New Zealand Society of Actuaries (Inc)

Social Unemployment Insurance Tripartite Working Group
Ministry of Business, Innovation and Employment
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Via email: ***incomeinsurance@mbie.govt.nz***

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Re: A New Zealand Income Insurance Scheme

Thank you for the opportunity to comment on your February 2022 consultation document relating to a new income insurance scheme.

We understand the intent of the proposal is to establish an income insurance scheme to provide a replacement income for displaced workers and those who cannot work because of health conditions or disabilities.

The proposal is a significant policy and change to the NZ labour market. Given this, it is important that there is a well-considered, transparent consultation with input from a wide variety of stakeholders with relevant experience.

Background

The New Zealand Society of Actuaries (NZSA) is the professional body for actuaries practicing in New Zealand. Our members work in public and private insurance supporting their employers and clients to estimate and manage the uncertainty and risk associated with the provision of insurance.

Members submitted feedback via email in respect of the consultation. A summary of the feedback was collated and presented to members via a webinar, where we obtained further member feedback on key submission points. This feedback has been incorporated into this submission on the proposal.

General comments on the proposal

The consultation sets out the proposed scheme design and asks a series of questions, we consider that it is necessary to provide general comments on the proposal not covered in the scope of the questions.

1. The discussion document does not provide strong quantitative information on the costing of the scheme or how it will successfully achieve its objectives. In addition, the discussion document presents a scheme design in a near-complete state with few options and asks for feedback on design elements without transparency on the costing of the scheme against alternative options. In the absence of such information, it is difficult to assess the relative merits of the scheme or various design options. We suggest that if supporting quantitative cost/benefit information was provided, the NZSA would be able to provide much more constructive feedback on the scheme. Alternatively, as a profession, we have expertise in the costing of insurance schemes and would be happy to assist in estimating or reviewing the costs.

2. The scheme would be exposed to moral hazard and exploitation. This has the potential to impact costs. It is unclear if this uncertainty is well understood and has been allowed for in the proposed levies. This is particularly true of redundancy cover, where there is much more agency for employees and employers to impact outcomes. We give some examples in the Appendix of how the scheme may be "gamed".
3. The discussion document notes that income insurance options are available via private insurance but private income protection insurance markets are "often neither efficient nor effective". The current private insurance market has low take-up primarily due to the affordability of insurance for this type of coverage for workers who may need it. NZSA would welcome discussion based on our experience on the reasons why the current private insurance market has low take-up and whether the proposed scheme could provide coverage for redundancy and/or health conditions and disability more efficiently or effectively than private insurers.
4. Elements of the scheme design will lead to significant cross-subsidies and inequities across levy payers. Fairness, conduct and culture has been a recent area of focus in the regulation of private insurance. Some examples of inequities in the proposed scheme:
    a. A flat levy rate regardless of age, gender, employment status and role, while it is certain there will be differences in claim rates and costs by these risk factors.
    b. Thresholds for claim and coverage exclusions which result in some levy payers being ineligible for cover despite paying levies.
5. The scheme would introduce a cost for employers which may have unintended consequences for employees. Employers may be less likely to provide pay rises to employees in order to fund their costs of the scheme. Employers may also remove existing employee benefits, more generous redundancy provisions and existing insurance provisions. We suggest that incentives could be provided to employers to encourage the retention of existing benefits so that employees under the proposed scheme are no worse off.

In the Appendix, we provide more detailed comments relating to specific questions asked in the consultation document.

Summary

There is a risk that the proposed New Zealand Income Insurance Scheme, as drafted, could lead to unintended outcomes and higher than expected costs as outlined in this submission. We have identified a number of areas which, in our opinion, warrant further consideration before the scheme is implemented. The implementation and ongoing management of an insurance scheme is an area that falls squarely within the expertise of actuaries. We would be happy to answer any questions on our submission points.

The NZSA would also be willing to help the Working Group to refine the proposal via workshops or informal feedback sessions between experienced actuaries and the Working Group to consider refinements which would minimise the risk of unintended outcomes and increased costs.

Given the impact of the change that would result from the proposed scheme, we suggest that the timeframes for planned implementation are extended. We consider additional time is necessary to ensure that alternative options can be worked through with quantitative information supporting.

The NZSA requests greater transparency on the costing of this scheme and requests the release of as much quantitative information as possible. This will allow a much stronger and informed public discourse on the proposed scheme.

Yours sincerely

Privacy of natural persons

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Appendix: Responses to specific questions

Coverage and entitlements for displacement

Question 6 to 8: Displacement and standard employment (full- and part-time permanent employees)

The proposal recommends coverage for workers in the case of complete job loss due to disestablishment of the job (i.e. redundancy) and the exclusion of coverage for 'voluntary' job loss. This design choice risks excluding certain cohorts of potential claimants and brings with it risks of the scheme not achieving its objectives. Consideration should be given to coverage in these circumstances, balanced against cost implications.

- Resignations - there may be circumstances where an employee loses their entitlement due to resignation. For example, where the employer took action to encourage resignation, rather than facing the extra costs of redundancy.
- Poor performance - some job losses due to poor performance may be outside of an employee's reasonable control. For example, where the expectations of a role have been poorly explained during the hiring process. In addition, a claimant of this scheme nearing the end of their entitlement may take a job that they are not well equipped for, later losing it due to poor performance.

Question 9 to 10: Coverage provided for complete job loss only

The proposal recommends coverage for workers in the case of complete job loss due to disestablishment of the job (i.e. redundancy) and the exclusion of partial job loss. This design choice risks excluding certain cohorts of potential claimants and brings with it risks of the scheme not achieving its objectives. Consideration should be given to coverage in these circumstances, balanced against cost implications.

Partial job loss - a forced change in responsibilities or hours may have similar financial consequences to redundancy. Consideration should be given to applying an income reduction threshold, consistent to that suggested for full loss of a part time job. Currently the proposal has an inconsistency in coverage between a partial loss of hours within a job and loss of a part-time job where the claimant has multiple jobs.

Questions 11 to 13: Displacement and non-standard employment – a principle-based approach

There are several potential problems of assessing claims based on the suggested principles of "established pattern of work" and "loss of reasonably anticipated income":

- The extra information required and complexities in assessing claims against these principles is likely to make the assessment process disproportionately costly, relative to more straightforward claims for permanent employees.
- These principles may be difficult to apply in certain circumstances. For example, where a recent role change has occurred, complicating the "established pattern of work". This may lead to either sub-optimal claims outcomes or increase assessment costs.
- A lack of clarity in how these principles would be applied will create uncertainty. This will be both a burden on employees and will make it challenging for the private insurance market to develop supporting products.

In addition, coverage for non-standard employees is exposed to being “gamed” with associated cost impacts for the scheme. Employers may look to structure employment arrangements to increase the likelihood of claim and make employment packages more attractive. For example, a role that would otherwise be a 6 month fixed-term contract could instead be structured as a permanent role, with redundancy after 6 months (effectively providing 12 months of income to the employee).

It is unclear how or if these costs have been allowed for.

Questions 18 to 22: Coverage for self-employed workers

Coverage for self-employed workers is exposed to being “gamed” with associated cost impacts for the scheme.

The self-employed will have significant agency to structure their business to benefit from the scheme. For example, employing a family member for a period, disestablishing the role (thus creating a claim entitlement), whilst the family member still undertakes the work without pay.

If cover for the self-employed is included in the final design, there will be challenges in the assessment of income. Income from an individual's personal exertion will need to be isolated from other income of the business. It is unclear how or if these costs have been allowed for. We note that this applies to the coverage for displacement as well as the coverage for health conditions and disability.

Questions 23 to 26: A modest minimum contribution period and limits on subsequent claims

The proposed design suggests a minimum contribution period (6 months of the preceding 18) and maximum on claims in a period (6 months in any 18). These will both serve to help manage costs but have other limitations.

There may be genuine instances of repeated redundancy that are excluded under this methodology. The minimum contribution period also creates an “all or nothing” threshold, leading to differences in treatment for individuals who have worked a day under 6 months and a day over 6 months.

We suggest considering an alternate “accrual” design option. This would help to mitigate the noted issues with some extra cost associated with assessing more small claims. An accrual design would see members accrue claim entitlement based on periods worked, with the accrued benefit expiring after a particular period.

For example, accruing 1 month of claim entitlement for each 2 months worked, expiring after 24 months. An employee who returns to work for 4 months and is made redundant would be entitled to a 2 month claim. If they returned to work after 1 month on claim, they would still retain their remaining 1 month of entitlement. A claimant who has a 6 month claim and returns to work for 2 months only to be made redundant again would still have 1 month of claim eligibility.

In the proposed design this limit also applies to coverage for health conditions and disability. Again, there may be genuine situations where an employee has different health conditions or disabilities but is excluded from coverage.

Questions 29 to 30: Income caps and income replacement rates that match the accident compensation scheme

The proposed caps and replacement rates for displacement are consistent with ACC but are high by international comparison. The higher replacement rates impact the overall costs of the schemes and reduce the incentive for claimants to search for work. There is no data provided which supports the proposed caps and replacement rates over alternatives. As noted above, it is unclear if the risks of potential cost escalation have been allowed for.

As there is currently with ACC, there will likely be complications around how the proposed coverage for health conditions and illness interacts with existing coverage provided by private insurers. Some examples include:

- a person may have an income replacement rate of over 100% when they combine private insurance with the proposed benefit of 80% of their income, which would then provide an incentive to claim.
- private insurers may choose not to offer complementary insurance (e.g. long-term insurance) if, due to the introduction of the proposed scheme, they cannot manage claims from when health conditions or disabilities first emerge.

This could be addressed if private insurers were allowed to retrospectively change the terms and conditions of their policies to include offsets (in the same way many insurance policies have ACC offsets). However, there are likely to be legal issues in doing this.

Question 43: Extending the maximum period in specified circumstances

The proposed extension to the claim period for training or vocational rehabilitation will reduce the incentive to search for work, introduce further opportunities to "game" the scheme and increase the burden on employers and employees in the form of a higher levy. As the consultation document does not include any detail on the costing, it is difficult to assess if these risks have been adequately captured.

Question 44: Enhancing the income insurance scheme with notice periods

The proposal calls for the employer to provide a minimum 4 week notice period on redundancy. Where an employee currently has a termination notice period of less than 4 weeks, this would be an additional cost that will borne by the employer. For transparency, these higher costs should be included in the levy.

Coverage and entitlements for health conditions and disability

Question 49: No restrictions on the types of conditions covered by the income insurance scheme

The consultation asks for feedback on whether all health conditions would be eligible for cover. Not covering all health conditions could be perceived as unfair and inequitable, but the costs of the scheme could be better managed if some conditions are carved out or have additional restrictions. Limitations for conditions such as those related to mental health exist in similar schemes overseas. Mental health conditions are complex to assess and could represent a significant cost to the scheme. We note that private insurance income protection claims arising from mental health conditions have increased in recent years.

Questions 51 to 52: Coverage for loss of at least 50 percent of capacity to work, for at least four weeks

The proposal is for coverage of health conditions that are expected to persist for at least four working weeks and includes a threshold for claim of a reduction in earnings of 50% or more and suggests that sick leave can fill the gap for those who don't qualify. The intent of the threshold is to control the costs of the scheme. Changing this threshold will influence the costs of the scheme.

Not covering partial loss of earnings (i.e. between 0% and 49% of earnings) is likely to discriminate against certain health conditions where impacts are expected to be of a partial nature. This may result in unintended outcomes or "gaming" where claimants are capable of some work but work less in order to meet the reduction in earnings requirement.

Not supporting people that are partially impacted may lead to worse outcomes and higher costs. For example, early intervention may result in a better outcome than waiting for a health condition or disability to lead to a more significant impact.

Sick leave is unlikely to be able to fill the gap for those who have a reduction in earnings of 0%-49% or disablement of less than 4 weeks, so the scheme may not meet its objective in this regard. Consideration may need to be given to how the needs of these people are met.

Income insurance for health conditions and disability would largely provide the same entitlements as income insurance for displacement (i.e., same replacement rate, length of coverage, limits on subsequent claims, etc.). The period of cover proposed is inconsistent with the length of cover provided by ACC and appears to not meet the objectives of the scheme, which is to align coverage with that for accidents.

The entitlements will directly impact the cost of the scheme. The entitlements for the scheme are aligned with the proposed entitlements for displacement. They are also broadly aligned with the entitlements under the ACC except for the length of coverage, where ACC supports claimants with wage replacement up to age 65. Increasing the length of coverage will increase the cost of the scheme, however the following should be considered:

- A 6-month period is sufficient time to be supported while looking for new employment following displacement, but is relatively short for those who are unable to work due to a health condition/disability.
- For a person newly impacted by a health condition or disability, 6 months may be too short a period for rehabilitation into alternative work. For example, someone may be coming to grips with their health condition and not be ready to be rehabilitated or be unable to complete necessary retraining within this time.
- The proposed 6-month period is not consistent with the ACC scheme, where wage replacement can be received to age 65. Therefore, the proposed scheme does not meet one of the stated objectives to address the current inequity whereby a person who experiences an accident can receive much more support than a person with a non-accident related health condition or disability, despite a similar loss of ability to work.

The proposal suggests where the thresholds for coverage under the scheme should be set.

Various thresholds are outlined for coverage including conditions covered, what work arrangements are covered, level of reduced earnings before eligible for cover and length of time that earnings are reduced before cover is eligible.

Thresholds for cover will have a significant impact on scheme costs. However, it is difficult to comment on these thresholds without information on their costing.

Questions 53 to 54: Claimants' medical practitioners would assess work capacity, with final eligibility assessed by the scheme administrator

The claimant's health practitioner will be the main assessor of work capacity in most cases (with some second opinions required in certain scenarios), and employers can provide information to support the assessment of the claim. This approach will likely reduce claim assessment costs but may lead to more claims.

Certain health conditions and disabilities may require more information or different assessment approaches. It is likely that scheme experience over time will show where additional focus is needed. It will be important to monitor which conditions and disabilities result in significant costs.

Providing health practitioners with training and clear assessment requirements will be necessary to ensure consistency of assessment between health providers. Otherwise, there is a risk of inconsistent experience for claimants, potentially weakening the claims assessment process. This may also result in more claims than expected.

Health practitioners are likely to be guided by potential claimants when assessing whether they can or cannot perform their role. This could be another opportunity for "gaming" the scheme and could lead to health practitioners inappropriately signing off more claims than expected.

Declarations by employers could support the robustness of the assessment process, but privacy requirements for claimants would need to be carefully considered with respect to sharing health information with, and involvement of, employers.

It would be sensible to have alignment with the assessment path for ACC injury claims, or if not, be clear around the rationale for differences.

Scheme Funding

Questions 88 to 90: Both the employee and employer would be charged at a flat rate

The consultation document explores some ways to vary levies paid by employees and employers as opposed to a simple, flat rate.

For employees, a levy-free threshold would make the scheme more progressive, by allowing lower-income workers to pay a lower overall effective levy rate than higher-income workers, however this introduces inequities.

For employers, experience rating would result in a levy rate that reflects their unique experience with regard to redundancies. We expect that this would be unlikely to drive behavioural changes except for perhaps the largest employers.

In considering these options, it is important to weigh their expected benefits against the costs of administration. For example, it may be simpler to set employer rates by industry rather than by experience rating, saving administration costs while having a similar effect.

Regardless of the levy framework selected, the experience of the scheme should be closely monitored and assessments made on appropriate ways to address cross-subsidies between levy-payers.

Questions 91 to 92: Levies would adjust smoothly over time, with independent fund management

The scheme is proposed to be funded by a levy on wages and salaries, payable by workers and employers. A dedicated levy, as opposed to funding via general taxation, will show that the scheme's finances operate at an arm's length from the rest of the government. Establishing a separate fund for the scheme is important, as it provides transparency of the income and costs of the scheme. We would expect there to be one levy for the scheme, and that the insurer would show the breakdown of this levy by component, i.e., redundancy and health/disability.

While it is expected that levies collected each year will be sufficient to fund the scheme in the long run, it is prudent to allow for the possibility of funding directly from the government in extraordinary circumstances.

The consultation document discusses two approaches to managing funds and levies:

- Pay as you go (PAYGO)
- Save as you go (SAYGO)

Under a PAYGO approach, scheme funding requirements are likely to be more volatile as they will vary with the economic cycle. For example, more funding would be needed during a recession as this is when more claims are likely to be filed and higher payments are expected to be made. This approach implies that levy rates would need to increase at times of economic contraction. This would not be ideal, as it would place further strain on levy-payers.

A SAYGO approach would imply greater stability in levy rates from year to year. This would have the benefit of providing more certainty to levy payers. It would also result in a reserve fund for the scheme, which would need to be managed in a similar manner to ACC and EQC.