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GOVERNMENT NOTICES

Authorities/Other Agencies of State

Report in Relation to Rates of Levies Prescribed in the Accident Compensation (Work Account Levies) Regulations 2016 and the Accident Compensation (Earners' Levy) Regulations 2016

Sections 331(5A) and 331(5B) of the Accident Compensation Act 2001 ("Act") require the Accident Compensation Corporation (ACC) to prepare a report in relation to the rates of levies prescribed in regulations in accordance with generally accepted practice within the insurance sector in New Zealand.

This report relates to the Work and Earners' Accounts and their respective levies for the year from 1 April 2016. It provides information about the expected long-term impacts of the 2016/17 levy rates for those Accounts and describes long-term projections of each Account's finances along with key assumptions on which the projections are based. Appendices A and B provide more information about the projections and assumptions.[1]

The average levy rates discussed in this report are shown in Figure 1.

Figure 1: Average levy rates for 2016/17 for the Work and Earners' Accounts

Work Account Average levy rate per $100 of liable earnings (excl. GST)	Earners' Account Average levy rate per $100 of liable earnings (excl. GST)
$0.80	$1.21

The Accident Compensation Scheme

ACC is a Crown agent providing comprehensive, no-fault personal injury cover to all New Zealand residents and visitors to New Zealand.

ACC cover is managed under five separate Accounts including the Work Account and the Earners' Account. ACC collects levies to fund both these Accounts.

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

The **Earners' Account** covers claims for non-work personal injuries for employed persons (including self-employed) not including motor vehicle injuries. The Earners' Levy is a flat rate paid by all employees and self-employed on their liable earnings up to a defined maximum. The Earners' Levy is expressed as a rate per $100 of liable earnings.

The Levy Setting Process

ACC reviews the expected costs of the levied Accounts to determine the levy rates required to meet the lifetime cost of claims in the upcoming period, along with funding adjustments to move each Account towards its funding target. The ACC Board ("Board") undertakes public consultation before recommending levy rates to the Minister for ACC.[2] Cabinet sets the levy rates for the forthcoming levy period after considering the Board's recommendations, along with the public interest as required by section 300 of the Act.

Work and Earners' Accounts' levies are set by regulation under the authority of sections 167, 218, 219, 244, 329 and 333 of the Act. Regulations for the forthcoming levy period will come into force on 1 April 2016.

Principles of Financial Responsibility in Relation to the Levied Accounts

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

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

These objectives result in a trade-off between funding stability and levy stability. The Board's funding policy (outlined below) specifies how these objectives are to be balanced.[3]

The ACC Board's Funding Policy

The Board's funding policy identifies the following requirements:

- Levies will be based on new year costs with an adjustment to return or collect any surplus or deficit in the Accounts.
- Accounts will aim to hold assets between 100% and 110% of liabilities and target a funding ratio of 105% over a ten-year horizon.
- The annual average levy increase for any Account must not exceed 15%.

The Board's funding policy is consistent with the principles in section 166A of the Act.

The levies recommended to the Minister by the Board for 2016/17, as well as those indicated for subsequent out-years, for both the Work Account and the Earners' Account were consistent with the Board's funding policy.

Assumptions Underlying the Levy Rate Recommendations for the Work and Earners' Accounts

The 2016/17 levy rates consulted on and recommended by the Board to the Minister were determined based on the following:

- The claims experience continuing in line with trends as at 31 March 2015;
- estimates of future investment returns given current and expected future market conditions as at 31 March 2015; and
- risk-free interest rates developing as implied by the New Zealand Government bond yield curve at 31 March 2015.

See Appendix C for an explanation of these terms.

Conditions, and particularly economic conditions, underlying ACC's assumptions are volatile. There has been significant movement in economic factors since the assumptions were set. Overall, the funding ratios for both Accounts are currently higher than was forecast at 31 March 2015. The actual and expected funding ratios are shown in Figure 2 below.

Figure 2: Work and Earners' Accounts—expected and actual funding ratios

	Funding ratio (31 December 2015 as projected at 31 March 2015)	**Actual funding ratio (31 December 2015)**
Work Account	115%	120%
Earners' Account	124%	130%

All else being equal, these higher funding ratios would be expected to reduce future levy requirements. However, the levy and funding ratio paths shown in Figures 3 and 4 below are based on the calculations used for levy consultation purposes. ACC will take all new information into account when calculating levy rates for the next levy consultation. The assumptions underlying the levy and funding ratio paths are reasonable.

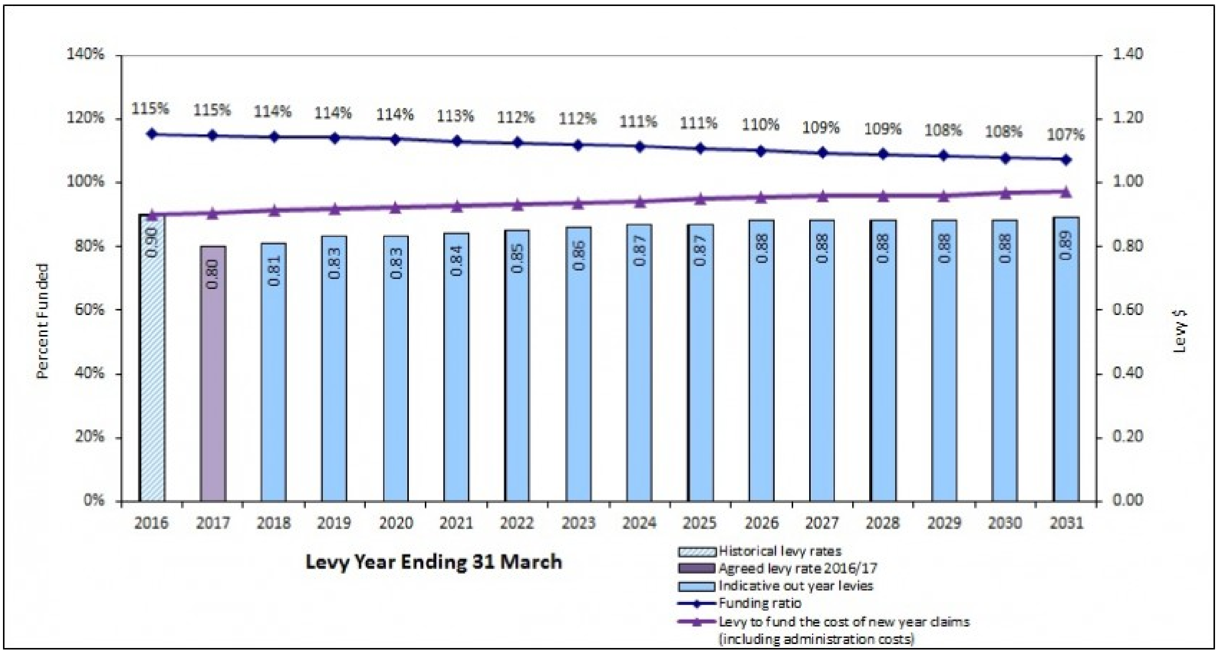
A. The Work Account

Prescribed Work Account Levy Rates for the 2016/17 Levy Year (1 April 2016 to 31 March 2017)

Following public consultation, the Board recommended that the government reduce the Work Account average levy by 11%, from $0.90 to $0.80 (excl. GST) per $100 liable earnings for the 2016/17 levy year. The recommended rates, as well as the indicative out-year levy rates in the Board's consultation, were consistent with the Board's funding policy. Cabinet agreed to the rates recommended by the Board, and the rates have now been prescribed in the Accident Compensation (Work Account Levies) Regulations 2016.

Levy rates have been set at a level intended to gradually move the Work Account's funding ratio towards the funding target. This amounts to setting levies below new year costs so as to incur a deficit of $8 million for the levy year and maintain the funding ratio at 115% by the levy year ending 31 March 2017.

Figure 3: Average Work Account levy rate and funding ratios recommended by the ACC Board and prescribed in the Accident Compensation (Work Account Levies) Regulations 2016



On 31 March 2016, the residual levy portion of Work Account levies will cease. This change will affect various groups of levy payers differently. More information about the residual portion can be found in Appendix C.

B. The Earners' Account

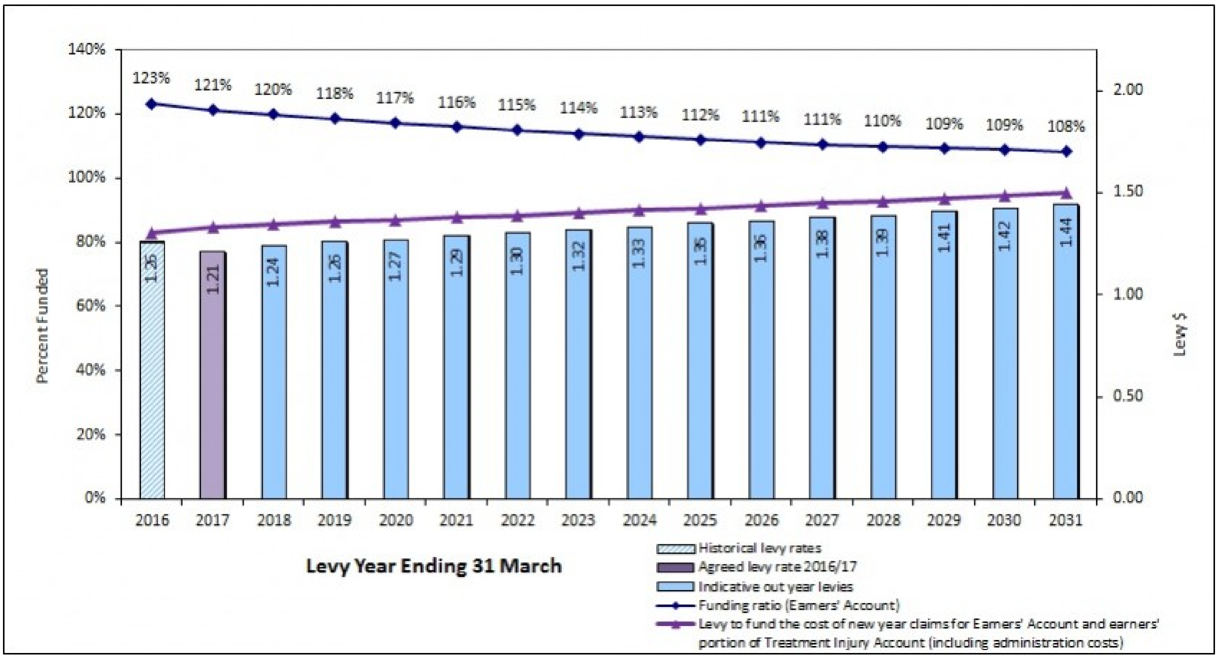
Prescribed Earners' Account Levy for the 2016/17 Levy Year (1 April 2016 to 31 March 2017)

Following public consultation, the Board recommended that the government reduce the Earners' Account levy by 4%, from $1.26 to $1.21 (excl. GST) per $100 liable earnings for the 2016/17 levy year. Cabinet agreed to the rate recommended by the Board, and the rate has now been prescribed in the Accident Compensation (Earners' Levy) Regulations 2016.

The recommended rate, as well as the indicative out-year levy rates in the Board's consultation, were consistent with the Board's funding policy.

The levy rate of $1.21 has been set at a level intended to gradually move the Earners' Account's funding ratio towards the funding target. This amounts to setting levies below new year costs so as to incur a deficit of $54 million for the levy year and reduce the funding ratio from 123% to 121% by the levy year ending 31 March 2017.

Figure 4: Earners' Account levy and funding ratios recommended by the ACC Board and prescribed in the Accident Compensation (Earners' Levy) Regulations 2016



Conclusion

The levy rates recommended by the Board to the Minister for ACC, and which were agreed by Cabinet, are consistent with the Board's funding policy and the principles of financial responsibility in the Act.

HERWIG RAUBAL, bec, fnzsa, fiaa, Chief Risk and Actuarial Officer, Accident Compensation Corporation.

1. Additional information can be found in the Work and Earners' Accounts 2016/17 Pricing Reports for Consultation, which are available on request from ACC.

2. ACC's levy consultation website is www.shapeyouracc.co.nz. Consultation relating to the 2016/17 levy period took place between 1 and 30 October 2015.

3. As of 24 September 2015, the government has responsibility for the funding policy to which ACC must give effect when making levy recommendations (see section 166B of the Act). This funding policy must be consistent with, and explain how it is consistent with, the financial responsibility principles in section 166A. The 2016/17 levy consultation process started before this change took effect and, therefore, the Board's funding policy applied.

Appendix A: Work Account

Work Account Long-Term Projections

							Levy year end			
Year ending 31 March	**Levy rates excl. GST ($ per $100 liable earnings)**	**Levy ($m)**	**Lifetime cost of new year claims ($m)**	**Administration costs for new year claims ($m)**	**Levy required to fund lifetime cost of new year claims ($ per $100 liable earnings)**	**Levy required to fund administration costs ($ per $100 liable earnings)**	**Accrued assets ($m)**	**OCL ($m)**	**Account balances ($m)**	**Funding ratio**
2015/16	0.90	822	583	248	0.63	0.27	8,336	7,237	1,099	115%
2016/17	0.80	690	615	259	0.64	0.27	8,487	7,396	1,091	115%
2017/18	0.81	727	645	272	0.64	0.27	8,650	7,562	1,088	114%
2018/19	0.83	775	675	285	0.65	0.27	8,828	7,738	1,090	114%
2019/20	0.83	805	705	295	0.65	0.27	9,011	7,932	1,079	114%
2020/21	0.84	844	736	305	0.65	0.27	9,211	8,147	1,064	113%
2021/22	0.85	884	771	316	0.66	0.27	9,420	8,374	1,046	112%
2022/23	0.86	926	805	326	0.67	0.27	9,637	8,611	1,026	112%
2023/24	0.87	970	841	336	0.67	0.27	9,867	8,859	1,008	111%
2024/25	0.87	1,004	878	347	0.68	0.27	10,104	9,125	979	111%
2025/26	0.88	1,051	916	358	0.69	0.27	10,361	9,409	952	110%

2026/27	0.88	1,087	956	369	0.69	0.27	10,628	9,710	918	109%
2027/28	0.88	1,124	990	380	0.69	0.27	10,905	10,014	891	109%

The table above presents the projected levy and funding path after applying the Board's funding policy. The table below summarises the key assumptions underlying these projections.

Work Account Key Assumptions

		Growth in average claim cost					
Year ending 31 March	**Claim numbers (entitlement claims)**	**Standard inflation (Labour Cost Index (LCI))**	**Superimposed inflation (growth in cost in addition to LCI)**	**Exposure (number of workers not in AEP)**	**Exposure (liable earnings) ($b)**	**Investment return forecasts (June year)**	**Risk-free interest rates (June year)**
2015/16	21,628	1.9%	1.5%	2,056,419	93	4.9%	3.2%
2016/17	22,058	1.9%	1.5%	2,097,297	96	4.9%	3.0%
2017/18	22,399	1.9%	1.3%	2,129,687	100	4.9%	3.0%
2018/19	22,669	1.9%	1.4%	2,155,403	105	4.9%	3.2%
2019/20	22,911	1.9%	1.5%	2,178,367	109	4.9%	3.3%
2020/21	23,146	1.9%	1.5%	2,200,755	112	4.9%	3.4%
2021/22	23,380	1.9%	1.7%	2,222,966	116	4.9%	3.5%
2022/23	23,610	1.9%	1.5%	2,244,859	121	4.9%	3.5%
2023/24	23,840	1.9%	1.5%	2,266,719	125	4.9%	3.6%
2024/25	24,066	1.9%	1.5%	2,288,167	129	4.9%	3.6%
2025/26	24,288	1.9%	1.5%	2,309,272	134	4.9%	3.6%
2026/27	24,494	1.9%	1.5%	2,328,911	138	4.9%	3.6%
2027/28	24,553	2.0%	1.4%	2,334,481	143	4.9%	3.7%

The following table compares the components of the 2016/17 prescribed average levy rate with those applied in 2015/16. The 2015/16 components are shown both as applied to set the levy rate in 2014 and as applied to set the levy rate for 2016/17.

Trend in underlying costs Levy excl. GST per $100 liable earnings	**Initial 2015/16 (last year's assessment)**	**Current 2015/16 (this year's assessment)**	**Prescribed 2016/17**
Work Levy:			
To fund the cost of new claims during the new levy year	$0.57	$0.63	$0.64
To fund administration costs	$0.26	$0.27	$0.27
Funding adjustment	-$0.25	-$0.31	-$0.11
Current levy portion	**$0.59**	**$0.59**	**$0.80**
Residual levy portion	$0.31	$0.31	$0.00
Total average Work Levy rate	**$0.90**	**$0.90**	**$0.80**

The current estimate of claim costs for 2015/16 has increased reflecting higher volumes of new claims than anticipated. In addition, projections for claim durations have been increased to reflect recent trends in rehabilitation performance. 2016/17 claim costs are projected to increase compared with the current 2015/16 estimate because of medical and rehabilitation cost inflation (above the Labour Cost Index (LCI)).

The total average Work Account levy rate for 2016/17 includes a negative funding adjustment. While the total average Work Account levy collected in 2015/16 is sufficient to fund new year claims, a funding adjustment of -$0.11 for 2016/17 is required to move the Work Account towards its funding target.

Appendix B: Earners' Account

Earners' Account Long-term Projections

	Earners' Account and the earners' portion of Treatment Injury Account						Earners' Account only (levy year end)			
Year ending 31 March	**Levy rates excl. GST ($ per $100 liable earnings)**	**Levy ($m)**	**Lifetime cost of new year claims ($m)**	**Administration costs for new year claims ($m)**	**Levy required to fund lifetime cost of new year claims (per $100 liable earnings)**	**Levy required to fund administration costs (per $100 liable earnings)**	**Accrued assets ($m)**	**OCL ($m)**	**Account balances ($m)**	**Funding ratio**
2015/16	1.26	1,477	1,298	233	1.10	0.20	8,510	6,905	1,605	123%

2016/17	1.21	1,479	1,389	243	1.13	0.20	8,845	7,294	1,551	121%
2017/18	1.24	1,579	1,466	254	1.15	0.20	9,195	7,679	1,516	120%
2018/19	1.26	1,669	1,538	265	1.16	0.20	9,557	8,068	1,489	118%
2019/20	1.27	1,747	1,610	273	1.17	0.20	9,927	8,470	1,456	117%
2020/21	1.29	1,839	1,685	282	1.18	0.20	10,320	8,891	1,429	116%
2021/22	1.30	1,919	1,765	291	1.19	0.20	10,722	9,331	1,391	115%
2022/23	1.32	2,018	1,846	300	1.20	0.20	11,151	9,791	1,361	114%
2023/24	1.33	2,104	1,931	309	1.22	0.19	11,587	10,264	1,323	113%
2024/25	1.35	2,211	2,020	318	1.23	0.19	12,050	10,755	1,295	112%
2025/26	1.36	2,305	2,112	327	1.24	0.19	12,525	11,265	1,261	111%
2026/27	1.38	2,419	2,208	337	1.26	0.19	13,032	11,790	1,242	111%
2027/28	1.39	2,520	2,309	341	1.27	0.19	13,551	12,334	1,216	110%

The table above presents the projected levy and funding path after applying the Board's funding policy. The table below summarises the key assumptions underlying these projections.

Earners' Account Key Assumptions

		Growth in average claim cost					
Year ending 31 March	**Claim numbers (entitlement claims)**	**Standard inflation (LCI)**	**Superimposed inflation (growth in cost in addition to LCI)**	**Exposure (number of earners)**	**Exposure (liable earnings) ($b)**	**Investment return forecasts (June year)**	**Risk-free interest rates (June year)**
2015/16	52,134	1.9%	1.9%	2,401,088	118	5.0%	3.2%
2016/17	53,722	1.9%	1.9%	2,449,642	123	5.0%	3.0%
2017/18	55,036	1.9%	1.1%	2,487,512	128	5.0%	3.0%
2018/19	55,787	1.9%	1.6%	2,518,167	133	5.0%	3.2%
2019/20	56,349	1.9%	1.7%	2,545,242	138	5.0%	3.3%
2020/21	56,914	1.9%	1.6%	2,570,773	143	5.0%	3.4%
2021/22	57,464	1.9%	1.7%	2,595,615	148	5.0%	3.5%
2022/23	58,004	1.9%	1.7%	2,620,005	153	5.0%	3.5%
2023/24	58,542	1.9%	1.7%	2,644,332	159	5.0%	3.6%
2024/25	59,071	1.9%	1.7%	2,668,205	164	5.0%	3.6%
2025/26	59,590	1.9%	1.7%	2,691,652	170	5.0%	3.6%
2026/27	60,074	1.9%	1.8%	2,713,511	176	5.0%	3.6%
2027/28	60,525	2.0%	1.8%	2,733,886	182	5.0%	3.7%

The following table compares the components of the 2016/17 prescribed levy rate with those applied in 2015/16. The 2015/16 components are shown both as applied to set the levy rate in 2014 and as applied to set the levy rate for 2016/17.

Trend in underlying costs Levy excl. GST per $100 liable earnings	**Initial 2015/16 (last year's assessment)**	**Current 2015/16 (this year's assessment)**	**Prescribed 2016/17**
Earners' portion only:			
To fund the cost of new claims during the new levy year	$0.97	$1.01	$1.04
To fund administration costs	$0.18	$0.18	$0.18
Funding adjustment	-$0.05	-$0.10	-$0.11
Earners' portion of Treatment Injury:			
To fund the cost of new claims during the new levy year and administration costs	$0.09	$0.11	$0.11
Funding adjustment	$0.03	$0.02	-$0.01
Current levy portion	**$1.22**	**$1.22**	**$1.21**
Residual levy portion – Earners' only	$0.02	$0.02	$0.00
Residual levy portion – Treatment Injury	$0.01	$0.01	$0.00
Total Earners' Levy rate	**$1.26**	**$1.26**	**$1.21**

The current estimate of claim costs for 2015/16 has increased, reflecting higher volumes of new claims than anticipated. In addition, projections for claim durations have been increased to reflect recent trends in rehabilitation performance. 2016/17 claim costs are projected to increase compared with the current 2015/16 estimate because of medical and rehabilitation cost inflation (above the Labour Cost Index (LCI)). Allowance has also been made for a projected increase in claim numbers above population growth.

Appendix C: Explanatory Notes

Funding adjustment

Adjustments to levy rates, which are used to move the funding ratio of an Account towards the funding target. The impact of funding adjustments is that levy rates will be higher or lower than the level needed to fund the cost of new year claims (including administration costs).

Funding ratio

The funding ratio is the ratio of each Account's assets to liabilities. It is a measure of whether the Accounts have sufficient assets to meet the outstanding claims liability. Solvency is another term for funding ratio.

The liability for incurred but not reported work-related gradual process disease and infection claims is included when calculating the Work Account funding ratio.

Funding target

ACC's funding target is a funding ratio of 105%. This is the midpoint of the funding band of 100% to 110%.

Investment returns

The expected returns are based on current strategic asset allocations and are consistent with ACC's long-term expected returns for the various asset classes that make up the total investment reserves. They allow for ACC's tax status.

Labour Cost Index (LCI)

The Labour Cost Index measures changes in salary and wage rates for a fixed quantity and quality of labour input.

Residual levy (or residual portion)

Until the 2016/17 levy year, the Earners', Work and Motor Vehicle Levies each consisted of two parts:

- A current portion; and
- a residual portion.

The purpose of the residual levy was to fund the ongoing costs of claims that occurred before 1 July 1999 when the Scheme was funded on a pay-as-you-go basis. Under pay-as-you-go, levies were sufficient to cover only the annual expenditure on injuries.

The government has decided to cease collecting the residual levy from 1 April 2016 for the Work and Earners' Accounts and from 1 July 2016 for the Motor Vehicle Account. This will avoid any future levy inequity between Accredited Employer Programme (AEP) and non-AEP employers, and make clearer the link between the Work Account levy and the underlying costs of new work claims for all businesses.

Discontinuing residual levies will change the distribution of Work Account levies across businesses.[4]

Risk-free interest rates

The risk-free interest rate is the theoretical rate of return of an investment with zero risk. It represents the nominal return an investor would expect from an absolutely risk-free investment over a given period of time.

4. More information can be found at www.shapeyouracc.co.nz/documents/.

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