

IAG Submission

Increasing choice in workplace accident compensation: Discussion document on options for extending the accredited employers programme and introducing choice in the ACC Work Account

15 July 2011

Introduction

This submission is a response by IAG New Zealand Limited (“IAG”) to the Department of Labour’s (“Department”) recently released document *‘Increasing choice in workplace accident compensation: Discussion document on options for extending the accredited employers programme and introducing choice is the ACC Work Account’*.

IAG welcomes the opportunity to build on the dialog it has had to date with the Department by setting out our views on the proposals. We start with comments on the general thrust of the proposals and our overall response to them. After that we provide answers to the specific questions posed by the discussion document.

IAG has contributed to and supports the submissions made by the Insurance Council of New Zealand (ICNZ) and Business New Zealand. Naturally the views expressed in those submissions reflect the broad memberships of the organisations and, as such, may vary from those set out in this document.

We would be happy to discuss with Department officials any of the points we raise.

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About IAG New Zealand Limited

IAG New Zealand Limited (IAG NZ) trades under the Lantern, NZI and State insurance brands and underwrites general insurance for some of the country’s leading financial institutions (including ASB, BNZ and PSIS). IAG NZ is New Zealand’s largest general insurer, with a 34% share of the insurance market, managing 2.6 million policies of 1.1 million New Zealanders. IAG NZ is a wholly owned subsidiary of Insurance Australia Group (IAG), Australasia’s largest general insurer.

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Overall Comments

The Government's stated aims for the proposed changes to ACC are to reduce the number of injuries and to manage treatment, rehabilitation and compensation as effectively and efficiently as possible. IAG wholeheartedly supports these aims and in fact plays an active role in accident compensation across Australian jurisdictions. However IAG can only participate if it makes commercial sense and it is an effective use of its capital.

The importance of incentives

The proposals do not focus enough on improving health, safety and rehabilitation outcomes.

The success of any accident compensation scheme requires getting the incentives right - the incentives for employers to improve their health and safety outcomes and to take responsibility for the rehabilitation of their injured workers, the incentives for the insurance provider to improve the efficiency and effectiveness of its services, and the incentives for the medical profession to support a wellness approach in improving health outcomes following injury.

For these incentives to be successful in changing New Zealand's health and safety outcomes, they must recognise and stimulate the important contributions needed from employers, employees, medical professionals, the injured themselves, and the insurance provider.

The Government proposes using greater risk sharing with business and insurers to create these incentives. In this, it is the prospect of commercial gains that incentivise employers; the reality of market forces that incentivise the ACC.

Regrettably, the proposals focus on making ACC 'shape up', not necessarily (or primarily) on improving health and safety outcomes. The proposals are limited in relation to employers and largely silent in relation to medical professionals, employees and the injured – fuelling the (sometimes ill-informed and ideologically driven) concerns from stakeholders.

Insufficient incentive

The proposals may not create the commercial incentive for IAG to participate

The limitations of the proposals notwithstanding, the Government has, to its credit, recognised the ideologically-charged nature of ACC reform and sought to ensure the sustainability of its proposals. Unfortunately in striking its balance between competing ideologies we believe the Government has gone too far for some and not far enough for others

Critically the Government may have fallen short in establishing the incentives needed to drive change and sustain ACC's performance over the long term. In particular it is not clear how the recommended changes help to drive employer choice of insurer (ACC or private) or incentivise employers to take responsibility for employees' health, safety and rehabilitation.

As an outcome, additional employers may seek to join an extended AEP. With the proposed design of competition, it is uncertain however, if insurers will look to enter the market for work-place accident insurance.

Introducing Choice

The introduction of choice aims to improve the effectiveness and efficiency of treatment, rehabilitation and compensation through the pressure of competition. In doing so the Government has sought to create a market sufficient to drive improvement in ACC; not to create a market per se. While IAG understands the reasons for this, we believe a full competitive market will deliver beneficial outcomes that a weak market or, more importantly, a monopoly provider cannot.

An unattractive market

The proposals create an unattractive market.

Sadly the proposals put forward in the discussion document create a relatively unattractive market and reduce the likelihood that sufficient competitive pressure will be created. The reasons for this are well known and have been the subject of many discussions between IAG and Government. Simply, the proposed 'playing field' is uneven. The continued participation of ACC with no requirement for profit or a return on capital creates a daunting competitor, but not one that can't be competed with.

Changes that would help level the playing field unhappily reduce the already questionable sustainability of the proposals and therefore are likely to receive a poor hearing from Government. Those proposals that are less formed, while important to the sound functioning of the market, are mostly peripheral to its economics (e.g. regulation, audits, etc).

An 'opt-in' approach would ensure considered choice by employers and stimulate true competition.

Requiring employers to 'opt in' is seen by many as an important leveller with employers being required to make an active consideration of their insurance provider. We note that the Government is seeking to introduce choice, not require it, hence the opt-out approach being taken. Of course IAG would have preferred the bolder 'opt-in' approach, as this would ensure considered choice by employers and stimulate true competition – quickly creating the market forces the Government desires. While this could reduce the proposals' sustainability, it would quickly create a meaningful evidence base to inform the ongoing participation of private insurers in workplace accident insurance.

Claim data is vital for insurers to decide whether to participate

Lacking a level playing field, insurers need a degree of certainty if they are to invest in a workplace accident insurance market. The absence of a political consensus on ACC limits the market to either one or two election cycles. The continued lack of data means insurers can't determine if an acceptable margin can be achieved or if they can compete at all. Both these factors add considerable uncertainty to a highly challenging market and make raising the capital needed to participate considerably more difficult.

Competition for capital

Naturally a potential workplace accident insurance market must compete for capital internationally. Insurers and reinsurers will look for the best sustainable return for their capital. If they can't obtain a satisfactory return on capital over the long term they will invest new (and quite possibly existing) capital outside of New Zealand.

At present given the points outlined it is uncertain if the proposed market can provide the necessary return. It will only be with the release of claims data by ACC that a firm decision either way is likely. We strongly urge the Government to make the release of claim data a priority, so that all would-be participants can make informed decisions and either seek the necessary capital to support market participation or avoid the unnecessary cost and disruption of continued uncertainty.

Even then the proposed market will compete against other local, regional and international options for capital. New Zealand is making a considerable demand on insurers and reinsurers through the continued support of the Canterbury region. The Reserve Bank is also proposing a non-life solvency standard that requires general insurers to hold capital locally to sustain a 1:1000 year earthquake. As a result reinsurers' view of the South Pacific has considerably altered and is impacting reinsurance capacity and affordability across all risk categories – not just natural disasters.

The Government cannot therefore consider a workplace accident insurance market in isolation of the New Zealand and global insurance markets. Care and attention is needed in seeking the Government's aims so that unintended consequences do not arise - including the potential for reduced insurance capacity, reduced competition and increased underinsurance and un-insurance. Witness the difficulties councils have experienced obtaining cover for building and infrastructure.

A lost opportunity?

Strict investment models will shape insurers decisions on participation.

We understand that insurer comments on the uncertainty of market entry may be seen as 'bluster' by some stakeholders. When the Government seeks to use private insurers' balance sheets to force operational improvement within the ACC, well run insurers will apply strict investment models to assess the attractiveness of that opportunity. Sadly the Government has fallen short in making that opportunity financially appealing; with recent levy changes accentuating the issue.

The Government has put at risk a key tool in ensuring that the ACC's operational performance and accounts do not deteriorate in the future. It may also have lost an opportunity to redirect a portion of its balance sheet to support investments needed for economic growth.

IAG's natural instinct is to participate. At this stage it is uncertain that we will. We could only make a firm decision once claim data is available to complete the financial modelling.

Extending the Accredited Employers Programme

IAG supports business taking on greater ownership of their risks and making informed decisions about how those risks are managed. A sound understanding of a risk's likelihood and impact allows business to decide how best to do this; through prevention, mitigation, transfer or acceptance.

The incentives however, must be in place; simply, the ability to reduce the impact of workplace injury on the business. The AEP provides this incentive to improve workplace injury outcomes by sheeting home the direct cost of claims to the business. Therefore IAG favours the principles of the programme.

Uncertain benefits

Increased risk sharing with business may bring diminishing returns.

Analysis of the AEP¹ for the ACC Stocktake Report concluded that participants achieved, by some measures, better outcomes than non-participants. By other measures the performance was reversed. We recognise that this naturally fosters debate amongst stakeholders about the report and its conclusions – generally divided along ideological lines. That debate notwithstanding, the programme is clearly important to and valued by existing participants and provides benefits that full participation in the ACC scheme does not.

In the absence of conclusive evidence on the outcomes achieved by existing participants, it is unclear whether broader participation in the programme - much of which could be at lower levels of risk sharing, will lead to commensurate improvements in outcomes for those businesses. Designed correctly it should, and to that end IAG supports the core elements of the proposed extension.

We note however, that introducing choice to the workers account raises the possibility of alternative risk sharing arrangements between private insurers (and indeed ACC) and employers. These may supersede the current AEP proposals and, importantly, may prove more attractive to employers. This does of course depend of insurer participation. Given the uncertainty about this, it seems premature to discount the possible extension of the scheme. IAG recommends that Government should wait to see what emerges in 2012.

Cautionary notes

Extension of the AEP carries the risk of negative impacts on costs and rehabilitation outcomes.

In considering the proposals a number of concerns and cautionary notes emerge:

- We doubt whether insurers will find the provision of stop loss or high cost cover an attractive commercial opportunity. As this is about insuring the tail, with a potentially limited book of business across which to spread this risk, private insurers' pricing would be considerably outside that of the ACC. An absence of private participation in the AEP however, need not deter the Government in providing the wider range of options to employers.
- We urge caution in the opening of the AEP to a broader set of participants. While the opening of the scheme – and with it a greater sharing of risk, is instinctively attractive, care is needed to ensure that participants have the financial strength and governance to meet their ongoing rehabilitation, compensation, and return work obligations to injured workers.
- There are known issues for providers with claim lodgement and processing of invoices under the current AEP scheme. This raises the potential for increased administration and compliance costs in an extended AEP scheme.

¹ 'Review of Employer-managed Workplace Injury Claims', Melville Jessop Weaver and Martin Jenkins, June 2010

- We caution the Government in the relaxation of 'red tape' in the form of audits and reviews, insofar as it may result in weaker practices and poorer outcomes over the long-term.

Additional matters

Insurance brokers will feature in the proposed workplace market. They will advise employers on the best insurer / workplace product; advocate for the employer and injured worker; and provide support to health, safety and rehabilitation programmes. This will be in return for a fee or commission on the business placed. In this way brokers could play an important role in fostering choice and improving outcomes.

Broking commission will be an additional cost borne by private insurers and by the ACC. Officials need to investigate mechanisms to regulate commission rates to minimise the potential for increased cost to the scheme. The ICNZ has addressed this point in detail as part of its submission. IAG believes that a commission rate of 3-4 % would be both appropriate and broadly consistent with other jurisdictions and that applied in 1999.

Specific Discussion Points

Extending the accredited employers programme

Greater range of risk sharing arrangements

2.2.1 *Do you agree that there should be a greater range of claims management periods?* **Yes**

Yes. In principle, businesses that meet the requirements associated with being granted longer (or shorter) claims management periods than currently available should have the choice to do so. This, on the assumption that it will lead to greater participation in the AEP and therefore broaden and deepen the benefits that current AEP participants achieve. In practice, it is unclear what demand exists for this proposed change - the discussion document is silent on this, and therefore what value it represents to the country.

Do you agree that the claims management period should be measured from the date of injury, rather than from the end of the current levy year? **Yes**

Yes. Measuring the claims management period from the date of injury is a truer reflection of the claims history.

2.2.2 *Do you agree that there should be more flexibility in the purchase of high cost claims cover and stop loss cover?* **Yes**

Yes. Greater availability of high cost and stop loss cover at differing levels will allow business to better match their cover to their in-house capability and risk appetite. This is central to improved ownership of risk.

2.2.3 *Do you agree that employers should be able to purchase high cost claims and stop loss cover from an approved third party?* **Yes**

Yes. In principle, insurers that are fully licensed by the Reserve Bank under the Insurance Prudential Supervision Act 2010 should be able to provide high cost claims and stop loss cover. It is unlikely however, that an insurer would see this as a commercially attractive market to enter. This business would be high risk and difficult to price competitively against the ACC.

2.2.4 *Do you agree that an employer's claims history should be taken into account when setting PDP levies?* **Yes**

Yes. The introduction of experience rating into the Work Account requires this change in order to maintain the attractiveness of the AEP to employers. The use of experience rating provides a truer reflection of an individual business and therefore is a fairer way to set levies.

Further, by understanding their claims history, employers can identify opportunities to improve risk management, health and safety, and ultimately the frequency and cost of workplace incidents.

2.2.5 *Do you agree that ACC should be required to take over management of any claim at the employers request and cost?* **No**

No. There are two points to make; one for and one against. First, allowing accredited employers to participate in relation to certain claims types and not others would support increased risk decision making by businesses, the administrative and operational practicalities notwithstanding.

Second, a blanket ability to pass to ACC, claims that are 'too hard' does not ensure participating employers meet their moral obligations. The current system, which allows ACC to refuse, should remain, with the criteria for refusal made clear and transparent with the well being of the employee and the return to work outcome as critical parameters.

2.2.6 *Do you agree that in the Full Self Cover option, there should be a choice of a full and final settlement?* **Yes**

Yes. This should be underpinned by a clear and, most importantly, agreed method for assessing future costs. Subject to an agreed method, the choice of settlement option should be at the discretion of the employer.

2.2.7 *Do you think that co-operatives, franchises or other groups should be able to enter the AEP?* **Yes**

Yes – with a strict proviso. The above business / legal structure should be able to participate in the AEP if they can demonstrate an equal ability to meet the obligations of participation (and manage the associated risks) as incorporated companies. IAG would support undertaking further work to understand if and how this could be done - on the presumption that there are potential participants that would warrant this investment.

Lower compliance costs

2.3.1 *Do you agree with the proposal to allow employers to use financial instruments or other forms of security as a means of meeting the AEP financial requirements?* **Yes**

Yes – with a strict proviso. The funding arrangements an AEP participant puts in place must be akin to that of an insurer. To ensure employees receive their full entitlements, participants must ensure sufficient resources are set aside to meet current and future liabilities. If financial instruments are ring fenced and provided in evidence of financial capacity, they must be acceptable to and be treated in accordance with the life solvency standard issued by the Reserve Bank of New Zealand – adjusted for the increased volatility in participants' 'books'.

2.3.2 *Do you agree with the proposals to streamline injury management practice audits?* **Yes**

Yes. Audits must adhere to a minimum standard, but could be tailored to industry types. They should address a combination of outcome and process factors to support a reduction in workplace risk and injury. They should be 'risk rated', with the nature, extent and, if appropriate, frequency of the audit reflecting recent health and safety outcomes. Self-assessment should only be permitted in conjunction with a reporting regime that enables early intervention if employer systems and practices weaken and incidents rise.

2.3.3 *Should health and safety audits be voluntary?*

No

No. Health and safety audits should, as above, vary in their method, nature, extent and frequency to reflect an employer's recent health and safety outcomes. This could range from retention of the current practise for those with a poor record, through to a reporting and self assessment regime for those with exemplary records. Underpinning this must be a consistent minimum standard (based on both health, safety and rehabilitation processes and outcomes) and frequencies to ensure that employees are protected and not exposed to unnecessary risk.

Options for risk sharing outside the AEP

2.4.1 *Do you agree with offering a range of excess options outside the AEP?*

Yes

Yes. Employing an excess provides a number of benefits. It reduces the cost to the employer, on the assumption that they will seek to improve the incident rate assumed by the ACC when setting levies for their industry and individual experience. The extent to which this can be achieved is questionable.

The question appears moot however, as providing ACC the 'flexibility' to compete (section 3.2.2) would enable ACC to introduce a range of excess options at will.

Introducing choice in the ACC Work Account

Facilitating Competition

3.1 *Do you agree that self-employed people should be able to purchase cover for both work-related and for non-work injuries from a private insurer?*

Yes

Yes. There are two elements to this question. First, given the practical difficulties in differentiating work and non-work injuries, the two types of cover should remain bundled if provided by private insurers. To split the two introduces increased risk of boundary disputes.

Second, private insurers should be able to provide work-and non-work cover to the self employed.

3.2 *Do you agree that transparency is necessary to facilitate a competitive environment?*

Yes

Yes. ACC will be the dominant player in any prospective market for workplace injury cover, with a marked cost advantage and the pooling benefit of a large book of business. Prospective competitors need ongoing assurance that this position will not be abused through inappropriate cost allocation.

Do you agree that flexibility is necessary to facilitate a competitive environment?

Yes

Yes. Competition is the mechanism through which ACC will improve the outcomes it achieves. Without the ability to compete, the benefits sought will not materialise. In this the ACC should be free to set work account levies and to offer new risk sharing products. This freedom must however be balanced with commensurate improvements in oversight that achieve regulatory consistency with other prospective market participants.

Are these proposals adequate?

No

No. As noted above, the continued participation of ACC with no requirement for profit or a return on capital in a prospective workplace accident insurance market creates a daunting competitor, but not one that can't be competed against. Private insurers successfully compete today against not-for-profit / mutual entities in the health and general insurance markets

IAG expects to face strong competitors, some with distinct advantages. In a regulated market however, IAG also expects those competitors to be subject to the same regulatory standards and obligations.

Exempting the ACC participation in the workplace market from the prudential oversight of the RBNZ establishes a two-tier system – with no clarity of which set of rules best protects injured workers. What confidence in the market does that generate amongst employers, employees, clinicians, the injured and the insurers?

3.2.3 *For what purposes would you require claims data? What type and level of data access would be necessary and why?*

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Put simply we need access to claims data in order to decide if we want to participate in the proposed market for work-place cover (market feasibility and pricing). For an insurer to be ready by the proposed October 2012 date for market opening – or to simply avoid the ongoing cost of uncertain participation, detailed claims data is required now.

IAG supports the data requires set out in the attachment of the submission made by the Insurance Council of New Zealand.

Do you see any other issues with the proposals to collect and share data? If so how might they be addressed?

No

No - As long as individual claimant data is disguised subject to the requirements of the Privacy Act (1993) and Health Information Privacy Code (1994). There needs to be agreement by all parties about data definitions

Protecting workers' rights

3.3.1 *Is continuous cover assured by the proposals to have ACC cover all workers unless private insurance is in place, and a register of private insurance cover?*

Yes

Yes, however while continuous cover requires default arrangements, this does not need to be provided by ACC. We agree that a register would be the most logical way to monitoring compliance. The purpose and costs of the register must be tightly set and maintained.

3.3.2 *Do you agree that the risks and consequences of insurer insolvency are adequately managed by the proposed approach?* **No**

No. IAG strenuously objects to ACC remaining outside the prudential oversight of the RBNZ. A market's participants should all be subject to the same regulation and oversight.

Any prospective participant in a workplace accident insurance market will need to be licensed by the Reserve Bank of New Zealand (RBNZ) and therefore subject to its solvency, risk management and governance standards and the RBNZ's powers of oversight and intervention. The surprise and unmanaged insolvency of one insurer (and the harm that might cause to injured workers) is not the responsibility of its competitors; it is that of its prudential regulator.

Other parts of the insurance market do not require this type of arrangement – prudential regulation is deemed sufficient. There is no compelling reason why workplace accident insurance should demand a higher level of protection. Further, when the market fails and causes harm to an individual (be it financial, physical or mental) the Crown is the final 'back stop' through its health and social welfare programmes.

We note that the proposed approach was employed when the workers account was last subject to market. That was at a time when insurers were self regulating and could therefore be seen in some way as collectively responsible for the sound operation of the market and its participants. That is not the case now.

3.3.3 *Do you agree that the establishment of a market regulator would adequately protect workers rights and entitlements? If not, what additional practical steps could be taken?* **Yes**

Yes. We feel the proposed regulator arrangement would adequately protect workers. This mechanism must be independent of ACC in a competitive environment. Participants in the market should be party to agreeing the terms of reference for the regulator, and the costs and governance should be transparent and challengeable by contributing insurers.

3.3.4 *Do you agree with the proposal to provide for independent dispute resolution in alignment with existing frameworks?* **Yes**

Yes. We agree with the proposal to provide for independent dispute resolution and that the chosen schemes need to be approved to resolve work related personal injury disputes.

Interactions with the health sector

- 3.4.1** *Do you agree that a single, central claims lodgement process would be effective? What else might be done to streamline claims administration processes and reduce the risk of increased transaction costs for providers?* **Yes**

Yes. We agree in principal to a single, central claims lodgement process. However the role of this process should be limited to ensure the timely allocation of claims to the correct insurer. This should not interfere with early internal reporting of injury and intervention - a key correlating factor to effective return to work outcomes.

Any centralised lodgement must be independent of ACC and any other insurer, with governance arrangements agreed by all participants. Its primary purpose should be the correct allocation of claims, not to make cover decisions, payments or other claim related decisions.

Operating costs should be shared across all insurers according to the volume of claims, however given the proposed soft start there needs to be clarity around cost allocation of establishment.

Clarity is also required on the participation in the clearing house by AEP employers and how this affects possible funding models.

- 3.4.2** *Do you have any comment on how the cost of public health acute services could be fairly allocated?* -

Costs must be appropriately apportioned. There must be a fair and transparent allocation of costs across; health and injury related access to services; and work and non work access to services. This includes the fair and transparent pricing of services.

It would be preferable for costs to be allocated according to actual utilisation. A utilisation approach reflects improvements achieved by employers with safer workplaces and reduced accident rates. The current proposed levy allocation does not create the incentives to improve workplace safety or to reduce accidents but in fact creates perverse incentives for the increased use of ED and hospital services and potential for cost shifting.

We understand that there are coding quality issues which impact on the ability of DHBs to provide accurate data and therefore the reality that an allocation based on actual utilisation is not achievable in the short term unless this was agreed to be a priority for the health system.

In light of competing priorities and the various incentives across the participant Government agencies with regards to this levy, there is likely to be a lack of Government appetite to revisit a methodology in the future. Therefore it is imperative that the methodology design at the outset is transparent, robust and includes insurer participation. In particular, the allocation of costs and levies across the Work and non-Work accounts must be subjected to independent audit.

The soft start option being pursued by Government will create further complication in the fair allocation of costs and therefore favours a retrospective allocation methodology.

3.4.3 *Do you think that private insurers should be able to contract with treatment providers for alternatives to the minimum prices and conditions?* **Yes**

Yes. Private insurers must have the ability to contract outside of regulated prices and conditions.

3.4.4 *Do you agree with the proposed approach to managing gradual process claims?* **Yes**

Yes. Considerable additional work is required to determine how this would work, in particular establishing the protocols for determining costs and agreeing how the previous period of competition would be treated where insurers on sold claims liability to ACC.

Potential impacts of the proposed changes

4 *Do you have any comment on the impact of the proposed changes?* **-**

As stated above, IAG does not believe the proposals as outlined will create the incentives needed to achieve the hoped for improvements in workplace health, safety and rehabilitation outcomes.

Do you think the proposed risk mitigation and management measures would adequately address the risks? If not, do you have any suggestions for alternative ways to manage these risks? **-**

IAG has no further comments to make.
