MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Carmel Sepuloni	Portfolio	ACC
Title of Cabinet paper	Preparing for the 2021 ACC levy round: implementing three-yearly levy rounds	**Date to be published**	28 April 2021

List of documents that have been proactively released		
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28 April 2021	Preparing for the 2021 ACC levy round: implementing three-yearly levy rounds	Office of the Minister for ACC
28 April 2021	Cabinet Economic Development Committee Minute of Decision [DEV-21-MIN-0050]	Cabinet Office

Information redacted **YES**

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Some information has been withheld for the reason of confidential advice to Government.

In Confidence

Office of the Minister for ACC

Chair, Cabinet Economic Development Committee

Preparing for the 2021 ACC levy round: implementing three-yearly levy rounds

Proposal

1 This paper seeks Cabinet's agreement to move to three-yearly Accident Compensation Corporation (ACC) levy rounds in 2021, in addition to minor, technical changes to the ACC Funding Policy Statement.

Relation to Government priorities

2 This proposal does not relate to Government priorities.

Executive Summary

3 The Accident Compensation Scheme (the Scheme) is funded by a mix of levies and Government appropriations. Under the Accident Compensation Act 2001 (the AC Act), ACC recommends levy rates on the basis of the ACC Funding Policy Statement (FPS). The Minister for ACC then makes a recommendation to Cabinet, which sets levy rates.

4 Previously, Cabinet set levy rates biennially. In 2019, Cabinet agreed to set levies for one year only in 2020 and noted that officials would provide further advice on moving to three-yearly levy rounds after the 2020 levy round [DEV-19-MIN-0348, CAB-19-MIN-0675 refer].

5 A levy round is scheduled to take place this year. In order to progress the 2021 levy round, I am seeking Cabinet's agreement to change the frequency of levy rounds and to make minor and technical changes to the ACC funding policy. I propose Cabinet agree that:

<u>Frequency of levy rounds</u>

a. ACC levy rounds are conducted every three years, commencing from the 2021 levy round

<u>Funding policy changes</u>

b. the ACC Funding Policy Statement (FPS) is changed from a levy-period basis to an annual basis

c. the cap on levy increases is changed to a 5 per cent annual cap

d. the funding ratio calculation is corrected to align the FPS with the method ACC uses in calculating funding ratios in its reports, excluding the unexpired risk liability (URL).

6 Commencing three-yearly levy rounds in 2021 encourages a longer-term view of Scheme solvency, avoids the time pressures associated with elections, and provides administrative cost savings for agencies involved in the levy-setting process.

7 The minor and technical changes to the ACC FPS enable ACC to implement the FPS for three-yearly levy rounds, and to progress actuarial work on recommending levy rates as part of the 2021 levy round.

8 ACC has indicated that it is planning to consult on its recommended levy rates from 1 September 2021 to 5 October 2021. Confirmation of the proposed move to three-yearly levy rounds (and associated funding policy changes) now allows actuarial work on levies to commence immediately, enabling consultation to occur in the agreed timeframe.

Background

9 ACC revenue (funded by levies and appropriations) is pooled in to specified Accounts, which fund specific injuries. These Accounts and the injuries they fund are set out in Table 1 below:

Table 1: Summary of Accounts

Account	Funded by	Pays for
Work	Levies on employers and the self-employed	Work-related injuries
Earners'	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)
Motor Vehicle	Levies on motor vehicle owners through registration fees and users at the petrol pump	Accidents on public roads involving motor vehicles
Non-Earners'	Government appropriations	Non-earners' injuries (not including motor vehicle and treatment injuries)
Treatment Injury	Levies from the Earners' Account and appropriations from the Non-Earners' Account	People injured as a result of medical treatment

10 The AC Act requires the Scheme to be fully-funded. This means that the ACC collects sufficient revenue to fund the lifetime cost of all claims under the levied Accounts[1].

[1] Section 166A(1) of the AC Act. In practice, it is sufficient that the amounts collected at any one time are broadly aiming for the full funding amount required.

ACC recommends levy rates on the basis of the Funding Policy Statement and Cabinet sets levy rates

11 The first step in the levy-setting process is for ACC to undertake an actuarial valuation on which levies are based, and then consult levy payers on recommended levy rates (section 331(2) of the AC Act).

12 In recommending levy rates, ACC must give effect to the FPS[2]. The purpose of the FPS is to ensure that ACC's recommended levy rates align with Government expectations.

13 The current FPS, last amended in July 2020, features four requirements:

13.1 **Full funding:** The average levy rate must be based on the expected lifetime costs of claims over the levy period.

13.2 **Target funding ratio:** Each levied Account has a target funding ratio of 100 per cent (essentially, this means holding assets equal to the value of liabilities).

13.3 **Smoothing mechanism:** Levy rates must include an adjustment to return an Account's funding ratio to the 100 per cent target smoothly over a ten year period.

13.4 **Cap on increases:** Levy rate increases must not exceed 15 per cent in each levy period.

14 The Minister for ACC must also have regard to the wider public interest in setting levy rates, including the interests of levy payers, claimants and potential claimants[3]. Ultimately, Cabinet sets levy rates and when taking recommended levy rates to Cabinet, I am not obliged to accept ACC's recommendations[4].

Cabinet has signalled a move to three-yearly levy rounds

15 Since 2016, ACC levy rates have been set every two years. This means that every two years, ACC recommends and consults on, and Cabinet sets, levy rates that would apply for the next two levy periods.

16 In 2019, Cabinet agreed to set levies for one year only at the 2020 levy round and noted that officials would provide further advice on moving to three-yearly levy rounds from 2021 [DEV-19-MIN-0348, CAB-19-MIN-0675 refer].

17 Cabinet also agreed to make two key changes to the ACC funding policy:

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[2] Section 331(3) of the AC Act.
[3] Section 300 of the AC Act.
[4] Section 331(5) of the AC Act.

(1) Levied Accounts:

Reduce the funding ratio target from a range of 100-110 per cent (targeting the midpoint of 105 per cent), including a risk margin, to a target of 100 per cent, excluding a risk margin

(2) Non-Earners' Account (NEA):

Treat NEA cost pressures as a forecast adjustment (rather than being considered through the annual Budget bid process) up to an annual cap of 7.5 per cent.

18 The reduction in the target funding ratio (and the removal of the risk margin) sought to better reflect the Scheme's status as a single provider, Government-backed scheme. The NEA changes sought to provide a more accurate reflection of the true cost of injuries and ensure intergenerational equity, as the NEA's solvency has been falling below its funding target of 100 per cent[5].

19 In July 2020, Cabinet agreed to continue 2020/21 levy rates into 2021/22 because of the economic uncertainty caused by COVID-19 [DEV-20-MIN-0118 refers].

I am seeking Cabinet's confirmation to commence three-yearly levy rounds

20 The next levy round is scheduled for 2021. ACC is planning to consult on its recommended levy rates from 1 September 2021 to 5 October 2021. Cabinet's confirmation of the proposed move to three-yearly levy rounds (and clarifications to the funding policy) now would allow ACC to commence its actuarial work on recommended levies.

Objectives for levy round settings

21 The AC Act does not specify the frequency of levy rounds. The current settings exist by way of convention and Cabinet can alter the frequency of levy rounds as it wishes.

22 I have assessed the options for levy round settings against the following five objectives:

Primary objectives

(1) providing **certainty** to levy payers

(2) allowing **flexibility** in responding to changes to the Scheme

(3) ensuring a **long-term view** of the Scheme's solvency

(4) **transparency and accountability** in determining solvency levels

[5] The NEA's funding position (the fully-funded portion) has reduced from 86% in 2018 to 59% in 2020.

Secondary objective

(5) ensuring a reasonable level of **administrative cost**.

23 The objectives are largely aligned as, for example, certainty for levy payers can co-exist with a long-term view of the Scheme's solvency. There can, however, be conflict between providing certainty to levy payers and allowing flexibility in responding to changes to the Scheme.

I propose that we move to three-yearly levy rounds in 2021

24 I propose commencing three-yearly levy rounds in 2021. Three-yearly levy rounds create longer-term certainty for levy payers over future levy rate movements and may support a longer-term perspective when setting levy rates, with increased ability to consider movements in levy paths and solvency. It ensures that levies come into effect in the middle of a Parliamentary term and provides administrative cost savings straight away.

25 However, there would be reduced flexibility in responding to market movements in the short-term, such as external interest rates and investment returns[6]. [redacted]

26 In addition to commencing three-yearly levy rounds in 2021, I also considered two alternative options on the timing for three-yearly levy rounds:

Option 1: commencing three-yearly levy rounds in 2024 (with a one year levy round in 2021 and a two year levy round in 2022)

Option 2: commencing three-yearly levy rounds in 2022 (with a one year levy round in 2021).

27 **Appendix 1** shows the timelines for each option. For all options, levy rates are not considered in Election years where the normal consultation timing might fall into the pre-election period. However, under Option 1 levies would initially come into effect in the next Election year (2023), while under Option 2 levies would always come into effect in an Election year.

28 Options 1 and 2 create additional uncertainty for levy payers and could mean that they are exposed to unnecessary financial volatility risk (for example, in the current circumstances, lower interest rates increase the lifetime costs of claims under the Scheme, likely leading to pressure to increase levy rates). In addition, administrative cost savings would be delayed with either option.

29 **Appendix 2** summarises the benefits and risks of the three options, based on the five objectives listed in paragraph 23.

[6] The ACC Board and I retain the ability to recommend changes to levy rates out of cycle under exceptional circumstances.

Minor, technical changes to the Funding Policy Statement to implement three-yearly levy rounds

30 If you agree to proceed with three-yearly levy rounds from 2021, minor, technical changes to the FPS are required to be made now. The proposed changes are limited to those that are necessary for ACC to be able to recommend and consult on levy rates in 2021.

31 If the funding settings were to change after March, there would be an increased risk that ACC's recommended levies could not be delivered in time for the 2021 levy consultation in September.

Proposed change 1: annualise the Funding Policy Statement

32 The current FPS is based on the 'levy period', which has previously been two years. The shift to three-yearly levy rounds creates issues for ACC's pricing model, which involves the calculation of the funding adjustment over a ten year horizon, as the final year of the ten year adjustment falls in the middle of a levy cycle.

33 If the FPS were amended to an annual basis, the levy calculation would be independent from the chosen levy period (i.e. three years). As a result, the three elements of levy calculation (new-year costs, the funding adjustment, and capping) could be applied on an annual basis and would therefore be consistent regardless of the underlying levy-setting period. This would mean that any future changes to the frequency of levy rounds would not require changes to the funding policy.

34 An annualised FPS also means that at each levy round ACC would recommend levy rates with stepped annual adjustments (i.e. three different levy rates across a three year levy period, rather than a flat rate across the levy period). However, I have the ability to request alternative scenarios from ACC that differ from the FPS to help inform my recommendation to Cabinet, and the AC Act provides me discretion to recommend to levy rates that do not align with ACC's recommendations[7].

Proposed change 2: change the cap on levy rate increases to a 5 per cent annual cap

35 Under the current FPS, the cap on levy increases is 15 per cent (in addition to inflation adjustments for the Motor Vehicle Account (MVA)). For biennial levy rounds, this has been applied across the levy period, implying an average cap on increases of around 7.5 per cent per year. With the shift to three-yearly levy rounds, a 15 per cent cap across a three year period would mean an implied average cap on increases of around 5 per cent per year[8].

[7] Section 331(5).
[8] A series of three 5 per cent increases works out to be a total increase of 15.76 per cent over the three year period.

36 Should Cabinet agree to annualise the FPS, I propose changing the cap to a 5 per cent annual cap to align it with an annualised FPS. The alternative option is to maintain the 15 per cent cap across the levy period. A cap that applies across the levy period can vary in yearly percentage increases within the particular levy period chosen (for instance, in a one year levy round, Cabinet could set a 15 per cent increase in levies). Both options maintain the additional inflation adjustments for the MVA.

37 Setting a cap on levy increases involves striking a balance between the speed of returning to the solvency target and the impact of levy increases on levy payers and the economy. The lower the cap, the more levy stability and the impact on levy payers is prioritised, the higher the cap the more a swift return to solvency is prioritised. A 7.5 per cent annual cap would return levied Accounts to their solvency target slightly more quickly, but would mean increased volatility in levy rates and more impact on levy payers and the economy. A 5 per cent annual cap would take longer to return Accounts to their solvency target, but protects levy payers and the economy against levy rate volatility. On balance, a 5 per cent annual cap aligns with the intent of the funding policy and strikes the right balance between solvency and avoiding volatility in levy rates.

38 Table 2 below assesses the two options.

Table 2: Options for the cap on levy increases

Option 1: 5 per cent annual cap [recommended]	**Option 2: 15 per cent cap across the levy period**
• **Consistent:** allows all elements of the funding policy to be applied on an annual basis • **Simple:** ACC can apply the cap in a simple way, without having to average out a 15 per cent cap across three years of levy calculations • **Aligns with the original intent of the funding policy:** while a 5 per cent cap is lower than the de facto annual cap of 7.5 per cent, the cap's purpose is to protect immediate levy payers by mitigating against large increases in levy rates	• **Inconsistent:** a cap that applies across the levy period would not align with an annualised FPS • **Complex:** introducing a levy period at the last step of the levy calculation process would complicate the pricing process and undermine certainty • **Not functional:** ACC's current modelling does not enable having a cap that applies across a three year period for a ten year funding horizon • **May improve solvency more quickly:** this option would allow for an earlier (15 per cent) increase in levy rates, creating larger but less frequent increases for levy payers

Proposed change 3: correct the funding ratio calculation to align with the method ACC uses in calculating funding ratios in its reports, excluding the unexpired risk liability

39 The current funding ratio calculation set out in the FPS differs from ACC's actuarial calculation of funding ratios for the purpose of levy pricing and reporting.

40 The key issue is that the current calculation (as a balance sheet definition) includes unexpired risk liability (URL)[9], whereas the actuarial pricing method starts with the balance sheet definition and then removes the URL. The URL is an accounting requirement and does not represent the true economic cost ACC needs to fund through levies[10]. This means the funding ratio calculation included in the current funding policy cannot be implemented.

41 The proposed changes to the funding ratio calculation correct this error by removing the URL, including assets for the accredited employers programme (AEP), and excluding AEP liabilities and the OCL risk margin. This essentially aligns with the method ACC uses in calculating funding ratios in its reporting, but with the URL removed.

Financial Implications

42 Reducing the frequency of ACC levy rounds from every two years to every three is likely to reduce administrative costs for ACC, MBIE and Treasury. However, reducing the cap on recommended levy increases from 15 per cent over a two year period to 5 per cent per year may extend the period over which ACC's levied Accounts can return to their funding target[11].

43 ACC's levy revenue and balance sheet position affect the Crown's financial accounts. These impacts would continue to be updated each financial year to reflect changes in assumptions, even though levies would be set every three years (for example, levy revenue is affected not only by levy rates, but by other assumptions, such as economic growth and employment rates).

Legislative Implications

44 There are no legislative implications for these proposals. If you wish to amend the FPS, this will need to be published in the *New Zealand Gazette*. Should new levy rates be set in December, regulations will be required to give effect to the new rates.

[9] The URL is a provision for claims ACC can expect to incur after 30 June 2020 that are funded by levies already received. If the levies are not enough to cover these claims (including a risk margin), a URL is held.
[10] Funding ratios reported by ACC reflect the actuarial method definition used, including the 2020/21 Service Agreement and Financial Condition Report.
[11] In saying this, the cap only applies to ACC's recommended levy rates. Cabinet makes final decisions on prescribing levy rates.

Impact Analysis

45 The Regulatory Impact Analysis Team at the Treasury has determined that there are no regulatory proposals in this paper, and therefore Cabinet's Regulatory Impact Analysis requirements do not apply.

Population implications

46 The proposals contained in this paper do not have any implications for population groups. Changes to the frequency of levy rounds (and associated changes to ACC's funding policy enabling this to occur) will not affect the cover and entitlements received by ACC claimants.

Human rights

47 The proposals contained in this paper do not have any implications for the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Consultation

48 The Ministry of Business, Innovation and Employment (MBIE) has consulted the Treasury, ACC, Inland Revenue, the Ministry of Transport, WorkSafe, New Zealand Customs Service, and the Ministry of Health. The Department of Prime Minister and Cabinet was informed.

49 ACC would prefer an alternative cap of 7.5 per cent (plus inflation) on levy increases for the Motor Vehicle Account (MVA), recognising the MVA's volatility. I consider this to be too significant a change to the funding policy for the purpose of implementing the 2021 levy round.

50 I have also consulted the New Zealand Council of Trade Unions (NZCTU), BusinessNZ, and the New Zealand Automobile Association (AA).

Communications

51 Should Cabinet agree to the proposed changes to the FPS, a new FPS will be published in the *New Zealand Gazette*. Should Cabinet agree to move to three-yearly levy rounds in 2021, I intend to announce this along with the proposed changes to the FPS.

Proactive Release

52 This paper will be made available on the MBIE website within 30 business days of Cabinet's decisions being confirmed, subject to redactions as appropriate under the Official Information Act 1982.

Recommendations

The Minister for ACC recommends that the Committee:

Frequency of levy rounds

a **note** that the Ministers of Finance and ACC signalled to Cabinet in 2019 that officials would provide further advice on moving to three-yearly levy rounds after the 2020 levy round [DEV-19-MIN-0348 refers]

b **note** that due to the uncertainty caused by COVID-19, Cabinet agreed in 2020 to roll-over 2020/21 levy rates into 2021/22

c **agree** to move to three-yearly ACC levy rounds from 2021 (with the first levies to apply from 2022/23)

Funding Policy

d **note** that if you wish to proceed with three-yearly levy cycles, minor, technical changes to the Funding Policy Statement are required

e **agree** to amend the Funding Policy Statement from a levy-period basis to an annual basis

f **agree** to change the cap on levy increases to a 5 per cent annual cap (in addition to inflation adjustments for the Motor Vehicle Account)

g **agree** to correct the funding ratio calculation to align the FPS with the method ACC uses in calculating funding ratios in its reports, excluding the unexpired risk liability (URL)

Announcements

h **invite** the Minister for ACC to announce these decisions

Funding Policy Statement

i **note** that the Funding Policy Statement will be gazetted immediately following Cabinet's decisions on three-yearly levy rounds and associated funding policy changes.

Authorised for lodgement

Hon Carmel Sepuloni
Minister for ACC

Appendices

Appendix 1: Levy round options

Appendix 2: Benefits and risks of levy round options

Appendix 3: Proposed changes to the ACC Funding Policy Statement

Appendix 1: Levy round options

Options	August-October 2021	December 2021	1 April/1 July 2022	August-October 2022	December 2022	1 April/1 July 2023	August-October 2023	December 2023	1 April/1 July 2024	August-October 2024	December 2024	1 April/ 1 July 2025	August-October 2025	December 2025	1 April/ 1 July 2026	August-October 2026	December 2026	1 April/ 1 July 2027	August-October 2027	December 2027
Option 1: Longer transition (first three-yearly levy round in 2024)	ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect	ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect				ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect							ACC consults on levy rates	Cabinet sets levy rates
			Levies set for **1** year			Levies set for **2** years						Levies set for **3** years								
Option 2: Shorter transition (first three-yearly levy round in 2022)	ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect	ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect							ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect					
			Levies set for **1** year			Levies set for **3** years									Levies set for **3** years (until 31 March/ 30 June 2029)					
Option 3: Move at the next levy round	ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect							ACC consults on levy rates	Cabinet sets levy rates	Levies come into effect							ACC consults on levy rates	Cabinet sets levy rates
			Levies set for **3** years									Levies set for **3** years								

** 2023 is an Election year*
Shaded areas signify a levy round (ACC consultation and Cabinet decisio

Appendix 2: Benefits and risks of levy round options

Option	Benefits	Risks
Option 1 Longer transition (First three-yearly levy round in **2024**)	• Allows medium-term economic effects of COVID-19 to bear out, recognising that economic uncertainty and volatility could continue for two to three years **(Flexibility)**	• Confusing, mixed messaging on frequency of levy rounds **(Certainty, Transparency and accountability)** • Least ability to save on administrative costs, with three levy rounds in four years **(Administrative costs)** • Levies set in 2022 would come into effect in an Election year (2023) **(Long-term view)** • First three-yearly levy round would not occur until the next Parliamentary term **(Administrative costs)**
Option 2 Shorter transition (First three-yearly levy round in **2022**)	• Allows one more year of economic volatility to bear out before setting three years of levy rates **(Flexibility)** • Some administrative cost savings **(Administrative costs)** • Consultation and decisions on levy rates and proposals in the middle year of a Parliamentary term (with over a year to consider levy consultation items) **(Flexibility, Long-term view)**	• Could cause confusion and uncertainty, with a levy roll-over (in 2020) followed by a one year levy round, then a three year levy round[12] **(Certainty)** • Levies would always come into effect in an Election year **(Long-term view)**
Option 3 –recommended Move at the next levy round (First three-yearly levy round in **2021**)	• Clear messaging, with three-yearly levy rounds the default from 2021 onwards **(Certainty, Transparency and accountability)** • Ensures that levies come into effect in the middle year of a Parliamentary term **(Long-term view)** • Same timetable and reference period for each levy round **(Certainty)** • Saves administrative costs straight away **(Administrative costs)**	• Risk of setting three years of levy rates during continued high uncertainty and volatility **(Flexibility)** • Requires incoming Minister to make levy decisions in the first full year of a Parliamentary term (in 2024) (including making decisions on levy consultation items in the first 4-6 months of the term) **(Flexibility, Long-term view)**

[12] This could be mitigated by clear communications signalling the change to a three-yearly cycle in 2022.

Appendix 3: Proposed changes to the ACC Funding Policy Statement

<table>
<tr><th>Current Funding Policy Statement</th><th>Proposed changes to Funding Policy Statement</th></tr>
<tr><td colspan="2">Consistent with the principles of financial responsibility, ACC must recommend levies for each levied Account according to the following requirements:</td></tr>
<tr><td>a. ACC must base the average levy rate on the expected lifetime cost of claims in relation to injuries occurring in the period for which ACC is recommending levies (“expected lifetime injury costs in the levy period”).</td><td>a. ACC must base the aggregate levy rate for a year on the expected lifetime cost of claims in relation to injuries occurring in that year (“expected lifetime cost of claims in the levy year”).</td></tr>
<tr><td>b. The funding ratio is calculated by dividing total assets, less payables, accrued liabilities, provisions, unearned levy liability and unexpired risk liability by the outstanding claims liability (including additional liability for work-related gradual process claims not yet made but excluding any risk margin).</td><td>b. The funding ratio is calculated by dividing the assets by the liabilities. The assets are defined as the total assets reported in the annual report less:
• payables
• accrued liabilities
• investment liabilities
• provisions
• unearned levy liability
• and any assets for the accredited employers programme (AEP)
The liabilities are defined as the balance sheet OCL but:
including:
• off balance sheet work-related gradual process claims not yet made
and excluding:
• liability for the AEP
• the OCL risk margin.</td></tr>
<tr><td>c. ACC must include an adjustment to the average levy rate that takes the Account’s funding ratio to the target defined in (b) smoothly over a ten-year horizon. This is to be achieved by setting the adjustment at a fixed proportion of expected lifetime injury costs in the levy period, and for each such period, over the ten-year horizon.</td><td>c. ACC must include an adjustment to the aggregate levy rate that takes the Account’s funding ratio to the target defined in b. smoothly over a ten-year horizon. This is to be achieved by setting the adjustment at a fixed proportion of expected lifetime injury costs in the levy year, and for each year over a ten-year horizon.</td></tr>
<tr><td>d. Any increase to the average levy rate for each Account must not exceed 15% (in addition to inflation adjustments for the Motor Vehicle Account).</td><td>d. Any annual increase to the aggregate levy rate for each Account must not exceed 5% (in addition to inflation adjustments for the Motor Vehicle Account).</td></tr>
<tr><td></td><td>e. Steps a. to d. are repeated for each levy year in the period for which ACC is recommending levies</td></tr>
</table>