THE FUTURE OF ACC

• UNIVERSITY OF AUCKLAND BUSINESS SCHOOL

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• Privatisation of the Work Account
The Stocktake recommended:

• Work, Earners and Motor Vehicle Accounts be opened up to private insurers

• No role for ACC as a competitor.

The government is consulting on:

• Private insurance in the Work Account only

• ACC to remain a competitor and to be the default insurer.
## Context: ACC in the wider insurance market
($ mill per annum: 2009)

<table>
<thead>
<tr>
<th>Type of cover</th>
<th>Premiums</th>
<th>ACC comparator</th>
<th>Levies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial, Marine and Earthquake</td>
<td>770</td>
<td>Work Account</td>
<td>540</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Residual Claims (work injuries)</td>
<td>496</td>
</tr>
<tr>
<td>Health, Disability and Income Replacement</td>
<td>1,100</td>
<td>Earners’ Account</td>
<td>1,112</td>
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<tr>
<td>Motor vehicles</td>
<td>1,250</td>
<td>Motor Vehicle Account</td>
<td>346</td>
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<td></td>
<td></td>
<td>Motor Vehicle residual levy</td>
<td>393</td>
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<tr>
<td>Domestic</td>
<td>790</td>
<td>Non-earners Account</td>
<td>982</td>
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<tr>
<td>Liability and Professional indemnity</td>
<td>280</td>
<td>Treatment Injury Account</td>
<td>315</td>
</tr>
<tr>
<td>Other general insurance</td>
<td>320</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,510</strong></td>
<td><strong>Total (including residual levies)</strong></td>
<td><strong>4,183</strong></td>
</tr>
</tbody>
</table>
For any market to work, we need participants in it:

• to know the rules of the game that they are going to have to play by (regulatory certainty)

• have some pricing margin within which to construct competitive price and quality product offerings.

Neither condition applies in the market for workplace accident insurance
UNCERTAINTIES IN THE REGULATORY STRUCTURE

• When, if and to what degree residual claims shortfalls will emerge, and how the costs of meeting them will be shared between insurers.

• How gradual process injuries will be paid for, especially if the original accident was with another employer or if the employer was with another insurer when it occurred.

• The basis on which the costs of public health and emergency transport services will be allocated across insurers.

• The nature of the special prudential regulatory regime that will apply to the insurance of personal injury.

• The cost of the administration and regulatory regimes and how they will be recovered.

• If, when and to what extent insurers will need to contribute to meeting the claims against failed insurers.
“Unknown unknowns”

• Almost by definition this list cannot exist, but even government officials note (in the Regulatory Impact Statement that accompanied the Cabinet Paper that

  “it is possible that there are potential impacts or risks that have not been identified or adequately considered.”

• Two possible unknowns are:

• whether there will be capacity and appetite within the global reinsurance market to reinsure risks of catastrophic events; and

• what sort of risk margin will need to be built into premiums to satisfy investors that there is adequate protection for their capital.
• Pricing discretion exists:

**below** the levy rate that ACC charges employers; and

**above** the relative returns required to pay taxes due and earn an acceptable return on capital invested.
Competitive margin has to fall below

• Ability to self-insure through Accredited Employer Programme

• In theory, employers should be able to match what a private insurer can offer by way of price through AEP, so there is no margin for a private insurer to undercut. Despite that, participation in the AEP has been declining by about six percent a year for the last four years, which on the surface suggests that ACC levies are close to what is achievable in a competitive market.

• Introduction (since April 2011) of compulsory experience rating of premiums

• Can qualify employers for discounts of up to 50 percent of standard industry levies. Experience rating should mimic private competitive premiums if both prices (ACC and private insurers’) are efficient. It is hard to see a private competitor beating the industry average by more than 50 percent, for non AEP participants, and make a return on any investment in this market.

• ACC is consulting on reducing levies by another 22 percent on average in the 2012/2013 levy year. Any perceived pricing margin is about to get a haircut!
Competitive margin has to be above

• As a Crown Agent ACC does not need to pay taxes or return a dividend to the Crown.

• However it is customised insurer, and cannot bundle work accident insurance with other insurance products.

• Government officials estimate that the tax and dividend needs of private insurers to equate to around 20 – 26 percent of premium charged.

• The advantages of being able to offer bundled products would need to be greater than 20 percent to offset the pricing advantage of a Crown Agent.

• That is simply not plausible.
ADVICE THE GOVERNMENT RECEIVED

• “there is a high degree of uncertainty regarding the magnitude of both the costs and benefits (and in some cases even the sign – whether they will have a net positive or negative impact…” and

• “better pricing signals to employers can be achieved through experience rating and self-insurance arrangements”.

• “the minimum mandated cover requirement – which is necessary to protect the rights of claimants and the liability of the Crown – means that we may not be able to capture all the benefits of a truly competitive insurance market”. (Treasury)

• Is this code for if “we” (identity not established) want to capture all the benefits of a truly competitive insurance market (not specified) then minimum mandated cover requirements need to be reduced (even if in turn that means weaker protections of the rights of claimants and the liability of the Crown)!
SO WHY IS THIS OPTION STILL ALIVE?

Three speculative reasons:

• The government’s election manifesto said it would look at this option, and it is simply doing that. If it doesn’t stack up, it won’t go anywhere. No conspiracy!

• If the current proposal doesn’t deliver positive results, structural changes to make private insurance might be needed. These could include reducing the entitlement of injured workers, converting ACC into a SoE so that it would have to earn a return on capital and pay tax and dividends, and/or taking ACC out of the market. If this is the scenario, “set up to fail” looks possible, but it is not really credible. The changes needed to make the market work would raise levies, so it seems the cure is worse than the disease.

• If insurance in the work account can’t work, the alternative would be to go the whole way with the Stocktake: throw the Earners and Motor Vehicle accounts into the pot and take ACC out of the market. This is the “prize” of a “set up to fail” scenario.

• My preference is always for process failure over conspiracy to explain bizarre policy pathways, but maybe I am naive.