

Meat Industry Association
of New Zealand (Inc)

Submission to the Accident
Compensation Corporation on

Proposed Levy Rates for 2005/06

16 September 2004

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TABLE OF CONTENTS

I.	INTRODUCTION	3
II.	SUMMARY OF SUBMISSIONS.....	3
III.	CLASSIFICATION UNIT (CU) 21110 – PROPOSED RATE FOR 2005/06	3
	Background to Meat Processing Levy.....	3
	Proposed Levies for 2005/06	4
	Levy Instability	4
	<i>Recommendation 1</i>	5
	Levy Rate	5
IV.	PARTNERSHIP PROGRAMME	7
	Administration Costs.....	7
	<i>Recommendation 2</i>	8
	Stop Loss Levy	8
	<i>Recommendation 3</i>	10

I. INTRODUCTION

1. This submission is made on behalf of the Meat Industry Association of New Zealand Incorporated ('MIA') in response to the ACC *Consultation Document on 2005/06 Levy Rates for Levies for Employers* ('the Proposal').
2. MIA is a trade association representing export sheep and beef processors and marketers. The Association represents virtually 100% of all beef and sheep processors/exporters in New Zealand.
3. This submission is mainly concerned with levy classification unit 21110 (meat processing) as the meat export industry is centred on the delivery of processed meat products.
4. In preparing this submission all members and affiliate members were consulted and asked for input. MIA members may make individual submissions reflecting concerns relating to their specific operations.
5. Figures quoted in the submission are based on those provided by ACC's *Information about Proposal 2005/06 ACC levy rates for Meat Processing* ('the Information Pack')

II. SUMMARY OF SUBMISSIONS

6. The MIA continues to be concerned with the dramatic annual increases in the CU 21110 employer levy. The MIA submits that the cap on annual increases is set too high, exposing meat processors to volatile employer levies. ACC acknowledges the desirability of levy stability, and the MIA submits that this objective would be better achieved through lowering the cap on annual increases from the 25% proposed.
7. The MIA submits that directly linking the costs of participation in the Partnership Programme to the CU 21110 employer levy creates significant and expensive inequities. The CU 21110 employer levy does not reflect the claims performance of Accredited Employers in CU 21110 as the levy is set relative to the claims performance of non-Partnership Programme employers. The result is that Accredited Employers in CU 21110 face unreasonably inflated administration costs, and are forced to purchase increasingly expensive Stop Loss cover that, because of the level at which the cover would take effect, has no real commercial value.

III. CLASSIFICATION UNIT (CU) 21110 – PROPOSED RATE FOR 2005/06

Background to Meat Processing Levy

8. The meat processing industry was traditionally been at the higher end of ACC employer levies and in 1996/97 the rate peaked at \$10.06 per \$100 liable earnings. Since then with a concerted effort in injury prevention and early rehabilitation the rate reduced dramatically so that prior to privatisation in July 1999 the employer account levies were at historical lows. That continued under the Accident Insurance Act 1998 where self-insurance emerged along with further targeted rehabilitation and injury prevention. With the resumption of ACC work cover in April 2000 there was, for a time, a continuation of historically low

levies. Over the last few years however, there has been significant and constant increases in levies payable under this account.

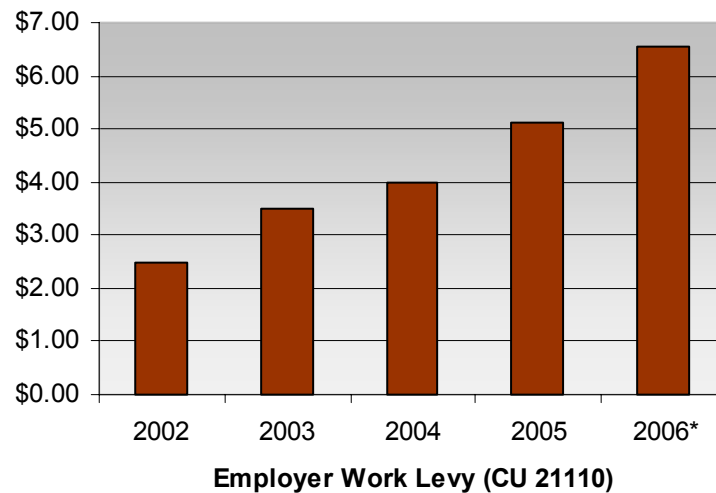
Proposed Levies for 2005/06

9. Under ACC's proposals for the 2005/06 levy year, the 'Meat Processing' Classification Unit (CU 2110) would rise by \$1.22c per \$100.00 payroll to \$6.55. This represents a 28% increase in employer work levy. When the proposed residual claims levy is factored in, the result is a 25% increase in the composite employer levy rate for CU2110 - from \$5.72 to \$7.16 per \$100 payroll.
10. Even taking into account the fact that 89% the industry's payroll is paid by Accredited Employers operating under ACC's Partnership Programme, the proposed increase will cost the industry almost \$1 million in additional employer work levies.

Levy Instability

11. This increase follows on from a trend of similar increase over the previous four years. The steady increase in the employer work levy payable by meat processors is clearly demonstrated below:

Figure 1: CU2110 Employer Levy Rate 2002-2006



* = Denotes proposed levy rate

12. Since 2002, the average annual increase in the CU 2110 employer work levy has been around 28%, and this would continue under the levy rates proposed for 2005/06. So although the rate at which the CU2110 employer work levy increases is relatively consistent, the levy itself is highly unstable and escalates significantly every 12 months.
13. At a time when ACC is proposing to retain a surplus in the interests of maintaining levy stability, the meat industry is increasingly concerned at the continued volatility of the CU2110 employer work levy. It is difficult, at best, for meat industry employers to continually budget for increases of this magnitude.

Recommendation 1

14. For this reason, while MIA supports maintaining a cap on annual levy increases, it recommends that the cap could be set at lower rate to provide for levy stability. The MIA notes that ACC quite explicitly recognises the desirability of levy stability both in the 'Principles and Rules' set out on pages 27 and 28 of the Proposal, and also, by clear implication, in the proposed application of the surplus from the 2003/04 levy year.

Levy Rate

15. As in previous years, the MIA questions the methodology used to set the CU21110 standard levy rate.

16. In February 2004, the MIA received, via the office of Hon Annette King, a document from ACC that responded to issues raised in the course of the MIA's submissions on proposed ACC levy rates for 2004/05. The document outlined the way in which ACC set levy rates generally, but also more specifically explained how the CU21110 standard work levy for 2004/05 came to be struck as it was. A copy of this information is attached.

17. Of particular interest to the MIA was the way in which ACC assesses 'Ultimate Claims Cost'. Apparently, ultimate claims cost is the sum of:

- (a) claim payments to date in respect of claims incurred in a given accident year;
- (b) estimated claims payments still to be made in respect of claims incurred in that year;
- (c) an allowance for 'incurred but not reported' claims; and
- (d) an allowance for claims the occurred in that year that are now closed but may re-open.

18. It is part (b) of this calculation that is of most interest to the MIA. Although the MIA does not have a breakdown of 'ultimate claims cost' into its various components (i.e., parts (a)-(d) above), one would logically assume that part (b) will make up the bulk of the difference between claims actually incurred to date and ultimate claims cost. The MIA would welcome a clarification of this point from ACC, however.

19. In the document provided by ACC to the MIA via Hon King's office, the following information was given as to the difference between claim costs to date in various accident years and the ultimate claim costs for that year:

Table 1: Claims Costs Incurred and Ultimate Claims Cost

	2000/01	2001/02	2002/03
Claim Costs to Date (as at Feb 2004)	\$1.69m	\$2.08m	\$1.38m
Ultimate Claim Costs	\$2.73m	\$3.44m	\$4.06m

20. Looking specifically at 2002/03, then, ACC was predicting that the ultimate claim costs that accident year would be approximately \$2.68m more than had already been paid by February 2004. In other words, as at February 2004, ACC predicted its liability for claims in that year would be around 300% greater than the value of claims it had already paid was expected. Again, the MIA can only assume that the bulk of this projected increase is attributable to the estimate of claims still to be made in respect of known claims that were incurred in the 2002/03 accident year.

21. This assumes then, that the still active claims from the 2002/03 accident year pose a significant contingent liability. MIA members though this appeared to be at odds with the general claims profile experienced by the meat processing industry generally, which is essentially one of high frequency:low claims cost.
22. As part of the preparation of this submission, then, the MIA sought information from ACC as to the number of long-term claimants still 'on the books'. A copy of the information provided by ACC in response is also attached. What this information shows is that, as at 1 September 2004, there were between 55 and 61¹ claimants whose claim was incurred in the 2002/03 year.
23. MIA appreciates that the projected ultimate claims cost referred to above was made at February 2004, while the figures relating to long-term claimants date from September 2004 – a fact which means that the two set of figures are not directly comparable. Particularly, some of the \$2.68m projected as the future cost of claims in February 2004 will have been paid out between February and September. Similarly, this \$2.68 million still also includes the allowances made for IBNR claims and 'temporarily' closed claims. Roughly speaking, however, the MIA presumes that once these matters are taken into account it would not be unreasonable to assume the projected future cost of claims as at 1 September 2004 would be somewhere in the region of \$1.5m - \$2m. Again, the MIA would gratefully accept a clarification on this point from ACC.
24. The following table, taken from the 'long-term claimant' information provided by ACC, shows how the number of long-term claimants reduces over time:

Table 2: Currently Active 'Long Term' Claimants

Accident Year	Claims Incurred²	Currently Active Claims³
2003/04	488	198-200
2002/03	529	55-61
2001/02	647	32-38
2000/01	604	16-24

25. What Table 2 shows that one could reasonably expect the number of claimants will continue to tail off over time at a reasonably steady rate. In this context, predicting the future cost of claims for the 55-61 currently active 2002/03 claimants as being in the region of \$1.5 - \$2m, would certainly appear to assume a worst case scenario. MIA submits that assuming such a worst case scenario (while, incidentally, maintaining a 15% prudential margin to protect against worst case scenarios) would have the effect of inflating the ultimate claims cost. As this forms the basis of the cost of claims, and the cost of claims is in turn the major driver behind the setting of levy rates, the MIA queries whether inflated estimates of ultimate claims cost are resulting in an inflated CU21110 standard work levy.

¹ ACC could not provide the exact figure due to confidentiality concerns.

² Figures quoted taken from the Information Pack

³ ACC could not provide the exact figures due to confidentiality concerns.

IV. PARTNERSHIP PROGRAMME

26. This section of the MIA submission addresses concerns raised by MIA members who are currently involved in ACC's Partnership Programme. These Members generally operate under the Full Self Cover plan, and accordingly the following is most relevant to that aspect of the Partnership Programme.
27. As noted above, the great majority of the payroll of the meat processing industry (around 89%) is paid by employers that are within the Partnership Programme. A matter of significant concern to these employers is the continual increase in the costs of participation in the Partnership Programme.
28. As the CU 21110 standard levy rate increases, so too do the cost of participation in the Partnership Programme – simply because these costs are set with reference to the standard levy rate. In the case of the meat processing industry, however, this creates a significant inequity as the standard levy is set relative to the performance of a minority of the industry (on a total payroll basis) that operate outside of the Partnership Programme. Two specific areas of concern are discussed below.

Administration Costs

29. Administration costs for participating in the Partnership Programme are set at 2% of the standard levy the participating employer would otherwise pay. The assumption underlying the linking of administration costs to standard levies appears to be that the rate at which the standard levy is set will in some way directly relate to ACC's costs of administering the Partnership Programme. To address this assumption, one must first look at the factors that influence the standard levy rate.
30. Page 10 of the Information Pack states that the biggest part of CU21110 is for covering cost of claims. As shown in page 16 of the Proposal, the amount needed to cover the cost of claims is calculated with reference to four matters: average cost of claims; number of claims; earnings of employees; interest rate change.
31. The MIA submits that the average cost of claims, number of claims, earnings of employees and interest rate change bear no relevance to the administrative costs of the Partnership Programme. Rather than reflecting costs to ACC, they are directly relevant only to the costs faced by Accredited Employers as a result of assuming responsibility for dealing with work injury claims. On this basis alone, it is difficult to see the justification for linking administration costs to the standard CU 21110 levy rate.
32. One possible justification that has been advanced by ACC is that employer groupings that would ordinarily be subject to a higher levy rate are more likely to make use of programmes or services that ACC puts in place to assist Partnership Programme employers. The MIA does not accept this proposition, however.
33. For the CU 21110 standard levy to be relevant under this argument, the level of ACC assistance received by CU 21110 Accredited Employers would have to be seven times the level of assistance received by an average Accredited Employer (i.e., one subject to the average employer work levy). The experience of MIA members is that this is simply not the case. Yet CU 21110 Accredited Employers are required to pay administration costs based on a standard levy that is over seven times the average employer work levy. The MIA submits, therefore, that standard levy is not a reliable predictor of the level of assistance CU 21110 Accredited Employers will receive from ACC under the Partnership Programme.

34. On the basis of the above, the MIA submits that it is inequitable to simply assume that standard levy payable is directly relevant to the costs of administering the Partnership Programme for CU21110 Accredited Employers. None of the factor that dictate the striking of employer work levy (average cost of claims; number of claims; earnings of employees; interest rate change) are directly relevant to administration costs. Further, Accredited Employers paying administration costs based on a high standard levy rate do not receive extra assistance as part of the Partnership Programme at a level commensurate with the additional costs they face.
35. What exacerbates the situation for CU 21110 Accredited Employers is that, as noted above, the standard levy is set by reference to the minority of employers (by total payroll) captured by the classification unit. The costs of the majority of the industry (by payroll) are dictated by the performance of the minority, which is, in the MIA's view, plainly inequitable.
36. The MIA submits, therefore, that CU 21110 should not directly dictate the administration costs payable by Partnership Programme employers as there is no logical link between the two. Assuming such a link it imposing costs based on the performance of irrelevant parties (i.e., non-Partnership Programme employers), which is not only unfair, but also fails to properly reward Partnership Programme employers for their commitment to reducing the incidence of work-place injury.

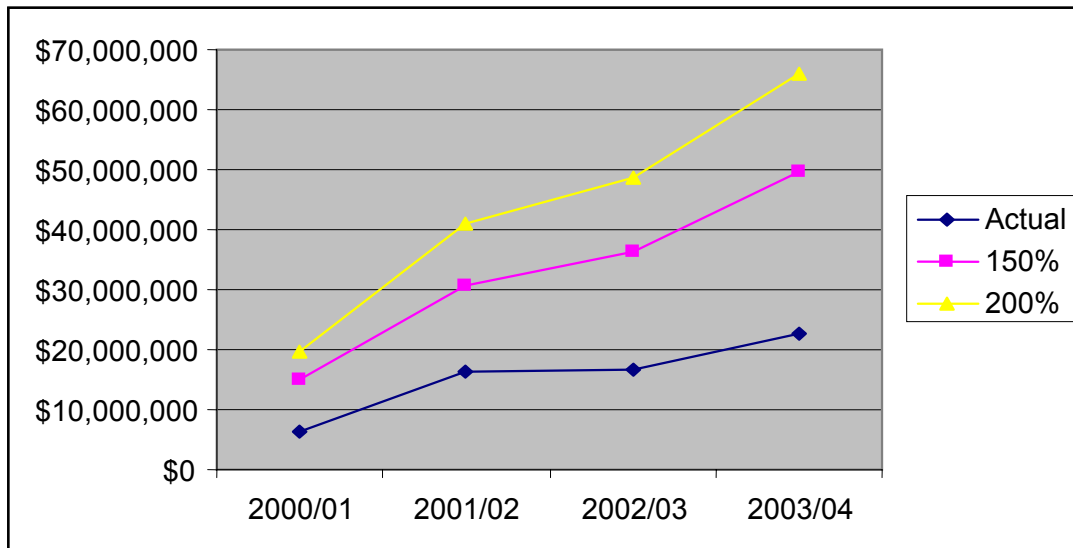
Recommendation 2

37. The MIA submits that a much more equitable approach would be to recover administration costs as a flat rate on a per Accredited Employer basis. Alternatively MIA suggests that basing an administration fee on the average employer work levy, would also be a more equitable approach than that contained in the Proposal.

Stop Loss Levy

38. A second significant way in which CU 21110 inflates the cost of Partnership Programme employers relates to the 'Stop Loss Cover'. Accredited Employers in the Full Self Cover plan are required to purchase insurance to prevent claims costs exceeding either 150% or 200% of what they would have otherwise paid in standard levy.
39. However, the likelihood that Stop Loss cover would be triggered for a CU21110 Accredited Employer is actually quite remote. To illustrate, the aggregate standard CU21110 levy payable by Partnership Programme employers in 2003/04 would have been around \$33 million. Therefore, assuming a uniform spread of claim costs across relevant employers, the aggregate cost of claims would need to reach almost \$50 million before 150% Stop Loss Cover took effect. However, the actual cost of claims in 2003/04 was \$22.64 million. In other words, the cost of claims would have needed to more than double before 150% Stop Loss Cover would take effect. Before 200% Stop Loss Cover would kick in, the cost of claims would have had to have tripled.
40. This situation is not an anomaly. The following graph shows the combined actual costs of claims of CU21110 Partnership Programme employers over four years. It also shows both 150% and 200% of what the combined CU21110 standard work levy would have been for those employers in those years:

Figure 2: Actual claims cost compared to 150% and 200% of standard levy



41. What the above shows is that, as a group, CU21110 Accredited Employers are forced to significantly over-insure. As the CU 21110 standard levy continues to rise (due to the claims performance of non-Partnership Programme employers) a gulf is opening between the actual cost of claims and the point at which stop loss insurance would take effect.
42. This is all the more concerning when one considers the claims profile for the meat processing industry. This profile is essentially one of relatively high claim frequency, but a relatively low average claim cost. Such a profile is not prone to dramatic fluctuation, which ACC itself recognises when it assesses the industry as one in which there is a low chance of significant variations in claims cost (refer page 121 of the Proposal).
43. The net result of the above is that chances of reaching the thresholds are so remote that Stop Loss cover is basically irrelevant. In an open, competitive insurance market, few (if any) employers would choose 150% or 200% Stop Loss cover because it is so unlikely to the cost of claims would ever meet either threshold. In short, the chances of the insured risk occurring are so slight that it makes no commercial sense to insure against that risk.
44. To provide some context to this issue, one MIA member has offered the following account of its actual experience. In 1997, the member purchased insurance for accident claims liability. The member paid a \$35,000 premium for the policy, which indemnified the member against all accident compensation liability in excess of \$2.5 million. The member had estimated its accident compensation liability for that year at \$1.5 million.
45. In 2005/06, however, that member would be required to pay \$119,210 for 150% Stop Loss cover that would only protect the company in the event that its claim liability reached \$12,772,500. Such a figure which represents approximately 48% of the entire industry's claims liability for the 2003/04 year. The chances of the company's claims liability reaching \$12,772,500 are so slight, then, that the member cannot see a commercial justification to pay the premium of \$119,210 – although it would have to pay the premium nonetheless.

46. As with administration costs, the underlying reason behind why the protection afforded by Stop Loss cover is ineffective is because the 150% and 200% thresholds are linked to the CU 21110 standard levy. The thresholds are set relative to the claims experience of a group other than the group being insured, with the result being that the thresholds are not relevant to the insured group. What is more, because the cost of Stop Loss cover is also linked to the CU 21110 standard work levy, the cost of the cover continues to increase as the relevance of the cover decreases.

Recommendation 3

47. The MIA submits, therefore, that Accredited Employers should have the opportunity to purchase or negotiate stop loss insurance cover that bears some relevance to the realistic potential cost of claims. Accredited employers should have a genuine choice as to the level of risk that they are willing to accept, and have access to meaningful insurance against those risks that they are unwilling to take.