ACC Levies for 2019/20 and 2020/21 Cost Recovery Impact Statement

Agency Disclosure Statement

This Cost Recovery Impact Statement has been prepared by the Ministry of Business, Innovation and Employment. It provides an analysis of options to set the 2019/20 and 2020/21 ACC levy rates for the Work Account, Earners' Account and the Motor Vehicle Account (collectively "the levied Accounts") under the scheme's full funding model.

ACC levies are reviewed biennially and apply for a two year period. The current Work Account and Earners' Account levies will expire on 31 March 2019, and the current Motor Vehicle Account levy will expire on 30 June 2019. When set, the average levy rates for the Work Account and the Earners' Account will take effect from 1 April 2019, and the average Motor Vehicle levy rate will be effective from 1 July 2019.

Accident compensation is by nature an uncertain and long-term activity with liabilities that stretch over decades. For the relevant levy period, ACC estimates how much money is needed to cover the lifetime costs of injuries that are expected to occur in that levy period (new year claims costs). This is a requirement of the full funding model.

The proposed levy changes for each levy year are set against assumptions about the volume, duration and cost of new claims in the levied Accounts for the levy period. These are based on actuarial forecasting of injury rates, rehabilitation performance, healthcare costs, wage inflation, discount rates and investment returns. Uncertainties in these economic, behavioural, and policy assumptions include: fluctuations in volumes for accidental personal injury claims, variations from historical claims experience and changes in the wider economic environment. Variations from these assumptions have the potential to impact positively or negatively on the scheme's overall solvency rate.

ACC levies must also be consistent with the principles of financial responsibility in the *Accident Compensation Act 2001* (the Act) and the Government Funding Policy Statement. In addition to fully funding the levied Accounts, a funding adjustment is necessary where there is deficit or surplus for claims that have occurred prior to the levy period where those payments differ from what ACC previously projected. The Funding Policy details how this principle is applied. In effect this means that the costs collected through levy rates may be higher or lower than necessary to cover the projected new year claims cost.

The proposed levy rates will provide third-party funding to meet the costs of compensating, rehabilitating and treating people for injuries covered under the Act. It also provides funding for initiatives to prevent injuries from happening. Levies for this levy round will cover the expected lifetime costs of claims arising (i) from 1 April 2019 – 31 March 2021 for the Work and Earners' Accounts, and (ii) from 1 July 2019 – 30 June 2021 for the Motor Vehicle Account.

MBIE engaged independent actuarial consultants, Finity Consulting Pty Limited, to provide quality assurance of ACC's actuarial forecasts, assumptions, and recommendations. The review is a test for reasonableness and is not intended to provide an independent estimate of levy rates.

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In Finity's opinion, *"ACC's estimate of the required levies [for the 2019/20 and subsequent accident years] is reasonable. The long term and uncertain nature of ACC benefits means there will always be a range of reasonable projection assumptions, and different ways in which the required funds can be collected. However, taken together, the judgements made by ACC appear to strike an appropriate balance. For example, while ACC reflects increasing frequency and cost trends apparent for some payment types, it also anticipates savings from management initiatives underway or planned."*

The independent actuarial advice also concluded that *"…charging lower levies for the next two years would not be expected to significantly impact account solvency and ACC has sufficient assets to cover payments for many years under almost any plausible scenario. The main risk of charging lower levies over the next two years is that it increases the likelihood that a levy increase will be required next time levy rates are reviewed."*

Hayden Fenwick, Manager, Accident Compensation Policy, MBIE

November 29, 2018

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Executive summary

This CRIS analyses options for setting average levy rates for the Work, Earners' and Motor Vehicle Accounts for 2019/20 and 2020/21. Other levy-related proposals including the self-employed levies and the Vehicle Risk Rating (VRR) programme have also been considered.

This paper assesses three proposed levy rate options for 2019/20 and 2020/21:

- *Option A - ACC's Recommended Levy Changes :*
  - Increase the Earners' Account levy from $1.21 to $1.24 per $100 of liable earnings
  - Decrease the Work Account levy from $0.72 to $0.67 per $100 of liable earnings
  - Increase the average Motor Vehicle account levy component of the motor vehicle registration fee from $113.94 to $127.68 with no increase in the current petrol levy. Licence levies for motor cycles and mopeds will increase in line with the net 12% increase in the average Motor Vehicle levy rate. The Motorcycle Safety Levy will be retained at $25 per vehicle.
- *Option B - The Status Quo:*
  - Maintaining all rates and settings at 2018/19 levels
- *Option C – Retain the Current Earner Account levy, Moderate the Motor Vehicle Account increase, and reduce the Work Account Levy:*
  - Maintain levy rates and settings for the Earners' Account at 2018/19 levels (including those that apply to motor cycles and mopeds)
  - Increase the Motor Vehicle Levy to $120.81 (an average $7 increase on the current levy funded entirely through an increase in the average annual vehicle registration fee with the petrol levy unchanged at 6 cents per litre)
  - Reduce the Work Account levy as recommended by ACC.

These options have been assessed against criteria that reflect the principles of financial responsibility in the *Accident Compensation Act 2001* and the Government's funding policy which ACC applies when recommending levy changes. The high level criteria are:

- Meeting the life time costs of claims each year
- Correcting for any funding surplus or deficit
- Avoiding large changes in levies
- Public interest considerations.

We have not applied any weighting to particular criteria when undertaking our initial assessment.

All options meet the requirements of the Government's full funding model which requires ACC to collect sufficient funds to meet the lifetime cost of injuries by offsetting the outstanding claims liability with a sufficient level of assets.

Our assessment concludes, however, that Option C – maintaining the Earners' Account levy rate at 2018/19 levels while decreasing the Work Account levy and increasing the Motor Vehicle Account levy rate - rates most highly against the full criteria.

The preferred option C uses more of the accumulated funding surplus to move towards the funding policy's target solvency level more quickly than ACC's option, while continuing to meet the life time costs of claims and maintaining prudent solvency levels. While there is a greater risk of larger changes in levy rates in future levy rounds in comparison with ACC's recommended levy rates, we consider this risk is outweighed by to the benefit of using more of the funding surplus to reduce the levy burden on current levy payers.

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Option C rates most highly against the assessment criteria when all criteria are given equal weight. From MBIE's perspective there is a case for greater weight to be given to returning to the target solvency rate of 105% and less weight to reducing the risk of future larger changes in levy rates. In which case option C would rate even more highly. We consider this approach is also in the public interest as it reduces the amount of money that is taken from levy payers who are then able to use it for other purposes.

Conversely, ACC's recommended approach (Option A) appears to give greater weight to levy stability over time which involves using the surplus more slowly and holding levy rates above the 105% target for longer. Because ACC is required to follow the Government's Funding Policy, it is not allowed to take into account the broader public interest considerations that MBIE factors into its advice.

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Introduction

What is the rationale for government intervention?

The accident compensation scheme provides entitlements that cover the cost of personal injuries in New Zealand. Collecting levies to cover the cost of injuries ensures a reliable and durable source of funds which is essential for delivering the services which New Zealanders are entitled to under the Act and the financial sustainability of the scheme.

Current Levy rates

ACC levies for the Earners' Account, Work Account and the Motor Vehicle Account are set every two years. The current levies were last set in 2016 for the 2017/18 and 2018/19 years:

Table 1: Current levy rates

	Current year costs	Funding adjustment	Average 2018/19 levy rate
Earners	$1.41 Per $100 liable earnings	-$0.21	$1.21 Per $100 liable earnings
Work	$0.94 Per $100 liable earnings	-$0.21	$0.72 Per $100 liable earnings
Motor Vehicle	$157 Per motor vehicle	-$43	$114 Per motor vehicle

The two key factors that determine the levy rates are:

- *Current year claims costs*, being the total cost required to cover claims that will occur within the next year. These costs are estimated on a fully funded basis, meaning that the levy charged each year reflects the estimated total cost of all accidents expected to occur in the year, including payments in future years that relate to those accidents.
- *Funding adjustment*, which is the additional amount or reduction to cover the differences between ACC's liabilities for claims that occurred in previous years and the assets ACC holds in respect of those claims. This is unique to the setting of ACC levies and is a legislated financial responsibility requirement.

The Work Account and Motor Vehicle Account levies are average rates that levy payers would pay if ACC charged a flat rate. However, the actual rate paid by employers, self-employed and motorists differs from the average rate. The actual Work levy rate paid by each business is determined by the claims experience of its classification unit, individual business' claims experience, and any ACC incentive products and programmes. Motor Vehicle levies are paid through a levy on petrol and as part of vehicle licence fee. This fee varies for different classes of vehicle which reflect the risk of injury they present in the event of a crash.

These levy rates are contained in the Accident Compensation (Earners' Levy) Regulations 2017, the Accident Compensation (Work Levy) Regulations 2017 and the Accident Compensation (Motor Vehicle Levy) Regulations 2017.

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What policy outcomes will the activity achieve?

The levy setting process aims to ensure:

- The financial sustainability of the accident compensation scheme
- Levy payers meet their fair share of claims costs
- Large fluctuations in levy rates are avoided to provide certainty to levy payers
- Adjustments are made to correct for any surplus or deficit that has arisen through variation between actual and forecast scheme performance.

The Earners' levy ensures sufficient funds are available to meet the cost of claims for non-work personal injuries for employed persons (including self-employed not including motor vehicle injuries. The Work levy ensures sufficient funds are available to meet the cost of claims for all work–related injuries. The Motor Vehicle levy ensures sufficient funds are available to meet the full cost of claims for all injuries that happen on public roads involving moving motor vehicles.

Cost Recovery Principles and Objectives

This levy review is underpinned by the following cost recovery principles:

Table 2

Principle	Description
Authority	The *Accident Compensation Act 2001* (the Act) and the Regulations provide authority to fund entitlements provided under the Act through levies.
Financial responsibility	ACC's average levy rates must meet statutory principles of financial responsibility and the Funding Policy Statement. All levied accounts must be fully funded, funding adjustments must be made to correct surplus or deficits and large changes in levies are to be avoided. The Funding Policy Statement details the target and time horizon of the funding adjustment and caps any increase to the average levy rate.
Transparency and Consultation	ACC has undertaken public consultation on (i) the proposed levy rates, and (ii) ACC and the Minister's levy-related proposals. Information on the underlying cost drivers has been provided in the consultation document.
Efficiency	Biennial review of the levies ensures that they reflect the expected underlying cost of claims and operating expenses, and support efficient resource allocation. Efficiency gains through ACC's injury prevention investments to avoid accidents occurring and the Integrated Change Investment Portfolio (ICIP) initiatives (including investments to improve claims management and health services purchasing) have ameliorated cost pressures that would have otherwise occurred. The proposed increases in Earners and Motor Vehicle levies have factored in the expected efficiency gains from these additional investments.
Accountability	Levies must be set by regulations approved by the Government where the usual regulatory accountability mechanisms apply.

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Objectives of the levies proposal

Table 3

Objective	Description
Meeting the lifetime cost of claims in each levy period	• Average levy rates meet the expected lifetime cost of claims in relation to injuries occurring in the levy period • Ensures levy payers meet their fair share of the true cost of injuries by targeting the mid-point of a funding band of 100-110% • Ensures intergenerational equity by minimising intergenerational transfers (cross-subsidisation) • Provide accurate price signals to incentivise injury prevention.
Correcting for any surplus or deficit from claims performance in previous years	• Return to funding target of 105% • Provide confidence to ACC claimants that funds will be available to meet their treatment, rehabilitation and compensation costs • Return surplus funds to levy payers so ACC does not remove more money from the economy than required.
Avoiding large changes in levies	• Provide levy stability for levy payers to provide certainty to levy payers. This includes taking account of the Funding Policy requirement that any increase to the average levy rate for each Account must not exceed 15%, in addition to inflation adjustments to the Motor Vehicle Account.
Public interest considerations	• Impact on the economy • Social impact • Impact on the Crown Accounts.

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Why is cost recovery appropriate for the activity (over and above the legal authority to charge) i.e., why should it be third party funded rather than funded by the Crown?

The different Account levies are designed to reflect forecast scheme costs attributable to different groups of levy payers.

For injuries that are work-related, or happen on public roads involving a moving vehicle or that happen to working people outside of work, recovering the costs to fund the prevention, rehabilitation and compensation for these injuries from levy payers is consistent with the principle of community responsibility which is a founding principle of the accident compensation scheme.

Is full or partial cost recovery being proposed? What is the rationale for proposing full or partial cost recovery?

The proposed levy rates are intended to cover the full cost of claims arising in each levy period after taking account of any surplus or deficit in the scheme accounts (the funding adjustment).

Because all accounts have solvency rates in excess of the funding target of 105%, the proposed levy rates have been set below the amount required to meet the estimated full cost of claims in each levy period. The short fall is met by the ‘funding adjustment’ that draws down on surplus funds in each account.

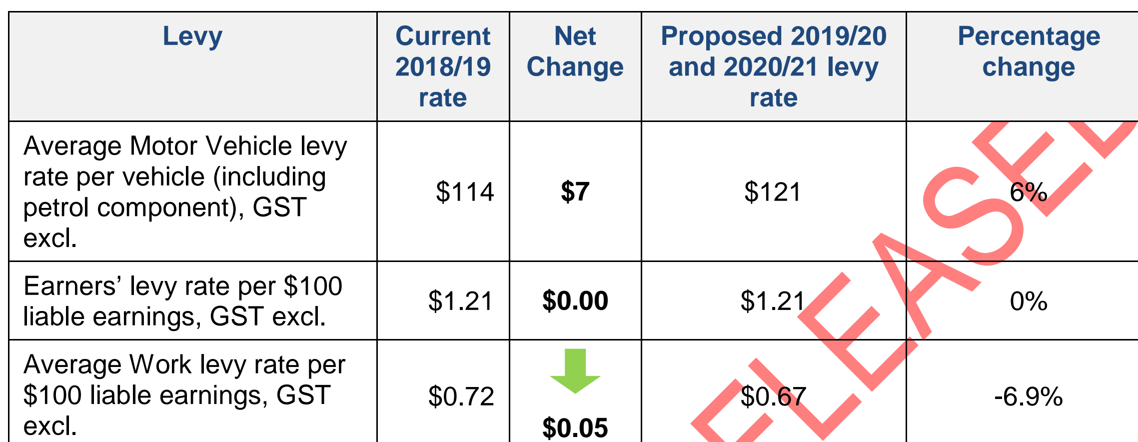
Policy rationale for reviewing levies

ACC reviews Account levies to meet the requirements of the previous Government's Funding Policy Statement which is issued under section 166B of the Act. It conducts this review on a biennial basis in accord with a Cabinet decision in May 2016.

The level of the proposed fee and its cost components (cost recovery model)

The levy changes in our preferred option are set out in the following table.

Table 4



Levy	Current 2018/19 rate	Net Change	Proposed 2019/20 and 2020/21 levy rate	Percentage change
Average Motor Vehicle levy rate per vehicle (including petrol component), GST excl.	$114	**$7**	$121	6%
Earners' levy rate per $100 liable earnings, GST excl.	$1.21	**$0.00**	$1.21	0%
Average Work levy rate per $100 liable earnings, GST excl.	$0.72	↓ **$0.05**	$0.67	-6.9%

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The largest component of the levy rates is claims costs. This is the amount needed to fund entitlements for injured people including:

- Weekly compensation which is earnings-related compensation
- Vocational rehabilitation which can include a fitness programme, guidance on gradually returning to work, workplace equipment and retraining if necessary
- Social rehabilitation, for example accommodation and vehicle modification, equipment, attendant care and home help
- Treatment costs
- Ambulance and emergency care.

Other costs components are:

- Operating costs which are expenses associated with scheme operations including levy collection, claims management and general office and equipment overheads
- Injury prevention costs.

A significant component affecting the levy rate is the funding adjustment which ensures that any over- or under-funding of claims from prior years is accounted for and that the levy rates are set to ensure that the account achieves its funding target within the timeframe set by the Government. A negative adjustment reflects that the Account is above the funding target and that this excess will be returned over the funding horizon. All levied accounts are currently above the funding target.

The final levy rate is arrived at after factoring in ACC's management responses. These represent the forecast financial impact of ACC management initiatives. For this levy round the management responses are categorised into the Integrated Change Investment Portfolio (ICIP) and the injury prevention initiatives.

Each levied account is subject to different costs drivers.

The proposed levy rate for the Earners Account takes account of:

- higher than expected claim costs in respect of weekly compensation benefits (reflecting higher than expected claims volumes) and higher than expected costs for most other payment types are offset by assumed lower severity for elective surgery claims (including lower inflation rates for elective surgery that reduces levies by $0.04). Based on historical increases over a long time, ACC had previously assumed average claim size for elective surgery would increase by five per cent above the labour cost index (LCI). As claims inflation has been lower than this for the last six years, ACC has reduced the assumed rate of inflation to three per cent above LCI
- claims costs offset by a larger drawn down from the funding surplus than originally proposed by ACC
- allowances for management responses which have reduced levies by $0.05 (per $100 liable earnings)
- higher than expected wages offset by changes in assumed inflation and the discount rate.

The proposed levy rates for the Work Account take account of:

- claims costs that are significantly lower (seven per cent decrease) than was expected two years ago, driven mainly by lower than expected average claim size for long term weekly compensation. In effect, reflecting this experience, ACC is forecasting that it will be able to rehabilitate these long term claims within a shorter period of time than allowed for previously. For weekly compensation, the change also relates to funding entitlements for the small proportion of claimants for many years. Another contributor is the growth in liable earnings relative to population growth
- the expense impact of changes to financial incentives. Removal of a loading which increased the average Work levy to offset a discount offered under a previous scheme. These discounts have been removed and as such the loading is no longer required
- changes in economic assumptions that have increased expected cost of claims by $0.05 per $100 liable earnings
- allowances for management responses have reduced levies by $0.01 (per $100 liable earnings)
- a lower funding adjustment as the surplus is lower than previously estimated.

The proposed levy rates for the Motor Vehicle Account take account of:

- a larger draw down from the funding surplus than originally proposed by ACC
- over 34 per cent of the new year's claims costs are in respect of social rehabilitation payments for serious injuries and over 25 per cent is for weekly compensation. While very few serious injury claims are reported each year, the lifetime cost of caring for each claimant averages several million dollars per year (around $6 million expected in 2018/19 before discounting)
- an increase in claims costs from a faster than expected rate of increase in frequency of weekly compensation claims which is assumed to be largely offset by the impact of management responses
- allowances for management responses that reduce levies by $6 per vehicle
- changes in economic assumptions that increase expected cost of claims by $10 per vehicle.

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Present estimates of expenses and revenue for the activity. The estimates should illustrate the potential for revenue and expenses to align.

The following table provides a forecast estimate of the impact of the scheme expenses and scheme revenue on the funding ratio in 2029/30 for each of the levy rate options. The expenses and revenues are expressed in levy rate terms.

Table 5:

Impact of ACC Expected Costs and Revenue (expressed in levy rate terms) on Account Funding Ratios						
Options	Current Levy Rate	Expected Costs[1]	Funding Adjustment	Proposed Rate[1]	Change	Funding ratio at 2029/30
Option A: ACC's Recommended Levy Rates						
• Work Account	$0.72	$0.81	-$0.14	$0.67	$0.05 7% decrease	110%
• Earners Account	$1.21	$1.37	-$0.13	$1.24	$0.03 3% Increase	108%
• Motor Vehicle Account	$114	$158	-$30	$128	$14 12% Increase	107%
Option B: Status Quo						
• Work Account	$0.72	$0.81	$0.09	$0.72	$0.00 No change	111%
• Earners Account	$1.21	$1.37	$0.16	$1.21	$0.00 No Change	107%
• Motor Vehicle Account	$114	$158	-$44	$114	$0.00 No change	$106
Option C: Maintain current Earners Levy, moderate the increase in the MV Account Levy, and reduce the Work Account levy in line with ACC's recommendation						
• Work Account	$0.72	$0.81	-$0.14	$0.67	$0.05 7% decrease	110%
• Earners' Account	$1.21	$1.37	$0.16	$1.21	$0.00 No Change	107%
• Motor Vehicle Account	$114	$158	-$37.19	$120.81	$6.81 Increase	106%

[1] Covers the biennial levy period 2019/2020 and 2020/2021.

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MBIE's recommended levy rates in Option C would translate into a total Crown revenue average decrease of $94.2m per annum, as compared with an average $9.4m per annum decrease under ACC's recommended rates in Option A.[1] Leaving Earners' and Motor Vehicle levies unchanged now is expected to increase the risk that larger levy increases may be required in future under current funding policy settings.

Discuss how changes in the underlying assumptions will affect financial estimates.

The levy rate is influenced by a range of different cost assumptions. These assumptions can be grouped into four broad categories:

- Economic assumptions – these are economic-type assumptions that ACC generally (but not exclusively) sources from external organisations (such as Treasury and Statistics New Zealand), ensuring alignment with other government agencies
- Behaviour assumptions – these assumptions predominately describe ACC's view of claimant behaviours over time (such as claim frequencies and claim duration), and are set by ACC

[1] This is the forecast movement against Half Year Economic and Fiscal Update (HYEFU).

- Treatment and rehabilitation cost assumptions – these assumptions are focused on describing ACC's perspective of expected changes to the costs of services provided to claimants
- Policy and operational settings assumptions – these assumptions describe the expected impact of changes to policies and ACC's operational settings that apply to each levied Account.

ACC's Pricing Report's for each account detail the key assumptions that have the greatest impact on the recommended levy rates. In summary these reports outline

Economic assumptions that include:

- A decrease in the discount rate from 5.50% as at 31 March 2016 to 4.75 per cent as at 30 June 2018 which has resulted in a smaller negative funding adjustment
- A decrease in forecast investment returns by -0.73 per cent and -0.71 per cent since the previous pricing review, which reduces the revenue available to offset claims costs
- An unchanged Labour Cost Index forecast of 2.2 per cent for base inflation
- Population projections based on NZ Statistics Forecasts as at 31 December 2017 and Treasury unemployment forecasts as at 31 December 2017 which are used to project future claims volumes
- An increase in liable earnings forecasts by 8 per cent for 2019/20 and 9 per cent for the 2020/21 levy year, which impact on future weekly compensation claims costs
- A 13 per cent increase in the forecast number of motor vehicles based on licence data received from NZTA as at 31 December 2017 which is used to project future claims volumes and therefore claims costs for the Motor Vehicle Account.

Behavioural assumptions that cover:

- Forecast weekly compensation claims volumes & costs
- Elective surgery claims frequency and costs, including superimposed inflation
- Radiology costs including superimposed inflation
- Forecast social rehabilitation serious injuries frequency and severity
- Other medical claims severity.

In summary, ACC is forecasting a growth in claims costs over the levy period across the Work, Earner's and Motor Vehicle Accounts.

ACC's policy and operational setting assumptions are covered in the following section which addresses ACC's management actions in further detail.

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If this proposal is a review and an increase in user charges is proposed, is pursuing options for efficiency/productivity improvements, or making changes to levels of expected service delivery, or vary the expected memorandum account balance, without any change in fee levels a feasible option?

ACC has explicitly incorporated an estimate of the impact of planned management actions on claims cost, and reduced the proposed levies accordingly. This is the first time ACC has allowed for such responses on the levied accounts which were previously allowed for only when their impact was apparent in the claims experience.

The allowances for management responses have reduced the requested levies by the following amounts:

- Work Account: $0.01 (per $100 of liable earnings)
- Earners' Account: $0.05 (per $100 of liable earnings)
- Motor Vehicle Account: $6 (per vehicle).

ACC's management responses are:

- Integrated Change Investment Portfolio (ICIP) initiatives which are designed to improve ACC's productivity, improve its customer service and deliver cost savings. This suite of initiatives includes, inter alia:
    - Next Generation Case Management – redesign of ACC's case management model to improve client outcomes and increase productivity
    - Health Services Strategy – greater collaboration and partnerships with providers to support outcomes-based commissioning
    - Client Front End Establishment – new solution for claims lodgement to improve productivity and Net Trust Score
    - Analytics – using analytics to better pinpoint where to focus effort and improve ACC's performance.
- Injury prevention investments:
    - Initiatives such as ACC's Ride Forever motor cycle training course and other investments like this are expected to balance some of the growth ACC is forecasting in claims numbers and costs.
    - ACC plans to launch a new investment fund of $22 million over five years from March 2019 ($4.4 million per annum). The purpose of the fund is to create targeted financial incentives (subsidies and grants) that promote specific and effective efforts to accelerate health and safety performance improvement in workplace, industry or supply chain. The subsidies are intended to support small and medium sized businesses (6-99 employees) to increase their investment in effective workplace health and safety solutions businesses, industry associations, workers' groups, research institutions and collaborative groups will be able to apply for grants that will target projects that have the potential influence health and safety behaviours across several organisations or an entire sector or supply chain.

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Impact analysis

The proposed decrease in the average levy rate for the Work Account will impact all employers. All employees will have to pay the Earners' levy, all owners of licensed motor vehicles will pay the Motor Vehicle levy and all employers have to pay the Work levy.

Table 6 models the impact of levy changes on a range of households, while Table 7 models the impact on businesses.

Table 6: Impact on households

	Household with average income[2]		One full time minimum wage earner		One average income earner[3]		One earner above max liable earnings	
	2 low risk cars	No VRR	1 high risk car	No VRR	1 low risk car	No VRR	1 low risk car	No VRR
Option A: ACC's Recom-mendation	$1,511	$1,565	$677	$624	$850	$876	$1,940	$1,967
Option B: Status Quo	$1,463	_	$649	_	$823	_	$1,887	_
Option C	$1,467	$1,519	$656	$605	$826	$851	$1,889	$1,915

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[2] Assumes household average income of $90,806 based on the June 2018 wages and salaries from the: https://www.stats.govt.nz/information-releases/household-income-and-housing-cost-statistics-year-ended-june-2018.

[3] Assumes median wage rate of $25 per hour based on June 2018 labour market statistics: https://www.stats.govt.nz/information-releases/labour-market-statistics-income-june-2018-quarter.

Table 7: Impact on businesses

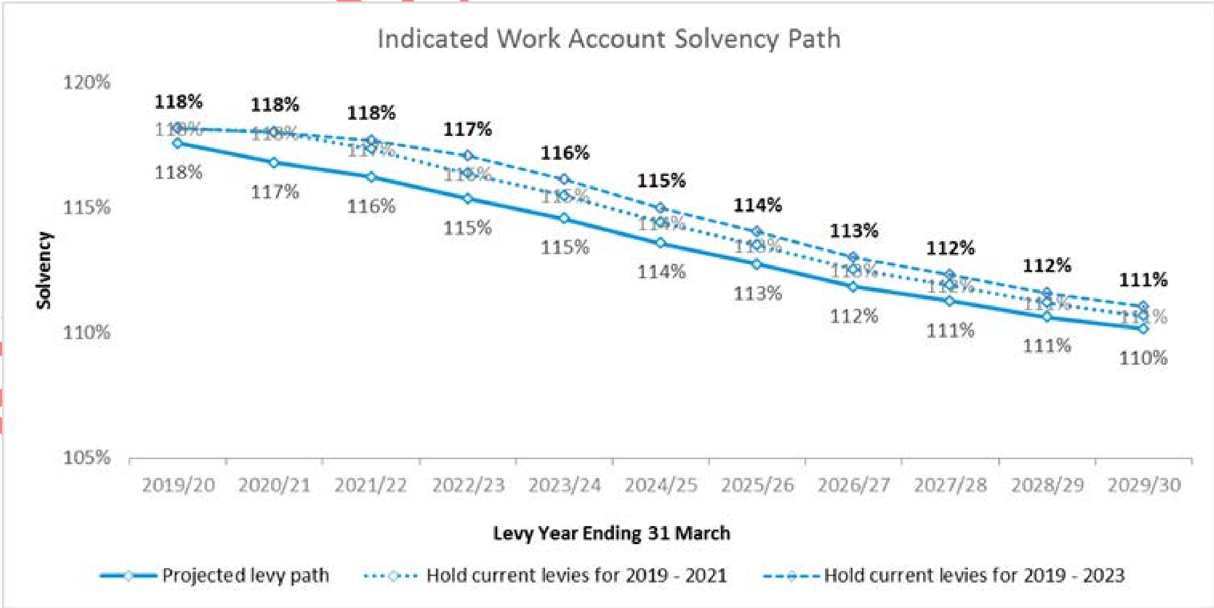
	Small business (with liable earnings of $150k)		Medium business (with liable earnings of $1m)		Large business (with liable earnings of $10m)	
	Levy	Change	Levy	Change	Levy	Change
Option B Status Quo	$1,080		$7,200		$72,000	
Options A & C	$1,008	-$72	$6,722	-$478	$67,215	-$4,785

The following section shows the impact of selected levy rate options on solvency rates and future levy rates, given ACC's current forecast assumptions.

Work Account:

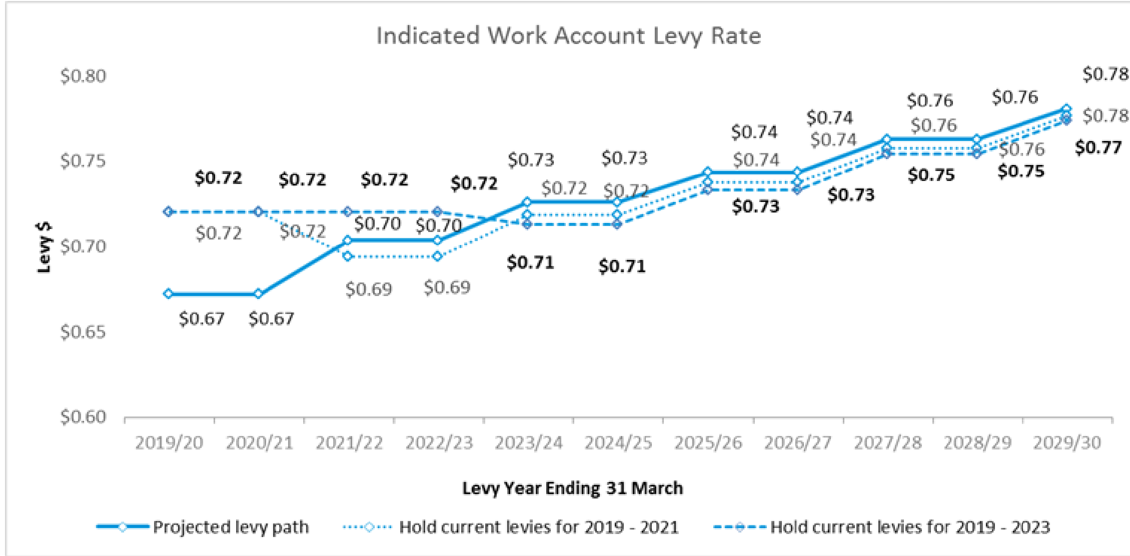
Given that the Work Account funding ratio is expected to remain above the 110 per cent target over the next 10 years, the levy reduction is appropriate to get the Account to the 105 per cent funding position over a shorter period of time (as shown by the figure below).

Figure 1: Work Account solvency projections 2019/20-2029/30



However, as the funding position is wound down, expected cost increases will be offset to a lesser extent. This means that levies will need to be increased at some point beyond the next levy round, as shown in the figure below if forecast claims experience eventuates. Given this risk, we have not recommended an even larger levy reduction in this levy round.

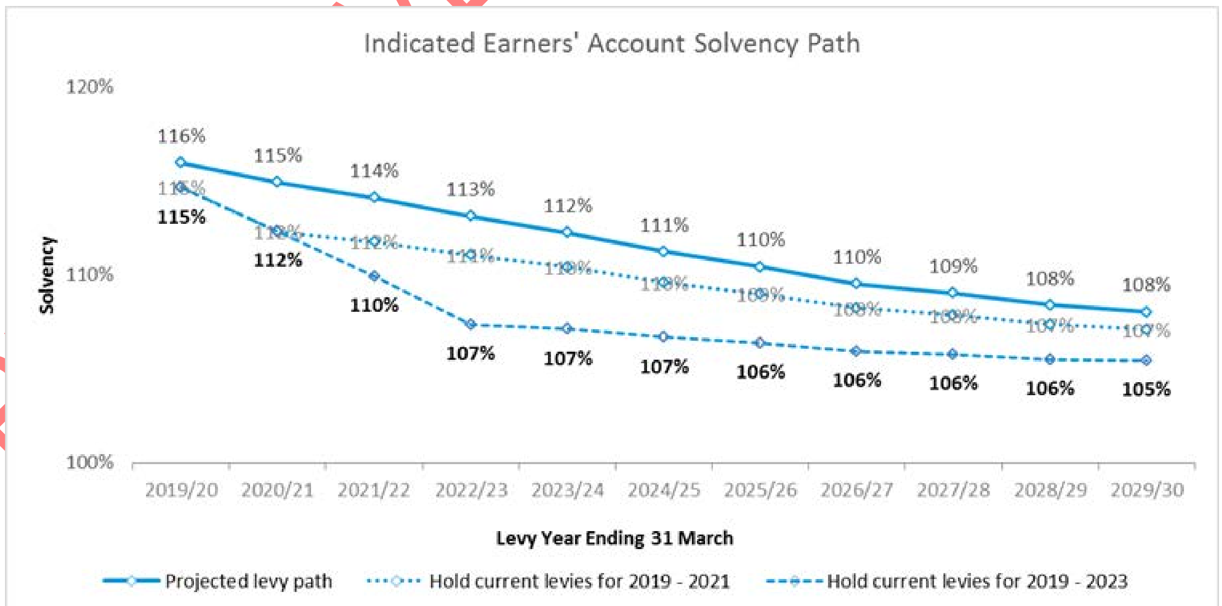
Figure 2: Work Account levy projections 2019/20-2029/30



Earners' Account

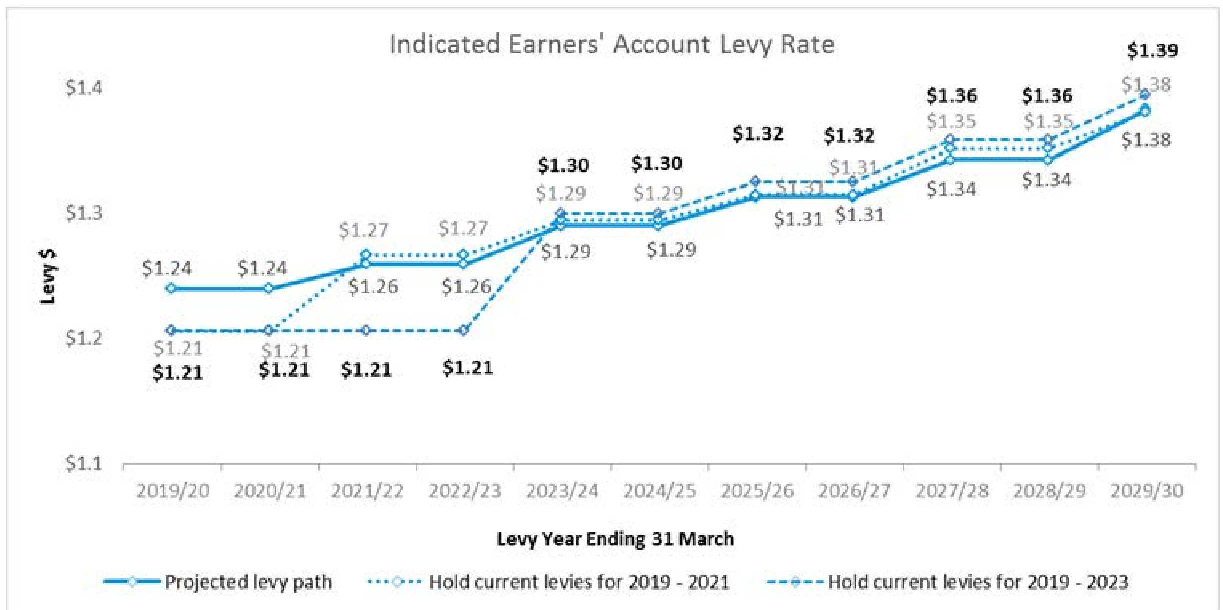
MBIE considers there is not a strong rationale for increasing average rates when the Account is unlikely to reach the mid-point of the funding band within the next 10 years. Compared with ACC's proposed increase (Options A), the funding position associated with MBIE's recommendation at future levy years would be lower, but the funding target at the end of 10 years would still sit above 105 per cent.

Figure 3: Earners' Account solvency projections 2019/20-2029/30



As shown in the table below, all things being equal, MBIE's recommendation to maintain the current levy rate would only result in a marginal difference in the levy increase required in future levy periods.

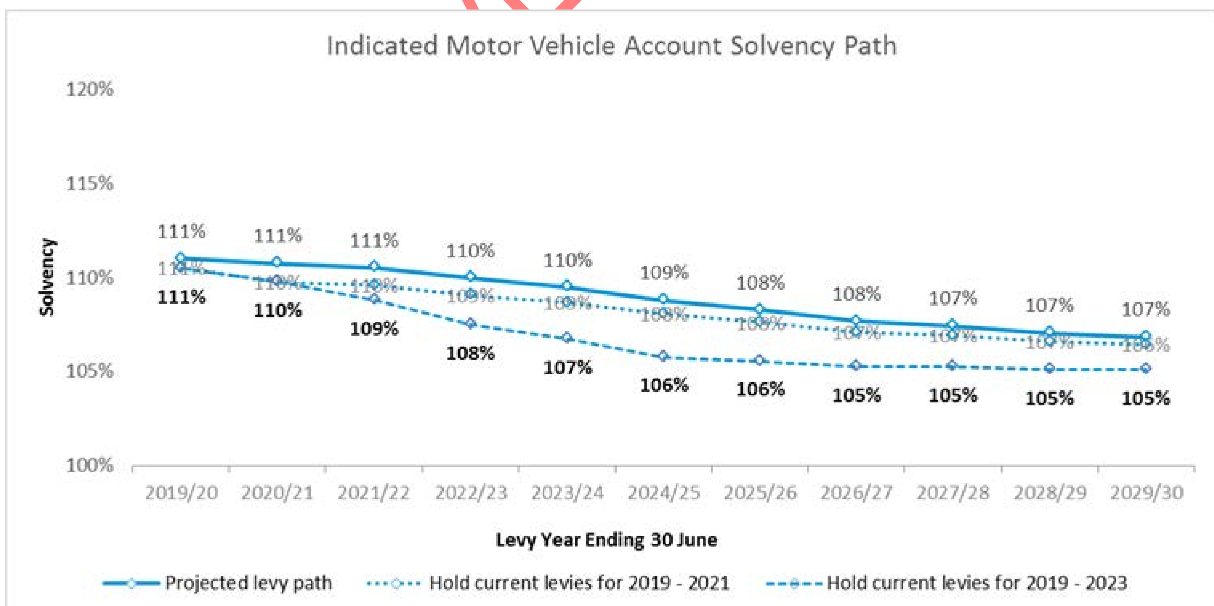
Figure 4: Earners' Account levy projections 2019/20-2029/30



Motor Vehicle Account

As the figure below shows, by providing a smaller increase in the levy rates for the next two years as recommended in Option C, the Account's funding position would be 1 per cent lower than if it were increased as recommended by ACC in Option A. It would also still sit above the funding target at the end of 10 years.

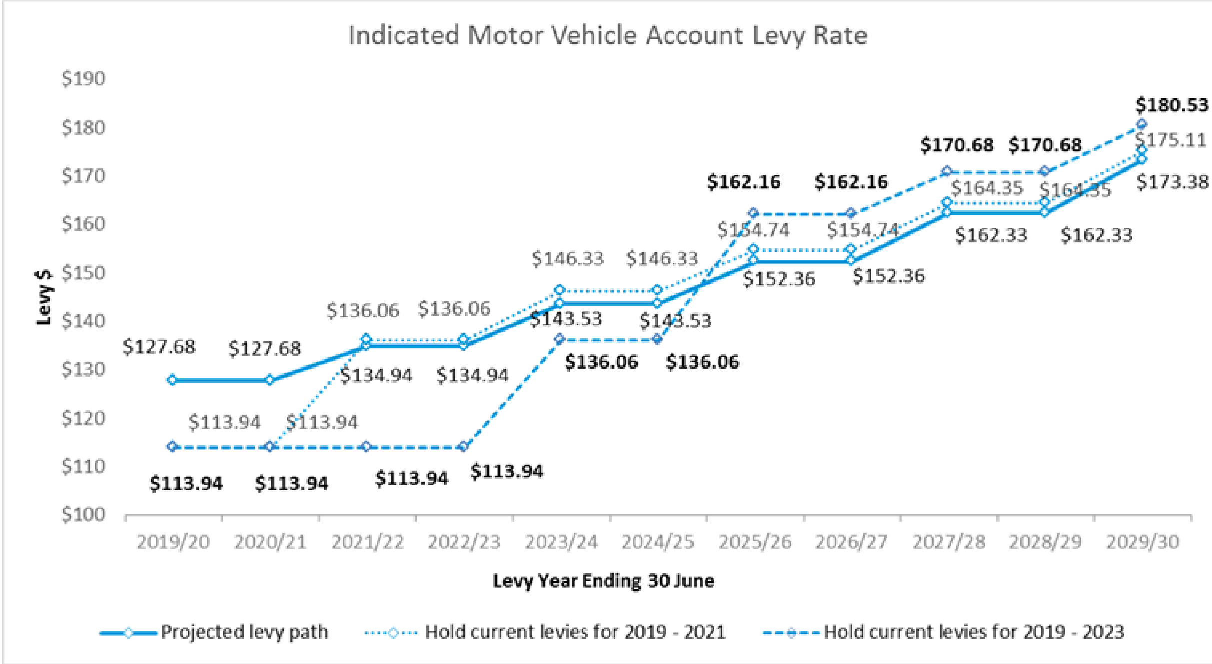
Figure 5: Motor Vehicle Account solvency projections 2019/20-2029/30



MBIE's actuary has advised that "charging lower levies for the next two years would not be expected to significantly impact account solvency, and ACC has sufficient assets to cover payments for many years under any plausible scenario. The main risk of charging lower levies over the next two years is that it increases the likelihood that a levy increase will be required the next time levy rates are reviewed."

ACC is of the view that holding levies constant for two or more years will require a levy increase that exceeds the funding policy's maximum capping rules. When the capping rules[4] are applied, holding the Motor Vehicle levy at the current rate of $114 would be expected to result in a $22 increase at the next levy round, rather than the estimated $13 increase today, followed by a further $10 in two years' time. This is shown below:

Figure 6: Motor Vehicle Account levy projections 2019/20-2029/30



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We acknowledge that under the current funding policy, given current forecast assumptions, levies could need to increase the next time levy rates are reviewed in order to cover the cost of new accident year claims in future years in accordance with the funding policy statement. ACC's future year levy rate recommendations could be limited to the 15 per cent cap but, as noted, we consider there is an opportunity to review, for instance, the funding target given the public nature of the scheme.

In summary, while maintaining current rates for another two years increases the likelihood that a levy increase will be required the next time levy rates are reviewed in 2020, there are choices on the magnitude of any increase. These choices depend on judgements on the funding policy and other public interest considerations.

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[4] Levy rate increases capped at 15 per cent plus the change in LCI over the two year period immediately preceding the new levy rate.

Analysis of options against criteria and levy-setting objectives for the Work, Earners' and Motor Vehicle Accounts

The criteria underpinning this analysis reflect the principles of financial responsibility in the Accident Compensation Act 2001. They take account of, but are broader than the Government's current funding policy that is applied by ACC when it recommends levy changes.

Table 8

Criteria and Objectives	Option A – ACC's recommendation	Option B – Status Quo - Maintain 2018/19 rates	Option C – Maintain Earners' Account Levy, Moderate increase in the Motor Vehicle Account & reduce the Work Account Levy
Work Levy **Earners' Levy** **Motor Vehicle Levy**	$0.67 $1.24 $128	$0.72 $1.21 $114	$0.67 $1.21 $120.81
Meeting the lifetime cost of claims each year • reflect the true cost of injuries so that ACC, the Government, and levy payers can make informed decisions • provide accurate price signals to incentivise injury prevention • intergenerational equity (Minimise intergenerational transfers through each year's levy payers paying the appropriate amount and not subsiding future levy payers)	**Positive (+)** (+)This option better reflects the forecast full cost of claims than the status quo as it takes account of the latest actuarial assessment of claims rates and costs for the levy period. (+) Because this option uses less of the funding surplus than the status quo to reduce overall claims costs in the Motor Vehicle and Earner Accounts, the increase in claims costs is signalled more clearly to levy payers. (-) By using less of the surplus in the Earners' and Motor Vehicle Accounts to reduce costs for current levy payers than the status quo, this option increases the subsidy available for future levy payers, which is not as well aligned with the intergenerational equity objective (It does, however, use more of the surplus in the Work Account than the status quo which partially offsets this negative outcome).	**Neutral (0)** (0)The status quo does not reflect the latest assessment of forecast claims rates and costs. (0)The status quo does not include an adjustment for the increase in claims costs. It does not send a price signal reflecting these changes to premium payers.	**Positive (+)** (+)This option better reflects the forecast full cost of claims than the status quo as it takes account of the latest actuarial assessment of claims rates and costs for the levy period. (-) This option uses more of the funding surplus in the Earners' Account than the Status Quo, which dampens the price signal that would otherwise be sent given increasing claims costs (+) By using more of the surplus in the Earners' and Work Accounts to reduce costs for current levy payers than the status quo, this option reduces the subsidy available for future levy payers and better meets the intergenerational equity objective.

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Criteria and Objectives	Option A – ACC's Levy Consultation Proposal	Option B – Status Quo - Maintain 2018/19 rates	Option C - Maintain Earners' Account Levy, Moderate increase in the Motor Vehicle Account & reduce the Work Account Levy
Correcting for any surplus or deficits • return to target solvency • provide certainty to ACC clients that funds will be available to meet scheme costs • return surplus funds to levy payers so ACC does not remove more from the economy than required	**Negative (-)** This option moves towards the target solvency rate for the Earners and Motor Vehicle Accounts more slowly than the status quo option and Option C. It moves towards the Work Account target solvency rate more quickly than the status quo and at the same rate Option C. All Accounts continue to sit above the 105% funding target providing reasonable assurance that scheme costs will be met.	**Neutral (0)** Maintaining 2018/19 levy rates makes no correction for the funding surplus in each of the Accounts. All Accounts continue to sit above the 105% funding target providing certainty that scheme costs will be met.	**Positive (+)** This option moves towards the target solvency rates for the Earners' and Motor Vehicle Accounts at the same rate as the Status Quo option, but to a greater extent than option A. It moves the Work Account funding position towards the target solvency rate to a greater extent than the status quo option and at the same rate as Options A. All Accounts continue to sit above the 105% funding target providing certainty that scheme costs will be met.
Avoiding large changes in levies • provide levy stability for levy payers to allow levy payers to plan financially	**Positive (+)** Increasing Earner and Motor Vehicle levies in this levy round, reduces the risk of larger increases in future rounds – allowing for greater forecast levy stability than the status quo or option C. The solvency rate for the Work Account, means a levy reduction can still be accommodated without+ significant risk of a major variation at the next levy review round.	**Neutral (0)** Maintaining the current rate for all Accounts maintains levy stability in the short term. If claims costs continue to rise in future years as forecast it increases the likelihood of greater increases in future levy rounds than would occur under Options A for the Earners' & Motor Vehicle Accounts.	**Neutral (0)** Maintaining the current levy rate for Earners' Account maintains levy stability in the short term in line with the Status Quo. If claims costs continue to rise in future years as forecast the levy settings increase the likelihood of greater increases in future levy rounds than would occur under Option A for the Motor Vehicle and Earners' Accounts. The solvency rate for the Work Account means a levy reduction can still be accommodated without significant risk of a major variation at the next levy review round.
Public interest considerations • Economy • Impact on Crown accounts	**Negative (-)** Increasing earners and motor vehicle levies, leaves levy payers with less money to use for other purposes. The increase in the cost of petrol will have an adverse impact on low and middle income motorists. The positive impact on the Crown Accounts is offset by the increased cost to levy payers.	**Neutral (0)**	**Positive (+)** By reducing the Work Account levy on employers & the self-employed this option reduces their costs, providing them with a greater surplus that they can either invest in their business or use for other purposes. The negative impact on the Crown Accounts is offset by the removing less funds from levy payers.

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Consultation

ACC consulted on the proposed levy rates from 27 September to 25 October 2018. It received 6,334 submissions, which is a six-fold increase on submissions received in the 2016 consultation period.

An analysis by ACC of the submissions for the 2019/20 and 2020/21 consultations informed this document.

Please note that the attached submissions analysis is not intended as a final document. ACC will produce a public document in early 2019.

Earners' Account

Most submitters (80%) disagreed with the ACC's proposed increase to the Earners' levy, claiming that current levies are too expensive and the increase is unwarranted for those who rarely use ACC cover. We have noted concerns about the affordability of the levy increase, and balanced that with the requirement to meet the Government's Funding Policy in MBIE's preferred option which recommends holding the Earners' Levy at its current rate.

Work Account

The vast majority of submissions support decreasing the average Work Account levy (92%). Many submitters welcome the proposed reduction as the levy is a significant cost to their business. Submitters who disagreed with the proposed reduction consider the levy should be left at its current level with the additional funds used to improve ACC services (e.g. improved rehabilitation options or medical treatments). MBIE's preferred option incorporates the decrease in average levy rates that ACC consulted on.

Motor Vehicle Account

ACC consulted on increasing the average levy to $127.68 per vehicle, and maintaining the current funding split across petrol charges and registration fees.

Most submitters disagree with the proposed increase to the average Motor Vehicle levy (87%), stating that the cost of petrol and registration is already too high.

NZAA and the NZ Federation of Motoring Clubs both support increasing the registration fee and holding the current petrol rate, noting that petrol prices are at near-record high, while the cost of relicensing a car has substantially fallen and is comparatively low'. Twelve other submitters also specifically propose that the increase to the levy be collected via the registration, instead of an increase to the petrol. As this was not a specific question asked of submitters, ACC consider this number may underestimate support for this approach among all submitters.

There are also a similar number of submissions (11) that oppose a registration increase. While ACC received feedback from submitters on four different examples for collecting the Motor Vehicle Account levy included in the consultation material, there was not overwhelming support for one of these specific approaches.

Submissions from motorcyclists opposed increasing Motor Vehicle levies for motorcycles by 12.1%, in proportion to the average vehicle levy increases for 2019-21.

Over half of submitters (58%) are happy with the current Motorcycle Safety levy and the initiatives available through the Motorcycle Safety Advisory Council. Ride Forever programmes have considerable support, as well as motorcycle safety promotions and local road improvements.

Those who disagree with the Motorcycle Safety Levy note that levies are too high for motorcyclists and this levy adds an unnecessary fee to the overall cost. There are also concerns around the value of the initiatives available through the Motorcycle Safety Advisory Council. ACC will pass this feedback on to the Council for consideration.

Significant support was received for the Ride Forever rebate programme. 94% of submissions are in favour of the rebate and a lot of positive feedback was received by ACC.

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A small number of submitters oppose the rebate, stating that motorcyclists are already being subsidised by other motor vehicles.

Many submitters suggested changes or improvements to the proposed rebate, which ACC will consider in the design of the rebate. ACC's Road Injury Prevention team will engage with submitters and the motorcycle community in the final design of the rebate.

On balance we consider it appropriate to hold the Motor Vehicle levy rate and settings at the current levels.

Implementation plan

To enable the collection of the new levy rates from 1 April 2019 for the Work and Earners' Accounts, and 1 July 2019 for the Motor Vehicle Account, regulations must be made by 2 March 2019 and 1 May 2019 for the respective Accounts.

To enable the new Earners' Account levy rate to be in place on 1 April 2019, Inland Revenue requires notification of the approved Earners' Account rates by mid-December 2018 so that payroll software developers can update, test, and distribute their systems updates.

ACC will also need to make adjustments to its processes and systems to reflect the proposed changes in levy rates to the Work Account. It will also need to implement a communications plan to ensure levy payers and other stakeholders are informed of the changes and their implications.

Monitoring, evaluation and review

Monitoring, evaluation and review is built into the biennial review of ACC levies, which involves independent actuarial assessments of ACC's liabilities and assumptions about claims costs in the upcoming year.

While MBIE's independent actuaries – Finity – considered the assumptions underpinning ACC's forecasts were reasonable, they suggested ACC could undertake further work to inform the way ACC's modelling incorporates possible drivers for change.

Finity advised future ACC investigations focus on identifying the drivers of claim numbers which are not related to the New Zealand economy. This will allow ACC to determine whether these drivers can be controlled, or whether these factors should be incorporated into future levy projections.

Conclusion

Setting ACC levy rates involves balancing the principles of financial responsibility in the Act while considering matters of public interest.

All options meet the requirements of the Government's full funding model which requires ACC to collect sufficient funds to meet the lifetime cost of injuries by offsetting the outstanding claims liability with a sufficient level of assets.

Our assessment concludes, however, that Option C – maintaining the Earners Account levy rate at 2018/19 levels, providing a moderate increase in the Motor Vehicle Account levy rate, while decreasing the Work Account levy - rates most highly against the full criteria

The preferred option uses more of the accumulated funding surplus to move towards the funding policy's target solvency level more quickly than other options, while continuing to meet the life time costs of claims and maintaining prudent solvency levels.

While there is a greater risk of larger changes in premium rates in future levy rounds in comparison with ACC's proposal, we consider this risk is outweighed by the benefit of using more of the funding surplus to reduce the levy burden on current levy payers.

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Appendix A

Background on the Accident Compensation Scheme

ACC is a Crown agent delivering the fully-funded accident compensation scheme that provides no-fault personal injury cover to all New Zealand residents and overseas visitors to New Zealand.

ACC cover is managed under five separate Accounts including the three levied Accounts being the Work Account, the Earners' Account and the Motor Vehicle Account. ACC collects levies to finance entitlements provided under the Accident Compensation Act 2001 (the Act) for the levied Accounts.

This Cost Regulatory Impact Statement considers options for setting 2019/20 and 2020/21 levy rates for the Work, Earners' and Motor Vehicle Accounts. The appropriation for the Non-Earners' Account and portion of the Treatment Injury Account is considered during the government Budget process each year.

Table A1: 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 vehicle 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 related 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 (not including motor vehicle and treatment injuries)

The Work Levy is expressed as a rate per $100 of liable earnings. The average levy, reported here, is the rate that all employers and self-employed people in New Zealand would pay if ACC charged a flat levy rate. The actual rate paid by each business differs from the average rate and is determined by the claims experience of its classification unit, individual business' claims experience, and any ACC safety incentive products and programmes a business participates in.

The Earners' Levy is a flat rate paid by all employees and self-employed on their liable earnings up to a defined maximum and is expressed as a rate per $100 of liable earnings. It includes a component to fund Earner claims in the Treatment Injury Account.

The average Motor Vehicle levy is the rate that all vehicle owners would pay if ACC charged a flat levy rate. The actual rate a vehicle owner pays differs from the average rate depending on their vehicle type.

For petrol-driven vehicles, vehicle owners pay their levy through:

- a levy collected as part of the motor vehicle licensing fee (or “registration”); and
- a levy on the petrol they buy.

For non-petrol-driven vehicles, owners pay their entire levy through their registration. The levy component of the vehicle licence fee is higher for non-petrol-driven vehicles by an amount equivalent to the average petrol levy. The Regulations also prescribe a Motorcycle Safety Levy (MSL) payable in respect of motorcycles and mopeds. The Motorcycle Safety Advisory Council oversees the MSL fund, which is used to fund initiatives to improve the safety of motorcyclists.

Principles of Financial Responsibility in Relation to the Levied Accounts

Section 166A of the Act requires the cost of all claims under the levied Accounts to be fully funded. To achieve full funding when setting levies, section 166A requires the Minister for ACC to have regard to the following principles:

- The levies derived for each levied Account should meet the lifetime costs of claims made during the levy year.
- If an Account has a deficit or surplus of funds to meet the costs of claims incurred in past periods, that surplus or deficit is to be corrected by setting levies at an appropriate level for subsequent years.
- Large changes in levies are to be avoided.

The Levy-Setting Process

Work and Earners’ Accounts’ levies are set by regulation under the authority of sections 167, 218, 219, 244, 329 and 333 of the Act. Motor Vehicle Account levies are set by regulation under the authority of sections 213, 244, 329 and 333 of the Act.

ACC reviews the expected costs of the levied Accounts to determine the levy rates required to meet the lifetime cost of claims in the upcoming period, along with funding adjustments to move each Account towards its funding target of 105 per cent. The ACC Board undertakes public consultation before recommending levy rates to the Minister for ACC. Cabinet sets the levy rates for the forthcoming levy period after considering the Board’s recommendations, along with the public interest as required by section 300 of the Act.

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