New Zealand Gazette

FRIDAY, 22 APRIL 2016 — No. 35

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The *New Zealand Gazette*, the official newspaper of the Government of New Zealand, is published online on Thursdays between 10.00am and 11.00am.

The online version is the official publication and authoritative constitutional record.

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Notices for publication and related correspondence should be addressed to
New Zealand Gazette
Department of Internal Affairs
PO Box 805
Wellington 6140
Telephone: (04) 462 0313 / (04) 462 0312
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GOVERNMENT NOTICES

Authorities/Other Agencies of State

Report in Relation to Rates of Levies Prescribed in the Accident Compensation (Motor Vehicle Account Levies) 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 Motor Vehicle Account and its levies for the year from 1 July 2016 as prescribed in the Accident Compensation (Motor Vehicle Account Levies) Regulations 2016 ("Regulations"). It provides information about the expected long-term impacts of the 2016/17 levy rates for that Account and describes long-term projections of its finances along with key assumptions on which the projections are based. Appendix A provides more information about the projections and assumptions. Additional information can be found in the Motor Vehicle Account 2016/17 Pricing Report for Consultation, which is available on request from ACC.

Unless otherwise stated, all rates in this report are expressed exclusive of GST.

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, and ACC collects levies to fund three of these: the Motor Vehicle, Work and Earners' Accounts.

The Motor Vehicle Account

The Motor Vehicle Account covers claims for all injuries that happen on public roads involving moving motor vehicles.

The average Motor Vehicle levy is the rate that all vehicle owners would pay if ACC charged a flat levy rate. The actual rate a vehicle owner pays differs from the average rate depending on their vehicle's type.

For petrol-driven vehicles, vehicle owners pay their levy through:

- a levy collected as part of the motor vehicle licensing fee (or "registration"); and
- a levy on the petrol they buy.

For non-petrol-driven vehicles, owners pay their whole levy through their registration. The levy component of the vehicle licence fee is higher for non-petrol-driven vehicles by an amount equivalent to the average petrol levy. The Regulations also prescribe a Motorcycle Safety Levy (MSL) payable in respect of motorcycles and mopeds. The Motorcycle Safety Advisory Council oversees the MSL fund, which is used to fund initiatives to improve the safety of motorcyclists.

The Levy-setting Process

Motor Vehicle Account levies are set by regulation under the authority of sections 213, 244, 329 and 333 of the Act.

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. 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.

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. Further public consultation on differential rates reflecting risk for light passenger vehicles took place between 14 December 2015 and 29 January 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.

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.

The 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 reported liabilities ("funding band") and target a funding ratio of 105% over a ten-year horizon.
- The annual average levy increase for the Motor Vehicle Account must not exceed 15% above the Labour Cost Index (LCI).

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

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

Assumptions Underlying the Levy Rate Recommendations for the Motor Vehicle Account

The 2016/17 levy rates consulted on and recommended by the Board to the Minister for ACC 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 B 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 ratio for the Account is currently higher than was forecast at 31 March 2015. The expected and actual funding ratios are shown in Figure 1 below.

Figure 1: Motor Vehicle Account—expected and actual funding ratios

Funding ratio (31 December 2015 as projected at 31 March 2015)	**Actual funding ratio (31 December 2015)**
104%	116%

All else being equal, this higher funding ratio would be expected to reduce future levy requirements. However, the levy and funding ratio paths shown in Figure 2 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.

Prescribed Motor Vehicle Account levy rates for the 2016/17 levy year (1 July 2016 to 30 June 2017)

Following public consultation, the Board recommended that the government reduce the Motor Vehicle Account average levy by 33%, from $194.25 to $130.26 (excluding the MSL) 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 (Motor Vehicle Account Levies) Regulations 2016.

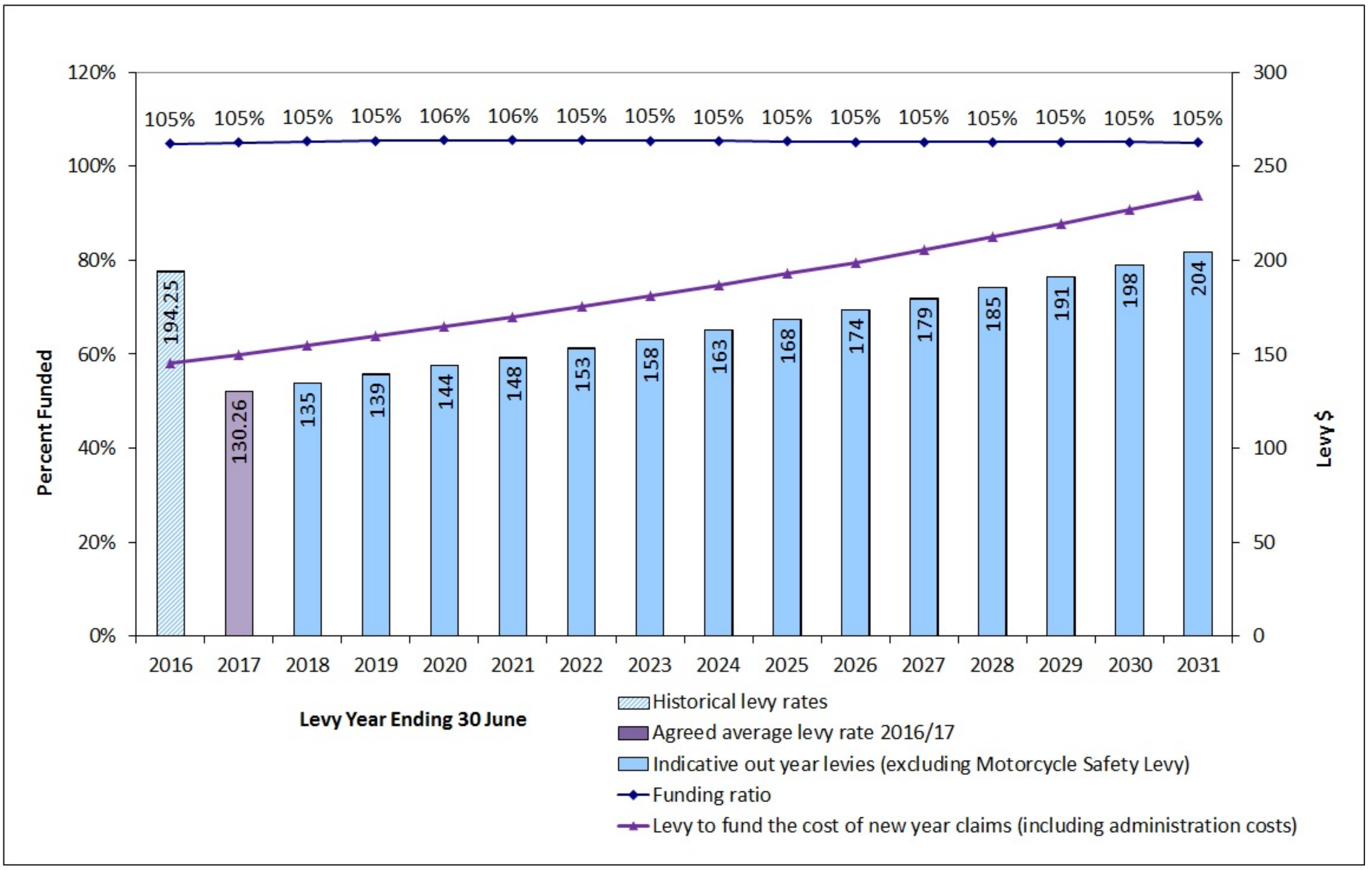
The 2015/16 levy rates included a positive funding adjustment to move the Account to its funding target. The funding target has now been reached so levy rates for 2016/17 can be reduced.

The new levy rates are projected to result in a surplus of $38 million for 2016/17, and maintain the funding ratio of 105% at year end.

The petrol levy component of the levy rate has been maintained at 6.9 cents per litre for the 2016/17 levy year.

The MSL has been reduced from $30 to $25 for the 2016/17 levy year.

Figure 2: Average Motor Vehicle Account levy rate and funding ratios recommended by the ACC Board and prescribed in the Accident Compensation (Motor Vehicle Account Levies) Regulations 2016



On 31 March 2016, the residual levy portion of Motor Vehicle Account levies will cease. This will not affect the amounts people pay in motor vehicle levies. More information about the residual portion can be found in Appendix B.

Conclusion

The levy rates recommended by the Board to the Minister for ACC, and which were agreed to 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.

Appendix A: Motor Vehicle Account

Motor Vehicle Account Long-Term Projections

							Levy year end			
Year ending 30 June	**Average levy rates (excluding MSL*)**	**Levy ($m)**	**Lifetime cost of new year claims ($m)**	**Administration costs for new year claims ($m)**	**Levy required to fund lifetime cost of new year claims ($ average per vehicle)**	**Levy required to fund administration costs ($ average per vehicle)**	**Accrued assets ($m)**	**OCL** ($m)**	**Account balances ($m)**	**Funding ratio**
2015/16	194.25	652	432	55	128.55	16.48	9,905	9,452	453	105%
2016/17	130.26	443	452	58	132.88	17.07	10,279	9,788	491	105%
2017/18	134.64	463	472	61	137.17	17.65	10,667	10,134	533	105%
2018/19	139.23	485	493	63	141.68	18.24	11,063	10,494	569	105%
2019/20	143.81	507	516	65	146.40	18.58	11,477	10,877	600	106%
2020/21	147.99	528	538	68	150.93	18.99	11,906	11,282	624	106%
2021/22	152.99	552	563	70	156.10	19.35	12,353	11,709	644	105%
2022/23	157.98	577	589	72	161.25	19.72	12,818	12,156	662	105%
2023/24	162.91	602	616	74	166.65	20.09	13,295	12,616	678	105%
2024/25	168.33	630	644	77	172.25	20.48	13,794	13,100	694	105%
2025/26	173.62	657	674	79	178.07	20.87	14,315	13,604	711	105%
2026/27	179.49	688	706	82	184.15	21.28	14,860	14,126	734	105%
2027/28	185.19	718	739	84	190.51	21.71	15,429	14,671	757	105%

*Motorcycle Safety Levy

**Outstanding Claims Liability

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.

Motor Vehicle Account Key Assumptions

		Growth in average claim cost				
Year ending 30 June	**Claim numbers (entitlement claims)**	**Standard inflation (LCI*)**	**Superimposed inflation (growth in cost in addition to LCI*)**	**Exposure (number of vehicles (000))**	**Investment return forecasts (June year)**	**Risk-free interest rates (June year)**
2015/16	5,995	1.9%	1.3%	3,358	5.0%	3.2%
2016/17	6,075	1.9%	1.3%	3,398	5.0%	3.0%
2017/18	6,149	1.9%	1.3%	3,440	5.0%	3.0%
2018/19	6,223	1.9%	1.4%	3,481	5.0%	3.2%
2019/20	6,298	1.9%	1.4%	3,523	5.0%	3.3%
2020/21	6,374	1.9%	1.2%	3,566	5.0%	3.4%
2021/22	6,451	1.9%	1.5%	3,609	5.0%	3.5%
2022/23	6,529	1.9%	1.4%	3,652	5.0%	3.5%
2023/24	6,607	1.9%	1.4%	3,696	5.0%	3.6%
2024/25	6,687	1.9%	1.4%	3,741	5.0%	3.6%
2025/26	6,768	1.9%	1.5%	3,786	5.0%	3.6%
2026/27	6,849	1.9%	1.5%	3,832	5.0%	3.6%
2027/28	6,932	2.0%	1.5%	3,878	5.0%	3.7%

*Labour Cost Index

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 average levy per vehicle	**Initial 2015/16 (last year's assessment)**	**Current 2015/16 (this year's assessment)**	**Prescribed 2016/17**
Motor Vehicle levy:			
To fund the cost of new claims during the new levy year	$120.02	$128.55	$132.88

Trend in underlying costs average levy per vehicle	Initial 2015/16 (last year's assessment)	Current 2015/16 (this year's assessment)	Prescribed 2016/17
Motor Vehicle levy:			
To fund administration costs	$19.37	$16.48	$17.07
Funding adjustment	-$3.44	-$9.08	-$19.69
Current levy portion	**$135.95**	**$135.95**	**$130.26**
Residual levy portion	$58.30	$58.30	$0.00
Total average motor vehicle levy rate	**$194.25**	**$194.25**	**$130.26**

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 LCI.

The total average Motor Vehicle Account levy rate for 2016/17 includes a funding adjustment of -$19.69 to maintain the Motor Vehicle Account at its funding target.

Appendix B: 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 target funding ratio is 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

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

New Year Claims

Claims that occur during a new levy year. New year claims costs are the estimated lifetime cost of those claims.

Outstanding Claims Liability

The Outstanding Claims Liability (OCL) is an actuarial estimate of net present value of all future costs for accidents that have already happened including an allowance for claims incurred but not reported, and re-opened claims.

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 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 not affect the amounts people pay in motor vehicle levies. More information can be found at

www.shapeyouracc.co.nz/documents/

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.

2016-au2285

PUBLISHED BY THE
DEPARTMENT OF INTERNAL AFFAIRS
PRINTED BY BLUE STAR GROUP

newzealand.govt.nz

INTERNAL AFFAIRS
Te Tari Taiwhenua

ISSN 0111-5650 (PRINT)
ISSN 1177-8415 (ONLINE)