Discount rates outweighed unfavourable claims experience. Unfavourable claims experience is due to poor rehabilitation with more claims and clients staying on for longer for Weekly Compensation.	ACC assumes average claim size increases with inflation, and frequency increasing with population growth. Frequency forecasts have been increased to reflect recent trends of higher use of Radiologists, Physiotherapists and Elective Surgery.
Work Account	Unfavourable claims experience outweighed favourable economic assumptions. Non-fatal weekly compensation (over half the cost of the Account) has been unfavourable because claims volumes and durations increased.	ACC assumes a year of claim inflation in line with long term inflationary trends (which is slightly higher than wage inflation). ACC is generally assuming that rehabilitation rates will remain at the current level, rather than allowing for further deterioration.
Motor Vehicle Account	The long term nature of injuries in this Account means economic factors have a significant impact. This time discount rates have a large positive impact that outweighs poor claims performance. In this account there were more claims and clients staying on for longer in relation to Social Rehabilitation and Weekly Compensation.	ACC has assumed average claim size increases with inflation. Claim frequency increases to reflect the number of vehicles on public roads in New Zealand. ACC is generally assuming that rehabilitation rates will remain at the current level, rather than allowing for further deterioration.

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

Appendix C: detailed assessment of options against levy setting objectives

Objectives	Option 1	Option 2a
Funding certainty	**Both options ensure certainty that funds will be available to meet their ongoing costs of rehabilitation and treatment**	
	With ACC's proposed rates, all three Accounts are expected to be within ACC's funding band. ACC's funding policy builds in margins for assets and liabilities to ensure that funds will be available to meet the ongoing costs of rehabilitation and treatment. ACC recommends setting the Work and Earners' Accounts marginally below expected cost of claims. This balances returning the surplus quickly and the stability of levy rates without compromising ACC's ability to pay for entitlements in the upcoming year and for historical levy years. For the Motor Vehicle Account this is above the expected cost of claims to improve the funding position and move it towards ACC's target which they consider provides funding certainty.	For all three Accounts, the proposed rate would be above expected cost of claims. ACC will be able to fund claims costs in the upcoming levy year and historical levy years even with larger levy reductions.
Collect the minimum necessary	**Better in the Work and Earners' Accounts**	**Slightly better in the Motor Vehicle Account**
	The Work and Earners' Accounts would be marginally below expected cost of claims, which manages the surplus for historical claims in these two Accounts. The Motor Vehicle Account is above the expected cost of claims, but this aims for ACC's target funding position in this Account. The proposed rates either reduce the funding position, or manage the rate of increase.	The surplus of assets to liabilities indicates that levy rates could be closer to expected cost, the smaller the positive adjustment or the greater the negative adjustment would see the balance shift from 'levies staying closer to expected cost' to 'reducing to the funding position quicker'. The rates for all three Accounts include positive adjustments, which would collect more than the minimum necessary given the funding position of each Account. This and Options 2b and 2c all propose to collect closer to expected costs in the Motor Vehicle Account than Option 1. These options are still significantly above expected costs.

Appropriate incentives	Better	
	This is likely to lead to more stable levies that are closer to expected cost. This means we except more accurate information that better reflects underlying cost. This is more appropriate as the basis for decision making. ACC recommendations are below expected cost for the Earners' and Work Accounts and above expected cost for the Motor Vehicle Account. 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. This is very important for the Work Account and the Motor Vehicle Account. For the Earners' Account pricing signals are less relevant as there are no incentive programmes.	The choice to return surplus funds more slowly for historical claims would see rates that are above expected cost in the short term. This also leads to future instability which means levy rates may be further from expected cost. This provides less accurate information for decision making. If levy rates fall in the future it would be less clear whether this is due to claims performance (of the industry/classification unit and the individual) or historical funding. Individual behaviour may be influenced by less appropriate pricing signals.
Levy stability	**Better**	
	In the Work and Earner's Accounts Option 1 proposes larger reductions than Option 2a. These are needed to manage each Account's funding position. This reduces future instability, is more likely to avoid the need for significant changes in the future, and leads to a more stable levy path.	Increasing the weight of the surplus target in the public interest test results in smaller reductions in the Work and Earners' Accounts. Not making reductions now may lead to less stable levies in the long-run that may require more significant changes in these Accounts. The converse is true for the Motor vehicle Account; however, the larger reduction in the Motor Vehicle Account in Option 2c may effectively crowd out some of the potential reductions in the Work and Earners' Accounts next levy round compared to Option 2a and 2b.
Minimise inter-generational transfers	**Better in the Work and Earners' Accounts.**	**Slightly better in the Motor Vehicle Account**
	Levy rates would be closer to expected cost of claims which reduces inter-generational transfers in the short term and the medium term. It should be noted that this year's levy payers are being cross-subsidised by past levy payers if levy rates are below expected cost. For the Motor Vehicle Account a reduction now will smooth the transition from 2014/15 levy rates to future levy rates, meaning we	This is better for minimising intergenerational transfer in the Motor Vehicle Account with the levy rate being closer to above expected cost of claims. The levy rates for the Earners' and Work Accounts are further away from the expected cost of claims which represents an over collection from today's levy payers which would subsidise future levy payers

	minimises the over-collection and cross-subsidisation of future levy payers by today's levy payers. However, with the proposed rates above expected cost, some cross-subsidisation would still occur. ACC considers this as necessary to provide funding certainty.	(based on current information). For the Motor Vehicle Account, the Government's risk preference means this could be reduced to expected cost of claims to manage the Account towards a preferred funding position. However, levy stability in the short term (from 2014/15 to 2015/16) indicates a slower reduction would be more appropriate. Even though this would lead to an over collection and cross-subsidisation of future levy payers by today's levy payers, this is minimised.
Public interest (appropriate levy revenue transfer, avoid detrimental effects on Crown accounts, and support Government's economic goals)	**This would reduce levy rates and minimises any opportunity cost and revenue transfer by leaving more in the pockets of levy payer for the 2015/16 levy year.**	**Would represent higher revenue in Crown accounts. This is consistent with the Government's fiscal strategy to balance the books.**
	Would represent lower revenue in Crown accounts. Leaving more in levy payer pockets would better support the Government's goals for economic growth.	This has a larger opportunity cost and revenue transfer from levy payers to ACC. There would also be the benefit for levy payers through ACC's contribution to the economy through its investment portfolio.