Appendix A

CHOICE IN THE ACC WORKPLACE ACCOUNT

A solution looking for a problem?

Analysis of the Department of Labour options discussion document.

A report prepared for the ACC Futures Coalition

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Contents

Executive Summary

The government is consulting on two options to change the funding of the ACC Work Account:

- extending the coverage of the Accredited Employer Programme, by reducing some compliance obligations and widening choice of the form of partial self insurance that participating employers can select;
- introducing the option of insuring with private providers to cover employer obligations for workplace accidents.

There is very little evidence that there is a "problem" that either of these "solutions" needs to address, and less evidence that they will have positive benefits.

Between 2000 and 2009, AEP employers had better accident records (and therefore lower ACC costs), but there is no evidence that AEP **caused** the better performance. It is equally plausible (and more likely) that employers with better pre-existing accident records took advantage of the option of AEP to capture the benefits of their better systems and practices.

Actuarial analysis done during the recent "Stocktake" of ACC shows that

- "…there is no evidence to support the hypothesis that accredited employers show greater improvements in rates of claim over time". If AEP was "delivering" better results the expectation would be that claim rates *would* improve over time.
- Since 2006, the number of employers participating in the programme has declined steadily, by about 6 percent a year. If it was delivering improved results, it would, over time, be opening up a gap between what the ACC charges for cover and what self-insurance could achieve, and the expectation would be that participant numbers would increase, not decrease.
- Over the last decade "standard employers have had marked improvements in the rate of weekly compensation claims while accredited employers have been virtually static". The relative claim rate for standard employers was 40 percent above that of accredited employers in 2001, but by 2007 the relative standing reversed, and by 2010 their claim rates are about 25 percent below those of accredited employers. If the AEP was *delivering* fewer claims and lower costs, the expectation would be that those trends would go in the opposite direction.

Any "margin" to lower costs in comparison with paying ACC levies will have been further eroded by the probability that work account levies will fall by 22 percent in 2012/13. High-risk firms (which would tend to have more opportunity to lower costs through improved systems, and who would be more likely to enter the AEP as a result), will receive larger proportionate discounts than the average.

Experience rating was introduced from 1 April 2011. Leaving aside possible problems that experience rating could bring for claimants, if it is applied accurately levies should mimic what employers could achieve through self insurance, and therefore remove the incentives of participation in the AEP.

It is precisely the wrong time (falling participation, falling levies, levies matching performance) to be trying to expand AEP coverage.

Private insurance is an even worse option. There are a number of uncertainties about how private insurance will operate, and so it is difficult to evaluate what benefits it might bring. Key uncertainties are:

- the precise detail of the regulatory apparatus that will be needed to ensure that entitlements are met, and what it will cost to operate;
- the nature of the prudential regime that participating insurers will have to operate under;
- how residual claims (i.e. all claims existing at the time of the introduction of the insurance option) will be funded, especially if the cost of meeting residual claims rises in the future, for example if assets in the Work Account are eroded by another finance sector collapse;
- if, when, and to what extent participants will need to pick up a share of the cost of meeting claim inherited from failed insurers;
- how the costs of gradual process injuries will be allocated, especially if the initial injury occurred when the employee was covered by another insurer;
- how the costs of public health and emergency transport services will be allocated.

These “known unknowns” are so fundamental that in advice to Cabinet, government officials concluded that “there is a high degree of uncertainty regarding the magnitude of both costs and benefits (and in some cases, even the sign – i.e. whether they will have a net positive or negative impact…”

Officials concluded that “better pricing signals to employers can be achieved through experience rating and self-insurance arrangements”.

With all of the changes currently in train - the bedding in of experience rating, falling Work Account levies, a degree of turmoil in the insurance industry in general, and fading enthusiasm for the AEP – change for the sake of change cannot be justified.

1.0 Scope of this report

This report discusses the issues raised in the Department of Labour Discussion Document on options for extending the Accredited Employer Programme and for introducing options for employers taking out private insurance cover to meet some of their obligations within the ACC Work Account.[1] (discussion document from here on in).

It does **not** discuss the much wider suite of changes recommended by the Steering Group that carried out the "stocktake" of ACC Accounts.[2] This is because the main structural features of that group's recommendations: opening up all accounts to competitive private delivery of services, and removing ACC as a competitor in the resulting market; have not been progressed by the government.

The proposals in the Discussion Document are the current live issues.

2.0 Main conclusions

This report concludes that:

- the appetite among employers for additional choice options to discharge their ACC obligations has not been established;
- there is no evidence that widening choice will improve performance under the scheme;
- there are a large number of cost and regulatory uncertainties that have yet to be determined, but that until these outstanding loose ends have been tidied up it is not possible to draw firm conclusions about the likely impact of any or all of the proposed changes.

In short , the proposals are solutions looking for a problem.

3.0 The Work Account in the broader scheme of things

All costs of doing business are of concern to organisations, be they in the private, public or not-for-profit sectors. However, the relative importance of elements of overall costs will tend to shape the degree to which employers are incentivised to allocate time to reducing them.

In New Zealand "compensation of employees" (effectively the cost of labour) is about 44 per cent of Gross Domestic Product. There will be some sectors where labour is a very high proportion of the cost of production (accountancy, architecture, education etc.) and others where it is very low given the scale of plant and materials required, high cost of raw materials and energy intensity of production (for example pulp and paper).

[1] **Increasing choice in workplace accident compensation:** *discussion document on options for extending the Accredited Employer Programme and introducing choice in the ACC Work Account,* Department of Labour, June 2011.

[2] **Accident Compensation Services in New Zealand:** *the performance of the ACC scheme and opportunities for improvement.* Final report prepared for the Minister for ACC by the Steering Group for the Stocktake of ACC Accounts. 30 June 2010

The levy in the Work Account is currently, on average, $1.47 for every $100 of liable earnings. Hence the Work Account adds 1.47 percent to 44 percent of the overall cost of production: about 0.6 percent of the cost of doing business on average.

Employers would need to reduce that cost **by more than they can under existing options within the work account** to be incentivised to seek out and use new options .

4.0 Existing choice in the Work Account

Currently, employers can reduce their standard industry levy by choosing from three main pathways.

4.1 Workplace Safety Management Practices Programme

Discounts of 10, 20 or 30% are granted to employers who have put safety management systems in place to a certified qualifying standard.

4.2 Accredited Employer Programme

This is essentially a time limited, partial self insurance programme.

An analysis of the ACC Partnership Programme (under which the AEP operates) was done for the Stocktake group by actuarial company Melville Jessup Weaver and consultancy firm Martin Jenkins[3]. (Referred to as the Review from here).

It has limited appeal. Currently, only 136 of the larger employers participate, but they do cover 15% of the workforce and 23% of leviable earnings. (More detail on type of participant is provided later in this report. Numbers of participating employers have been declining steadily by a little over 6% a year since 2006. The discussion document attributes this to excessive compliance burdens and limited scope for innovation in how accidents are managed. The scheme has two elements.

(i) Partnership Discount Plan

Participants meet current claim costs and the costs for either the next year, or two years.

(ii) Full Self cover

Participants meet current claim costs and hand back claims for ACC to manage after an agreed period: either two, three or four years.

Insurance must be through ACC, but participants are able to contract third party agents to administer the management of claims.

[3] Review of Employer-managed claims, MJW and Martin Jenkins, 4 June 2010

4.3 Experience rating

This was introduced from 1 April 2011, and is mandatory. It is too early to judge how experience rating will work, and whether it will have adverse consequences like employers pressuring staff not to report workplace accidents or to report accidents as taking place outside of the workplace. What follows makes no judgement on the efficacy of this levy setting method.

Experience rating (for employers with over $10,000 p.a. premiums) can alter premiums by up to + or – 50%.

The size of enterprise that faces levies of over $10,000 will depend on the industry levy rate. Using a rough measure, a firm facing the average levy of $1.47 will need to have a wage bill of around $680,000 per annum. If wages in that company average out at the national average wage of $50,000, it would have to employ 136 workers to move into this experience rating band. Statistics New Zealand data on Business Demographics do not break down size of employer unit beyond those employing more than 100 workers. Firms employing more than 100 workers employ 47 percent of the total workforce.

By definition experience rating does not apply to full self cover AEP, because participants there are taking responsibility for their own claims management costs within the cover period, and passing longer term claims back to ACC at the end of that at an actuarially assessed cost.

In theory, if experience rating is applied accurately, the levies should mimic the costs that employers can achieve under AEP. The only incentive to go into AEP would be if employers thought that they could do better than the maximum discount:(i.e. beat the ACC by more than 50 percent)

There is a no claims discount (for employers with under $10,000 premiums.) The discount alters levies by either + or – 10 percent, or zero. Smaller employers might be tempted to enter the AEP if they felt that self cover might allow them to beat the industry average by more than 10 percent. However, that incentive exists now, and very few small employers seek to be accredited, (see later), so the incentive is not, on the evidence, sufficient to change employer practice.

4.4 Take-up of existing choice options

As noted above, experience rating can reduce levies by up to 50 percent on standard industry levies, so it is only a capacity to “beat the industry average” by **more than** 50 percent that would incentivise employers to explore wider options than those now available. Looking back at the average levy making up 0.6 percent of total business cost, in an aggregate sense, that means that employers would need to be attracted to shaving the margin on 0.3 percent of total business cost for new choices to meet any market need.

Of course that is an average, and averages conceal as much as they reveal.

In industries like accounting services, the labour cost is high but the levy is low, so the incentive is likely to be remote.

In industries like pulp and paper, the levy is high but the labour cost is low. Firms in these industries would focus much more on, say, electricity usage and tariffs as core drivers of business performance.

It is only in industries where there is a coincidence of high labour cost, high levies, and a capacity to manage accident and injury costs down that the incentive exists.

Just where that coincidence of factors exists, and how pervasive it is, has not been quantified in **any** of the background research and analysis that sits behind the proposals. Hence the conclusion that there is no evidence on which to specify the "problem".

A proxy measure for the extent of the problem would be employers who have "voted with their feet" and entered the AEP. Currently, 136 employers are in the AEP and they cover 15 percent of the workforce.(Report, p15)

99.8 percent of the 228,497 work account levy payers have levies of less than $100,000 a year, and of those, only **six** are in the AEP. It is only when ACC levies are big business that cost reducing options are taken up. It is only when the wage bill exceeds $50 million per annum that participation is significant. There are only two AEP participants with a wage bill of less than $5 million per annum. For those with wage bills of between $10m and $50 million, 7.8 percent of employers participate. More than half participate only when wage costs exceed $100 million per annum (80 percent of employers in this category).

The degree of the "problem" is further illustrated by the fact that since 2006, AEP participant numbers have declined by 24 percent. All of this was **before** experience rating was introduced from 1 April 2011. Experience rating enables employers with good accident and claims records to reduce levies by up to 50 percent from the industry standard levy. The degree to which more flexibility and choice with AEP is needed after that new avenue has been opened has yet to be established. At the very least, until that regime has bedded in, it would be premature to base policy change on the demonstrated need for such additional choice.

Since experience rating was introduced,(but not because of it) the ACC financial position has improved, so that it is now proposing to reduce work account levies by 22 percent in 2012/13[4]. High-risk firms (which would tend to have more opportunity to lower costs through improved systems, and who would be more likely to enter the AEP as a result), will receive larger proportionate discounts than the average. Even without experience rating, the "margin" within which self cover under AEP can "beat" the ACC average has contracted significantly.

4.5 Evidence that choice delivers better results.

Even if there is no demonstration of need for greater choice, a new regime could be justified if there was evidence that self or private insurance produced better results. There is, however, no such evidence.

A stated aim of the proposals outlined in the discussion document is to extend the coverage of the Accredited Employer Programme. A briefing given by DoL officials to CTU affiliates (22 June) indicated that the target coverage of AEP was for employers of around 50 percent of the total workforce.

[4] Consultation on Proposed 2012/13 Acc Levies, ACC, 12 July 2011.

This aim, though, begs the question of whether there is any evidence that this would be a good policy result.

In brief, there is no evidence that the AEP achieves a better result than the standard scheme administered by ACC.

The fragment of evidence used in the discussion document is that AEP “delivered safer workplaces with 12 percent fewer claims and more effective rehabilitation with 15 percent fewer costs” (Ministerial forward to the discussion document).

That statement is simply not correct.

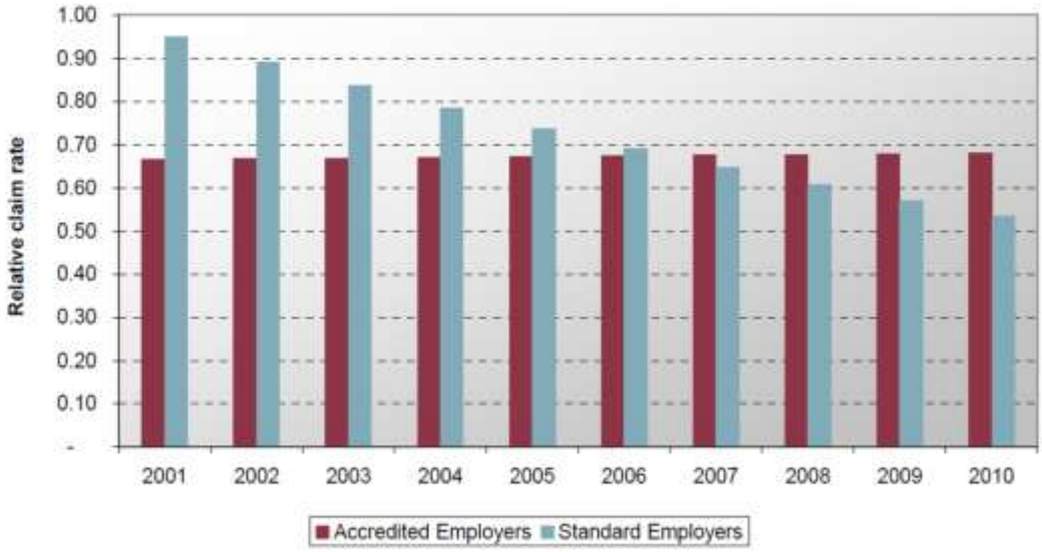
At no stage does the analysis conclude that the AEP *delivered* (i.e. caused) fewer claims and lower costs. It concludes that AEP firms *had* fewer claims and lower costs. But the direction of causality is not established. It is equally plausible that firms that had pre-existing better than average accident records entered AEP to save on levies.

Indeed the evidence in the Review strongly suggests that that was in fact the case.

- The comparison of accredited with standard employers was made over the period 2000 to 2009. However, “there is no evidence to support the hypothesis that accredited employers show greater improvements in rates of claim over time” (Review p35). If AEP was “delivering” better results the *a priori* expectation would be that claim rates would improve over time.
- Since 2006, the number of employers participating in the Partnership Programme[5] has declined steadily, by about 6 percent a year (Review p15). If it was delivering improved results, it would, over time, be opening up a gap between what the ACC charges for cover and what participating employers could achieve, and the expectation would be that participant numbers would increase, not decrease.
- Over the *duration* of the study period (i.e. not the average for the period as a whole), “standard employers have had marked improvements in the rate of weekly compensation claims while accredited employers have been virtually static, as illustrated in the following chart” (Review p36). The illustration shows the relative claim rate for standard employers being about 40 percent above that of accredited employers in 2001, but by 2007 the relative standing reverses, and standard employers have *lower* relative claim rates. By 2010 their claim rates are about 25 percent below those of accredited employers. If the AEP was *delivering* fewer claims and lower costs, the expectation would be that those trends would go in the opposite direction.

[5] The “Accredited Employer Programme” falls under the umbrella of the ACC’s “Partnership Programme”. The terms appear to be interchangeable in the MJ/MLW report.

Figure 8: Modelled results: weekly compensation claim rates



The AEP might be associated with other good injury prevention and management practice (such as reflecting good health and safety systems and processes, effective return to work and social rehabilitation practices and the like), but there is no evidence that it *causes* them. When those good practices exist, for whatever reason (enlightened employer, union engagement around robust prevention and rehabilitation systems etc.), then employers are able to capture a "second dividend" by entering the AEP and covering costs at less than levy rate.

5.0 Issues associated with widening choice

Thus far, this paper concludes that the need for wider choice has not been demonstrated, and there is no evidence that it would generate benefits anyway. There is no "problem" that has to be addressed. However, a "solution" like that proposed in the discussion paper could well introduce complexity, add risk and add costs.

The proposal essentially divides into two categories: making AEP more flexible, and allowing employers to meet their obligations by insuring privately in a competitive market.

6.0 Proposal to increase choice *within* ACC

The elements of this category are:

- Allowing more choice on claims management periods under AEP: both shorter (down to 3 months) and longer (up to 10 years or even in perpetuity subject to meeting ongoing solvency tests).

- Taking claims history into account when setting PDP discounts. This increases the risk of employers discouraging reportage of accidents or more likely encouraging their reporting as having been non-work accidents. However, the option is probably obsolete because mandatory experience rating does exactly the same thing anyway. It would only be if PDP discounts could go beyond the "bands" set under experience rating that this option would again become relevant, but that eventuality is better addressed by setting the experience rating bands at appropriate levels than having parallel discount systems.

- To start the cover period from the date of accident as opposed to the start of financial year

- Changing audit requirements, processes and standards (including the introduction of new certification standards such as Director declarations).

- Reducing minimum levels of required high cost and stop loss cover (to allow AEP participants the option to increase levels of self insurance)

- Introducing choice of provider of high cost and stop loss cover insurance.

- Allowing employers to select types of "excess" (e.g.. they meet the first $x of claim cost as is standard with motor vehicle and house insurance)

    - Weekly compensation excess

    - Medical cost excess

    - All costs excess, either

      time bound, or
      $ bound, or
      Both.

- Creating an option for third parties (like Banks) to offer financial guarantees to meet obligations to meet claims

- Allowing groups of employers (like franchise chains) to participate as single entities (i.e. accredited employers)

- Making it compulsory for ACC to take over the management of any or all claims (at actuarially assesses cost) at the request of a participating employer

- Creating an option for full and final settlement when claims are handed back (to cover off risk of reactivated claims, which would be priced into the hand back charge)

On the assumption that there will still be a demand for AEP cover even after experience rating beds in, each of these options introduces risks of one sort or another, which need to be covered off by introducing checks and balances into how they would work

At the end of the day, ACC has the statutory obligation to meet employee entitlements to a prevention, rehabilitation and compensation regime with no fault, 24/7 coverage meeting the standards defined in statute. Any variation *within* the schemes operated by ACC need to ensure that there is no residual liability that ACC will have to pick up, because in that event the costs are born by an increase in the levy applied to all other, complying employers, or the taxpayer.

6.1 Variation in claims management periods

The duration of claims management periods can be flexible **provided** flexibility does not compromise the integrity of the 24/7 no fault ACC scheme by, for example, encouraging participating employers to cut costs on rehabilitation when the claims periods is short and they are soon to be handing claims back to ACC, or creating a risk when an extended claims management period increases the chance that the employer may not be able to afford to meet the ongoing costs associated with the claim when it is handed back.

Over time, organizations – even large ones like the Shell petrol company – get taken over, merge, change their names and exit fields of business. An extended claims management period increases the risk of the longer term claimant being stranded: not knowing where to go to for continuity of entitlement, and not being seen as “their” responsibility by the new owner of a firm that was not responsible for the accident in the first instance.

The best way of managing the risk to entitlements is to have a limit on the maximum term over which a claim can be managed, and/ or to require the party seeking a longer duration to post a bond with ACC or to insure with ACC to cover potential for handing back ongoing claims in the event of employer insolvency, takeover, or exit from an industry. There is no evidence that the current four year maximum for full self cover is too short. Extending the period alongside bonding or insurance arrangements introduces complexity (and probably cost), for no apparent purpose.

6.2 Starting claims cover period from date of accident

This proposal does not challenge the integrity of the scheme or increase risk in a material way, but does introduce administrative complexity by requiring individual records to track claims management expiry periods. It should at least be optional for employer participants in the AEP, because they will be the parties meeting the additional compliance cost.

6.3 Changed audit requirements

In theory, changing audit requirements does not shift where residual risk lies (except for risk associated with employer insolvency). If more flexible audit arrangements are translated into less robust systems, employers meet the cost of higher claims, and pay more when claims are handed back to ACC. The risk of employer insolvency does not increase from the status quo unless the term of claims management is extended (so this risk is linked to the issue of longer duration).

However, flexible audit requirements **do** increase the chances of reducing the input of worker representatives (health and safety representatives or union delegates or officials), which is a feature of the existing set of arrangements, especially at the systems design end of the process, and which could dilute the effectiveness of both prevention and rehabilitation.

6.4 Reducing minimum levels of high cost and stop loss cover

This would not shift or increase risk provided that the cover is purchased from ACC. This is because ACC takes back the claim at the end of the self cover period at an actuarially assessed cost, so any over or under insurance washes out in the take back price. If flexible cover is through third party insurers, there is a need for appropriate prudential regulation of providers and a disputes resolution facility to avoid offloading underinsured cost onto the ACC, and effectively other levy payers.

6.5 Introducing choice of provider of high cost and stop loss cover

Choice of this sort adds risk to **both** ACC and the claimant. If the integrity of the scheme is to be maintained, the change would need to be accompanied by some sort of regulatory intervention, so that the claimant can know who to seek the amounts above the employer self cover maximum from, or the imposition of an obligation on the employer to recover the extra payment, the imposition of prudential standards on third party insurers, and provisions to cater for the consequences of insurer insolvency.

It is important to note that it is precisely when high cost injuries occur that employees are most vulnerable. They are either absent from the worksite and do not have access to peer support or direct contact with management, or have injuries (such as head injuries) that diminish their capacity to advocate their entitlements.

6.6 Allowing choice of "excess"

Voluntary excess is a standard feature of most insurance products, and basically shifts rather than increases risk. The only time when it increases risk to a third party (the claimant or ACC) is when the policy holder (in this case the employer) defaults. The most efficient way to manage that particular risk to make sure that the claims management period is not excessively long.

6.7 Third party financial guarantees

Third part financial guarantees are standard practice, and some form of third party guarantee (such as from a bank) can actually reduce risk for the default provider (ACC). Because the residual risk does not shift, the nature of the third party guarantee needs to be acceptable to the bearer of that risk (i.e. ACC)

6.8 Group participation

It is very difficult to assess the risk that would be associated with this option: a lot would depend on the collective capability of such groups. Accreditation and audit systems need to be robust, with some form of default guarantee if an individual franchisee fails or exits the franchise. Exit is much more likely for individual franchisees than for the chain as a whole.

These groups would inevitably have to rely on third party administrators to manage claims and there is strong evidence that TPAs deliver less satisfactory services from the point of view of claimants.[6] The discussion document raises the possibility of TPAs being centrally accredited, instead of employer by employer. This proposal could help overcome the problem provided that this accreditation process is also robust. Workers' experience of TPAs needs to be channeled into the accreditation process.

6.9 Compulsory take back by ACC at employer request

This option is theoretically risk neutral, provided that the take back is at full cost. There is risk of adverse selection if the take back at employer request is accompanied by a right of employers to opt for full and final settlement, because the employer is typically better placed to assess whether or not there is a risk of reactivation of claim, and would tend to exercise the take back option right when that risk was likely but not yet obvious to whoever is assessing the costing of the take back.

6.10 Full and final settlement on take back

Almost by definition, reactivated claims cannot be predicted at the time of settlement, and so can never be accurately priced into the hand back charge. This will lead to selection bias to the detriment of ACC and other levy payers: the employer seeking full and final settlement is more likely to be one who suspects that in the particular case reactivation is probable.

7.0 Proposal to increase choice *from* ACC

The discussion document proposes that from 1 October 2012, employers can choose to insure with either ACC or a private commercial insurer. Before examining the specifics of the proposal, this report examines the case for introducing this option and the benefits it might bring.

7.1 Potential for benefits from private insurance option

There is no evidence that there is a market opportunity that private insurers could meet.

As noted earlier, employers have the ability to reduce levies through experience rating by up to 50 percent on the industry standard levy, or by full self cover under the AEP if they feel that they can do even better than that. A private insurer has to reduce levies below that, while at the same time earning a margin to generate a return on capital after having paid tax. Officials estimate this margin to be around 25 percent over the rate ACC charges because as a Crown entity ACC does not have to pay tax or dividends.

The only possible room within which private insurers could compete would be for them to "bundle" accident insurance with other insurance products, because ACC would be prevented from adding other insurance products to the package of cover it delivers through the Work Account.

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[6] Research New Zealand, **Partnership programme:** *injured employees' satisfaction with the service they have received.* February – June 2010

On any practical assessment of the margin insurers would have to work within, there is no realistic chance that they would offer a product and a price that would generate net benefits to employers.

That pricing constraint would bind regardless of insurance market conditions, but in the current post-earthquake environment insurance markets are under stress, and are unlikely to find high risk, low margin market niches attractive.

This view is shared by government officials. In the Cabinet paper on the proposal, the Minister of ACC notes that the regulatory impact statement prepared by his officials "suggests that the costs of the option I am recommending may not be outweighed by the benefits, that there is uncertainty regarding the benefits that may be achieved and that there are a number of associated risks".[7]

The full Regulatory Impact Statement released alongside the Cabinet paper is much more explicitly critical of the evidential base of proceeding with the proposal. Specifically, it notes *inter alia*

> "there is a high degree of uncertainty regarding the magnitude of both costs and benefits (and in some cases, even the sign – i.e. whether they will have a net positive or negative impact…"
>
> "…it is possible that that there are potential impacts or risks that have not been identified or adequately considered by officials…"
>
> "…officials have been unable, at this stage, to quantify the likely uptake of the modified AEP by employers, which is critical to identifying the benefits of this option.."
>
> "…it is not possible to provide reliable, quantitative estimates of the size of likely benefits.." and, critically
>
> "***Better pricing signals to employers can be achieved through experience rating and self-insurance arrangements".***

In simple terms, officials' advice is that the competitive insurance option is a sub-optimal solution. Not only is this a solution looking for a problem, but it is not even the best available solution for dealing with the problem if one was found!

7.2 Particular features of the competitive insurance option

As noted, the proposed competitive arrangements are not entirely consistent across ACC and the private sector because:

- ACC will not be allowed to "bundle" work injury cover with other insurance cover to offer a complete insurance package, but
- it does not need to pay business tax or generate a return on capital.

[7] Cabinet paper dated 29 October 2010, released under the Official Information Act. Para 64

ACC would be the default insurer and would continue to be the insurer if any employer did not contract with a private insurer.

The discussion document notes that a number of specific problems were encountered during the 1999/2000 period of competitive delivery of cover. Specifically, additional administrative burdens saw some GPs charging higher co-payments; claimants reported not knowing who their insurer was; insurers were sometimes reluctant to approve claims and were late in honouring invoices; there was cost shifting when employers pressured workers not to lodge claims for workplace accidents; and workers were deterred by the paperwork involved.(discussion document p32)

Protections would therefore be introduced to cover those defects .

The main additions are

- to have a central claims handling facility (to ensure treatment providers know who to contact for recovery of costs and better regulatory supervision to ensure entitlements are met);

- the creation of obligations on employers to inform employees who the insurer is and what to do in the event of workplace injury;

The regulatory structures that would be needed to wrap around choice of insurer are:

- Register of employers alongside contracted insurer
- Independent claims lodgement (handling and clearing) unit
- Independent disputes resolution agency
- Market regulator to monitor and enforce compliance
- Central data pool to gather information on historical claims and costs to help insurers set prices and develop products.
- Default regime in event of insurer insolvency: ACC to take over cost of claims management to be paid for by levy on all insurers
- Prudential regulation of potential insurers (with adaptations of the standard insurer regulation to deal with circumstances specific to work related personal injury insurance: such as having adequate reserves to meet the “tail” of claims)

7.3 Detail still needing to be developed

It is difficult to assess the full range of risk associated with the private insurance model because a number of details have not been finalised, and until they are, the robustness and sustainability of the eventual package has to be taken on trust. In the meantime, the inherent risk of failure if the regime is too permissive is carried by ACC: and ultimately employees who will have difficulties in enforcing entitlements and employers who pay levies to ACC.

There are four critical areas where detail has yet to be developed. In combination, until these details are clarified, it is simply not possible to know if a competitive market can work, how it will work, the costs that will be associated with it, and the risks that injured workers will face if it does not work.

7.3.1 Funding of residual claims

When full funding of the work account was introduced in 1999 (as opposed to pay-as-you-go) a levy was introduced to cover the longer term costs of pre-1999 injuries. Over time, this has proved to be an extremely volatile component of levies because not only can liabilities fluctuate, but more importantly so can assets that support them, given the instability in global and domestic finance markets.

By way of example, in 2009/10, the Residual Claims Levy was 38 percent of the total levy, but by 2010/11 it had dropped to (a still significant) 28 percent. There is no way of predicting the direction and amount of future residual claims cost, because the term of the obligation is long, and asset prices are variable. If private insurance is introduced, any unfunded claims that apply to the 1999 to 2012 period will also have be paid for in some way.

The discussion document simply lists "how to fund and manage the ongoing cost of claims relating to workplace injuries suffered before 1 October 2012" as a detail still to be worked out. DoL officials advise that the intention is to recover costs of residual claims through a levy on all employers, in much the same way that the fire service levy on households is collected by insurers and passed on to the Fire Service(briefing). They suggest that the liability is now likely to be low, so do not see this as a major problem, but if that is the case the reduction from the current 40 percent of levies to a small amount has to be taken on trust.

7.3.2 Funding of gradual process injuries

The matter of how to handle costs of gradual process injuries and how to recover these from previous insurers (including ACC) is yet to be resolved. This is particularly problematic in a competitive insurance market because employees switch employers and employers can switch insurers. Just who is liable for the costs of a claim that might have originated with another employer or when the employer was with another insurer is bound to be a matter that gives rise to continuous dispute.

7.3.3 Allocating costs of public health and emergency transport services

As with costs of gradual process injuries, the calculation and allocation of shares of cost of public health acute services and emergency transport services are yet to be determined. The intention is to allocate these through a mechanism similar to that proposed for recovery of residual claims costs (briefing), but that in itself would introduce distortions into an insurance market. A unitised cost of public health and emergency services would cut across the ability of insurers to price products to employers where the probability of use of emergency services is low (for example in clerical work as opposed to higher risk construction or forestry work).

The alternative of self provision of emergency services is not viable because no private provider can maintain a nationwide 24/7 network to provide them.

7.3.4 The prudential regime that will apply to insurers

The adequacy of the prudential regime that applies to the insurance industry in general has been called into question with the government having to stand behind at least one insurer in the aftermath of the Christchurch earthquakes. Personal injury insurance is another matter altogether because a robust regulatory regime has to ensure that market participants have the reserves to cover extremely long term ongoing treatment and earnings compensation (or pay another party to take over the liability).

The nature of that regime has still to be developed, but depending on how it is structured, there will either be high risk to injured employees that they may be stranded, or a high entry cost to market participants to establish capital adequacy to meet all realistic estimates of liability.

7.4 Unknown dimensions of cost (partly derived from the unknown scheme detail)

As noted above, the costs of meeting legacy residual claims, of providing for public health and emergency service, and of covering costs of gradual process injuries will depend on the detailed provision for these features of a comprehensive accident compensation system.

There are two other features of scheme design that can also raise cost and distort where risk resides with a competitive market.

7.4.1 Pricing of risk

As a matter of policy and prudent practice, the ACC sets Work Account premiums by adopting a "75 percent risk margin". In essence, levies are set above the average expected level of claims liability to ensure that in 75 percent of the time, (not on average) all claims will be met. The effect is to raise levies by about 13 percent.

The discussion document is silent on whether risk margins will be required to be priced into premiums as part of the prudential regime applying to insurers. The presumption for this analysis has to be that they will not: a prudential regime tends to focus on capital adequacy and does not set prices.

In this environment, the end result is that the industry is incentivised to load risk back onto ACC (and therefore ultimately claimants, and/or employers insuring through ACC, and/or ultimately the taxpayer). An individual insurer has the incentive not to price a risk margin into premiums, because in the event of default any shortfall is simply recovered by a levy on all other insurers. But each individual private insurer is similarly incentivised, because there is an ultimate default insurer: ACC.

7.4.2 Cost of the administration and regulatory regime

The administration and regulatory regime described in s 7.2 of this report is reasonably extensive. No detail has been provided on what this will cost, and no assessment has been made of how that cost compares with the expected benefits that might be expected to mitigate that cost.

7.5 Conclusion on private insurance option

This option is fraught with uncertainty: over its costs, and what risks it will create and for whom. It cannot be effectively evaluated because too much critical detail about how it will operate has not been determined. The benefits it is supposed to generate cannot be quantified, and there is even uncertainty about whether they will be positive or negative. The market niche that this solution is designed to fill probably does not exist, at least if it is to be filled profitably. Where officials compare the option with the counter-factual - self insurance and/or experience rating – they find it to be inferior.

There is no evidence to support the introduction of this option and it cannot be justified on its analytical merit.

8.0 Is it broken?

The evidence suggests that:

a) internationally, ACC is a low cost, efficient and equitable way to deal with accident prevention, rehabilitation and compensation, and
b) within ACC, the work account is the best performing component of a cost effective system.

In 2007 the ACC commissioned Price Waterhouse Cooper Australia to carry out a comprehensive review of the scheme, in terms of it providing social and economic benefits, and in comparison with schemes in other countries. The report was comprehensive[8] and is not reproduced here.

However, its conclusions are unambiguous: "…we concluded that the current ACC scheme is consistent with the Woodhouse principles, adds considerable value to New Zealand society and economy and performs well in comparison to alternative schemes in operation internationally."

In the Cabinet paper, Treasury comments that "of all ACC accounts, the Work Account is in the best shape and is performing better than it was when competition was introduced in 1999".

Experience rating is being introduced to augment the AEP.

There is no evidence base to introduce radical change. What is more, this is precisely the wrong time to introduce structural change: experience rating is only three months old, and has not been given the chance to see if it makes a material difference, and the insurance industry is in turmoil.

[8] PWC Australia, **Accident Compensation Corporation New Zealand: Scheme Review,** March 2008

Some fine tuning to existing programmes can always be made, but care needs to be taken to ensure that entitlements are protected and risk is properly assigned to those who ought to carry it, and are best placed to do so.