ACC Proposed 2008/09 levy rates

September 2007

Introduction

This newsletter is based on the Consultative Documents issued by ACC as part of its consultation process for the 2008/09 levy rates, and the document entitled "Methodology for setting 2008/09 levy rates in the Work, Earners', Residual Claims and Motor Vehicle Accounts produced by ACC Actuarial Services, dated August 2007.

The key issues of note are:

- The proposed standard levy for 2008/09 is around 20% below the true on going cost, due to the substantial surplus in the Work Account.
- The substantial drop in the standard levy increases the attraction of paying the standard levy and decreases the financial attractions of the ACC PP, particularly the FSCP.
- The substantial drop in the total levies paid by all employers as at March 2015.
- The possible changes to the scheme that are costed and included in the document.

We would recommend employers make submissions on the document.

1. Overview on employer/work rates

The rates proposed for the current 2007/08 year by ACC were amended by the legislative decision to amalgamate the Employer and Self Employed accounts into the new Work Account. The proposed average Employer rates for 2007/08, before amalgamation, were 78 cents per $100 liable earnings for the Employer Account and 43 cents per $100 liable earnings for the Residual Account, a total of $1.21 per $100 liable earnings. After amalgamation the average rates for the composite employer rate, now known as the Work levy, became $1.32 per $100 liable earnings. The Residual Account levy remained unchanged.

Under the proposed 2008/09 rates the average composite levy rate is decreased from $1.32 to $1.25 per $100 liable earnings, split as follows:

- the average 2008/09 work levy is reduced from $0.89 to $0.78, and
- the average pre-1999 residual claims levy (RCL) rate is increased from $0.43 to $0.47.

2. Reasons for reduction in Work Levy

There are three main reasons for the reduction:

- cost of claims
- scheme management costs and
- funding adjustment.

The table below shows a breakdown of the components of the rate for the current and for the 2008/09 years.

	2007/08	2008/09
Cost of claims	$0.81	$0.77
Scheme costs	$0.24	$0.16
Funding adjustment	($0.19)	($0.17)
WSMP	$0.03	$0.02
Total	$0.89	$0.78

2.1 Cost of claims – down 4 cents

The main components of the reduction are illustrated in the table below.

Cost of claims	
2007/08 cost	$0.81
Average claim cost	$0.06
Number of claims	($0.03)
Increase in LE	($0.07)
2008/09	$0.77

For the purposes of deriving the levy, ACC determine an average entitlement claim cost, which includes allowance for the medical only claim costs. The average entitlement claim cost is expected to increase by 7.7% from $13,807 for the 2007/08 year to $14,877 for the 2008/09 year. (We note that these figures are not the average claim costs often quoted by some parties.) The key drivers of the 7.7% increase are:

- 19.7% increase in the average cost of weekly compensation component, from $6,929 to $8,295. This increase largely reflects wage rate inflation and an increase in the average amount paid for long-term claims
- 15.1% increase in the average cost of hospital treatment from $1,096 to $1,262, due to efforts to ensure appropriate surgical treatments are received earlier in the life of a claim
- 65% increase in 'other rehabilitation' from $217 to $358, mainly due to increases in the amounts payable for dental treatment.

However the cost increase is offset by two factors. Firstly the incidence rate for claims is falling, secondly the liable earnings base is up 9.3% to $66 billion.

2.2 Scheme costs – down 6 cents

The estimated costs of running the Work Account are down from $144.2m to $106.2m, due primarily to a 35% reduction in the operating costs allocated to the Work Account.

2.3 Funding adjustment – up 2 cents

The Work Account is now in surplus by $941 million as at 30 June 2007. This surplus will be returned to employers over the period to 2014.

3. Residual Claims Account (RCA)

The RCA pays for claims that occurred prior to 1999 and is due to be fully funded by 2014. The liabilities for the account were expanded in 2006 to include all the pre 1999 exposure costs for gradual process claims. Some of these claims will not be reported until after March 2015 and the ACC actuaries have to estimate these when determining the current levy. The rate will rise gradually to $0.58 cents by 2014.

4. Levies to 2014 and revised funding basis

The Consultative Document includes details of the expected contribution rates over the next 7 years, summarised in Appendix A to this Topix. The summary shows how the work levy is scheduled to reduce from the 2008/09 rate of $0.78 to $0.67 in 2014. Of major interest, in 2015 the total rate paid by an employer reduces from $1.25 to $0.98. The $0.98 just covers the Work levy with the RCA levy having then ceased.

The funding basis had previously been to smooth the rates over a 5 year period. If this basis had been continued, the combined rate would have dropped to $1.16. Instead the funding basis has been changed to achieve a level $1.25 rate through to 2014.

5. Different rates for self employed

While the Employer and Self Employed accounts were merged, there are still two different rates applicable. Of interest, the average employer rate is just $0.67. This is low compared to the average work rate of $0.78, which follows from the self employed being in the more risky employment groups.

6. Surplus for the June 2007 year

For the year ended June 2007, the Work Account had a surplus of $242 million compared to a budgeted deficit. The increase is due partly to a strong investment result.

More importantly, a stronger New Zealand economy had more participation in the work force and substantially higher levies collected than was expected. The claims experience was in line with that expected.

The impact of the surplus in the Work Account is so large that the expected direct cost of claims for just the employers, $0.71, is more than the average employer levy, $0.67. And, this is expected to continue up to 2014.

7. Changes to the Work Account

Number of levy risk groups: The 127 levy risk groups for the employer account are reduced to 117 while the 41 risk groups for the RCA remain unchanged.

Workplace Safety Discounts: Maximum liable earnings as entry criterion for the Workplace Safety Discounts programme are increased from $380,000 to $450,000.

Self Employed: The age-related discount applied to the CoverPlus Extra levy rate is removed, as analysis has shown there to be no significant differences in compensation costs for claimants from different age groups.

International accounting standards: Changes to the levy setting process arising from the implementation of International Financial Reporting Standards resulted in broadly the same funding targets. The 10% prudential margin has been replaced by a risk margin of 11% to cover the cost of the claims with 75% certainty.

8. Changes to the ACC PP

We first note that the discount referred to under the ACC PP is the allowance given by ACC for the employer to meet the cost of claims that ACC would otherwise be liable for. For the FSCP the full cost of the claims is discounted and the initial payment to ACC covers administration, stop loss, public health levy etc.

Partnership Discount Plan: Although the discounts vary by risk group, the average PDP discounts will decrease to 50.8% and 56.9% for 1 year and 2 year claims management periods (down from 55.8% and 63.6% for the current year). This is partly related to the change in the basis used to charge the administration fees, and the decrease in the levy rates.

The administration fee for 2008/2009 increases to 4.25% of the standard levy (up from 4.1% last year).

Full Self Cover Plan: The cost of the unallocated primary health cost fee has risen to 1.4% (up from 1.3%) and the bulk funded public health care cost to 4.5% (up from 4.4%).

Employers in the ACC PP may now select their own stop loss as a dollar amount between specified minimum and maximum limits. The limits are expressed as a percentage of expected claims costs, as this provides greater stability than relating them to standard levies. The proposed limits are a minimum 160% and a maximum of 250% of expected claims costs.

For 2008/09 the stop loss limits, expressed as percentages of the standard levy, are:
- FSCP 191% and 297%
- PDP 1 year CMP 92% and 142%
- PDP 2 year CMP 111% and 172%

9. Other issues

Possible future changes

Upcoming proposals which may impact on future levy rates include:

- ***On-hire employment industry:*** Revising the levy classifications that cover the on-hire employment industry (the hiring of temporary and/or contract staff). While there are 554 (in 2007/2008) classification units for all business activities, on-hire employment businesses must currently select from one of only four categories.

- ***Mental injury:*** Cover is to be extended for mental injury caused substantially by direct experience of a sudden traumatic event during the course of employment. This is expected to impact the average levy rate by between 1.3 cents and 12 cents per $100 liable earnings. It is understood that the range is so wide because the actual cover envisaged has yet to be fully defined.

- ***Weekly compensation:*** Improving access to weekly compensation for workers who become injured while between jobs (seasonal workers, or those on unpaid leave). The estimated impact on average levy rates is low at around 1 cent to 1.5 cents per $100 liable earnings.

- ***Vocational rehabilitation:*** Improving access to vocational rehabilitation by removing the current three year and upper age limits. As a result, average levy rates can be expected to rise by about 0.1 cents and 0.3 cents per $100 liable earnings.

- ***Gradual process claims:*** Increasing access to cover for gradual process injuries by clarifying that the responsibility and cost for investigating claims and how much allowable non-work exposure there can be rests with ACC. The impact on levy rates is expected to be around 0.9 cents and 3.9 cents per $100 liable earnings.

10. Summary of other ACC rates for the 2008/09 year

The changes for the Earners Account and Motor Account are shown in the table below.

	2007/08	2008/09
Earners	$1.30	$1.40
Motor Vehicle:		
Levy per vehicle	$204.79	$254.63
Petrol levy per litre	$0.07	$0.09

The Motor Account includes a levy for pre 1999 claims and the current rate is projected to rise to $315 before falling to $170 in 2015.

11. Comments

Need to change the Residual Claims Account: While a long way off, the change in the total rate payable between 2014 and 2015 is a major concern. For a non ACC PP employer this is a reduction of $0.27. But for the ACC PP employer the reduction is $0.58, a very significant drop. We suggest that this was never the intention when the RCA was set up. The expectation was that with good management the RCA levy would be minimal in 2014 and so the change for the next year would be minimal.

The issue is that the RCA is now funding occupational disease claims and trying to fund all the pre 1999 exposure by 2014. We see it as inevitable that this position will change before 2014. We can see these occupational disease claims being put into a separate account and funded on an ongoing basis. This would have the advantage of leaving the non occupational pre 1999 claims to be funded by 2014 as was the intention, while allowing a slower pace of funding for the occupational claims. This would have the important effect of reducing the current composite levies.

Current cost of claims: The first table in section 2 shows that without the funding adjustment the levy for the 2008/09 year would be $0.95. The current levy is therefore hugely impacted by the surplus built up in the Employers Account since July 2000.

Comparing the ACC PP with the standard levy: As noted in section 6, the direct claims cost for an average employer is less than the levy. This has serious ramifications for employers in the ACC PP. The smaller employers need to consider carefully whether they should stay in the programme. Large employers are unlikely to shift but the relative cost advantages of the ACC PP will shrink.

Comparing the FSCP and the PDP options:

With the current levy rates significantly below the true cost of the claims, should some employers exit the ACC PP and move to paying the low standard levy. The examples in Appendix B have based the costs for the PDP (2 year cover period) and FSCP, on the average claims costs as included in the Consulting Document and then assumed that the outcomes achieved by the employers is 25% better than the ACC expected average. Whether this will be achieved would be a combination of both good luck (no bad accidents) and good rehabilitation processes.

In our experience few employers would want to exit the programme, as the benefits to them of being able to individually manage their own claims and look after their own people is too important. Note that we have included the cost of the residual levy in the illustrations.

Our comments on the results are:

- While the cost of the standard levy has reduced over the 2 years and the cost of the PDP has remained relatively the same, the cost of the FSCP has increased slightly.
- The difference in costs between the 3 options is so minimal that, even allowing for a 25% better claims experience under the ACC PP options, questions need to be asked as to whether continuing in the FSCP is worthwhile. The problem with the FSCP option is the large cost increase in the event of poor claims experience.
- The higher potential claims cost is also a problem for the PDP, but as there will be no hand back claims costs and the liability is limited to a maximum of 2 years post the accident year, this is an attractive option for an employer who wants to continue to manage their own claims.
- The case for many employers staying in the FSCP may be difficult to make.

Insurance options

Deciding which insurance option to select is important, even more so given the comments immediately above. An employer can now select their own stop loss cover within the allowable range and the High Claims Cover options have been expanded to include cover up to $2.5 million per event. MJW can assist in assessing the options looking at different claims scenarios.

12. Submissions

We see the issues on which to make assumptions to be the current funding of the RCA, and the possible future changes highlighted in section 6.

Submissions are due by 10 October 2007. MJW would be pleased to assist employers to make their submissions.

ABOUT MELVILLE JESSUP WEAVER

Melville Jessup Weaver is a New Zealand firm of consulting actuaries. The areas in which we provide advice include superannuation, employee benefits, life insurance, general insurance, health insurance, asset consulting, accident insurance and information technology. The firm has offices in Wellington and Auckland.

The firm is affiliated to Towers Perrin, a global professional services firm that helps organisations around the world optimise performance through effective people, risk and financial management. Towers Perrin has offices in 25 countries and the business covers human resources services, reinsurance and Tillinghast.

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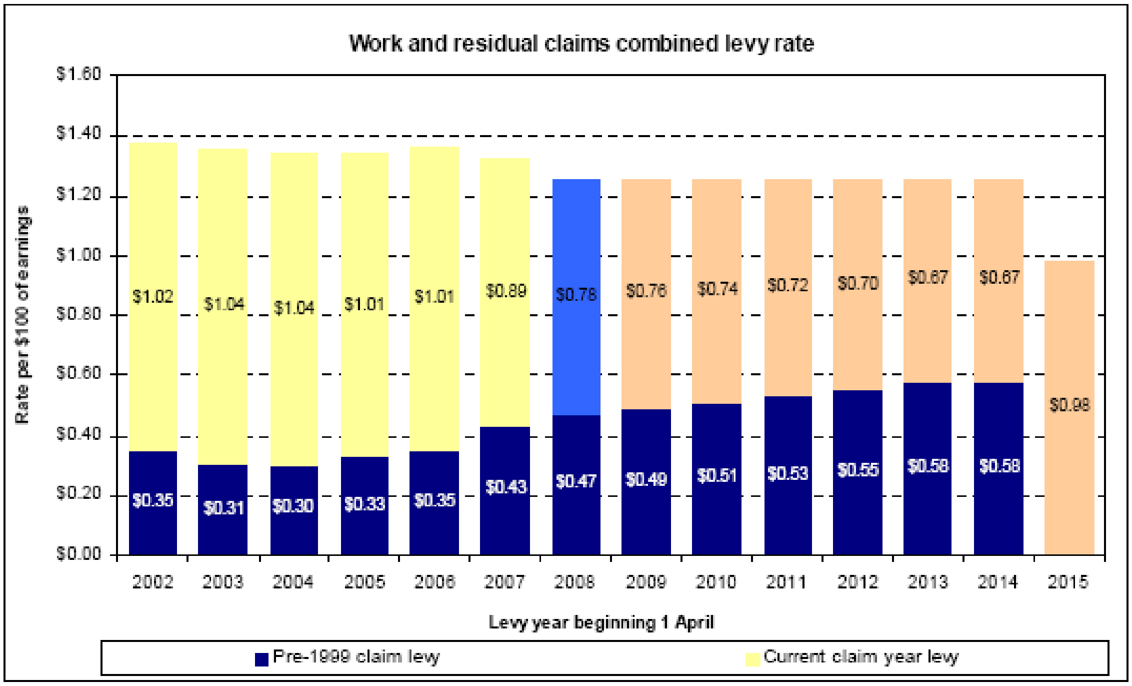
APPENDIX A


Work and residual claims combined levy rate
Rate per $100 of earnings
$1.60
$1.40
$1.20
$1.00
$0.80
$0.60
$0.40
$0.20
$0.00
$1.02
$1.04
$1.04
$1.01
$1.01
$0.89
$0.78
$0.76
$0.74
$0.72
$0.70
$0.67
$0.67
$0.98
$0.35
$0.31
$0.30
$0.33
$0.35
$0.43
$0.47
$0.49
$0.51
$0.53
$0.55
$0.58
$0.58
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
Levy year beginning 1 April
Pre-1999 claim levy
Current claim year levy

APPENDIX B

Example Company - levy calculation

	2007/08			2008/09		
	Standard	ACCPP		Standard	ACCPP	
		FSCP	PDP		FSCP	PDP
	$000	$000	$000	$000	$000	$000
Liable earnings	112,360	112,360	112,360	112,360	112,360	112,360
1. Standard levy / Claims						
Levy rate – per $100	0.89	0.89	0.89	0.78	0.78	0.78
Standard levy	1,000	1,000	1,000	876	876	876
SMP discount	-150	-150	-150	-131	-131	-131
	850	850	850	745	745	745
ACC PP discounts		-813	-567		-711	-498
Premium to ACC		37.4	283.0		33.5	247.1
Administration fee		42.0	42.0		37.2	37.2
Primary health cost fee		13.0	13.0		12.3	12.3
StopLoss / HCCC*		71.9	0.0		71.8	0.0
		164	338		155	297
Claims admin costs**		60	50		60	50
Claims costs		592	384		592	384
Total costs	850	816	772	745	807	730
ACC PP costs as % std costs		96%	91%		108%	98%
2. RCA levy						
Residual claims levy rate	0.43	0.43	0.43	0.47	0.47	0.47
Residual claims levy	483.1	483.1	483.1	528.1	528.1	528.1
3. Total costs	**1,333**	**1,300**	**1,255**	**1,273**	**1,335**	**1,258**
Saving under FSCP		34	78		-62	15
Costs as % std costs		97%	94%		105%	99%

*For the FSCP 2008/09 has a 200% SL i.e. $2m. For 2007/08 a 228% SL is elected as this is the equivalent.
** Claims administration costs are the additional costs that are incurred by being in the programme.
For the FSCP the "premium" payable to ACC covers the bulk funded health care costs.

FSCP assumptions	**2007/08**	**2008/09**
Standard levy	0.89	0.78
Residual levy	0.43	0.47
SMP discount	15%	15%
Bulk funded health care	4.4%	4.5%
Admin fee	4.2%	4.25%
Primary health fee	1.30%	1.40%
Stop Loss	200%	200%
HCCC	1,000,000	1,000,000
Premium options fee	7.2%	8.2%

PDP assumptions	**2007/08**	**2008/09**
Standard levy	0.89	0.78
Residual levy	0.43	0.47
SMP discount	15%	15%
PDP discount	56.7%	56.8%
Admin fee	4.20%	4.25%
Primary health fee	1.30%	1.40%
Stop Loss	none	none
HCCC	none	none
Premium options fee	0.00%	0.000%