NEW ZEALAND BUSINESS ROUNDTABLE

SUBMISSION ON THE ACCIDENT INSURANCE BILL

OCTOBER 1998

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1 Overview and Recommendations

Overview

1.1 This submission on the Accident Insurance Bill (the Bill) is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand firms. The organisation's purpose is to contribute to the development of sound public policies which reflect overall New Zealand interests.

1.2 The NZBR welcomes the key reform set out in the Bill. Opening up the Employers' Account to competition is a step in the direction that the NZBR has advocated since 1987.

1.3 Competition has a critical role to play in forcing suppliers to identify and satisfy customer needs at least cost, and in price discovery. Conferring a statutory monopoly on the Accident Compensation Scheme (the ACS) was an error of disastrous proportions. That decision made it impossible to give the provider a clear, meaningful, single objective, such as a profit objective. It perpetuated Crown ownership of a politicised provider with multiple, conflicting objectives and eliminated the possibility of any mechanism for price discovery while massively weakening incentives to discover customer preferences. Another major mistake was the suppression of freedom of choice in relation to critical features of accident cover.

1.4 But the measures in the Bill also contain flaws in respect of competition, ownership and freedom of choice. Much greater benefits for New Zealanders could be gained from more far-reaching reform than is contained in the Bill. The NZBR will shortly be publishing a detailed, independent analysis of these issues which will be made available to members of the Select Committee. In the NZBR's view, all other accounts should be opened to competition, the government should not own any provider of insurance, and

individuals should be permitted to choose any terms they desire for any insurance contracts they wish to purchase. The ARCIC should be wound up and any related activities not privatised should be absorbed within the Department of Labour. In due course, there should also be a re-examination of liability (right to sue) issues, which are independent of choices made about insurance market arrangements.

1.5 Current restrictions on choice appear to be severe. Where they do not exist, as in the provision of private income replacement insurance, some people obviously prefer to insure against loss of earnings from accidents *or sickness*. Such policies remove all the related boundary issues that bedevil the ACS. Similarly, the policies sold demonstrate that many people do not require compensation at 80 percent of earnings or many other premium-increasing options that are mandated under the ACS. Consumer welfare can only be reduced when people are forced to buy features that do not represent, in their view, value for money.

1.6 Reflecting the findings of this analysis, this submission focuses on identifying areas in which the Select Committee could recommend modifications that would enhance competitive pressures and usefully reduce costs or improve incentives and choice, while preserving the main intentions of the Bill. For example, it may be possible to increase the scope for employers to opt out of the mandatory level of cover prescribed in the Bill, perhaps with the agreement of all the employees of the firm. Alternatively, if maintaining the current level of cover is seen as important for transitional reasons, greater gains in consumer welfare may be achievable by amendments that increase future pressures to remove restrictions on choice and competition that are currently intended to be transitional.

1.7 In our view, optimal tax arguments favour financing the unfunded liability associated with the ACS out of general taxation. From an efficiency perspective, the proposed variable levy on employers is a particularly inefficient, distortionary payroll tax. Proposals for any new tax should be subject to the disciplines of the government's Generic Tax Policy Process and

this procedure has not been followed. Contrary to popular beliefs, the ultimate burden of a payroll tax does not fall on employers. In a competitive market place, the payroll-tax-inclusive cost of labour must be related to the productivity of the marginal worker. Since the tax cannot, by itself, improve the productivity of a given worker, it must tend to depress all workers' wages so that the total cost of the marginal worker continues to reflect that person's productivity. Where the tax reduces employment because some workers withhold their labour at the lower wage, gross wages may not fall by the full amount of the tax. In this case the burden of the tax will be likely to be ultimately met by consumers through higher product prices and by pre-existing employees through reduced wages and higher unemployment.

1.8 The Treasury argument that a risk-related payroll tax is efficient if it improves incentives to rehabilitate those who account for the outstanding liability is also flawed. First, if the government were serious about improving incentives to manage the tail, it would privatise this activity. This reform could be expected to be most efficacious in terms of that objective. Secondly, failing this reform it could, as owner, directly improve this aspect of the ARCIC's performance by requiring better contracting arrangements. Until recently it has failed to require the ARCIC to pay due attention to the rehabilitation objective. Thirdly, if, as manager of the tail, it wished to motivate employers to help with the rehabilitation of injured workers, it would do so on a commercial marginal benefit/marginal cost basis. No coercion would be required. For example, it might offer to pay employers who assisted in the rehabilitation of a specific injured worker an amount that reflected the employer's marginal cost and the marginal benefit to the manager in the form of the reduction in the scheme's liability to the injured worker. Such incentive arrangements would look very different from the proposed payroll tax and be much more efficient. As owner of the tail, the government could and should instruct the manager to devise incentives to employers that are commercially structured and reflect this balancing of costs and benefits.

1.9 In similar vein, the government should privatise the commercial government insurer as soon as private insurers are established in the market for workplace accident insurance. There is no justification for the continued presence of a government-owned insurer in the market, other than possibly as a transitional measure.

1.10 The Motor Vehicle and Earners' Accounts should be opened to competition as soon as possible. The government should also consider tendering its liabilities under the Non-Earners' Account to private insurers. Efficiency gains are likely to be achievable through bundling workplace, non-workplace and motor vehicle accident cover. Until the Motor Vehicle and Earners' Accounts are opened to competition, these gains cannot be made. There are currently significant cross-subsidies within the Motor Vehicle and Earners' Accounts. The NZBR believes that these cross-subsidies should be eliminated. However, if the government wants to continue to cross-subsidise individuals for social reasons, it should do so in a transparent manner.

1.11 The proposed government guarantee of benefits is a major policy error because it creates significant moral hazard problems and near-irresistible pressures to regulate so as to reduce the self-induced fiscal risks. It is folly for governments to underwrite any entrepreneurial business activity – witness the costs to New Zealand of the 'Think Big' projects and the DFC, Attempts to regulate in order to control the fiscal risks will be costly and will not necessarily be effective – as the disastrous experience in the United States with regulated and guaranteed savings and loans associations illustrates..

1.12 The government's guarantee of entitlements is the ostensible justification for the proposed prudential regime which is aimed at reducing the fiscal risks of insurer insolvency. Given this decision, the NZBR supports the government's attempt to retain a relatively light-handed disclosure-based regime. However, the best solution would be to review and remove the guarantee at the earliest possible date. The NZBR is not satisfied that the proposed mandatory use of trustee companies to monitor insurer solvency is better than alternatives that represent less of a subsidy for this sector.

1.13 The approach taken in the Bill to 'uninsurable risks' is preferable to the creation of an assigned risk pool for employers who cannot obtain a quotation. Assigned risk pools in other jurisdictions have tended to grow over time and in some cases destroy the primary insurance market. However, the Bill's requirement for all insurers to quote to all employers will increase insurer costs and may discourage entry of specialised insurers. It will not avoid problems of affordability for some employers, and insurers will find it difficult to price new risks for which there is no reliable history (such as new adventure tourism activities). (However, the underwritten self-insurance option may be useful here if the employer has financial substance.) It should be viewed only as a transitional measure. The NZBR recommends that the government consider making the costs of the role of insurer of last resort transparent by tendering for the purchase of this service.

1.14 The remaining sections of this submission provide more detailed comment on the Accident Insurance Bill. We have concentrated on the following areas of greatest concern to the NZBR:

- Funding of the liability for past accidents
- Level of mandatory entitlements
- Continuation of non-competitive insurance
- Prudential supervision regime
- Establishment of a government-owned competitive insurer.

This submission does not comment on tax issues. We understand that the Insurance Council of New Zealand's submission raises some tax issues that may warrant consideration.

Recommendations

1.15 The following is a summary of the NZBR's recommendations:

General recommendations for more far-reaching reform

1 All Crown insurers should be sold or closed to new business beyond any transitional period (section 7, particularly paragraph 7.4).

2 Benefits should be neither guaranteed nor mandated, at least beyond some transitional period (section 3 and paragraphs 1.12 and 5.3).

3 The Motor Vehicle and Earners' Accounts should be opened up to competition as soon as possible (paragraph 1.10). A date no later than 12 months after the new arrangements come into effect is suggested.

4 The Non-Earners' Account should be tendered to private insurers within a similar timetable (paragraph 1.10).

5 Any remaining government involvement in workplace accident compensation should be a responsibility of the Department of Labour and any parts of the ARCIC that are not privatised would be transferred to the department.

Specific Recommendations

6 The Bill should require the government to review its ownership of any accident insurance companies by July 2000 with a view to selling them or closing them to new business by July 2001 (section 7, particularly paragraph 7.4).

7 The Bill should require the government to review its guarantee and mandated entitlements at the same time that it reviews its prudential regime (paragraphs 1.12 and 5.3 and section 3).

8 Part 10 of the Bill should be amended to include the following provision:

> The Crown will allow insurers to offer contracts for all types of accident insurance from 1 July 2001 and will allow individuals to opt out of cover provided by the statutory manager (paragraph 4.1).

9 Consideration should be given to allowing employers to opt out of the mandatory level of cover prescribed in the Bill, possibly subject to obtaining the agreement of all the employees of the firm (paragraph 1.6 and section 3).

10 The self-employed should be permitted to take any level of cover they desire (paragraph 4.5). Failing this, boundary problems between non-earners and low income earners may need to be addressed by shifting the boundary and introducing an income threshold below which the self-employed are covered by the Non-Earners' Account (paragraph 4.6).

11 The tail should be funded from general taxation – option D – unless an alternative approach is shown to be superior as a result of following the requirements of the Generic Tax Policy Process. If the tail is to be funded by a temporary payroll tax, that tax should not be risk-related (paragraphs 1.7–1.8 and section 2).

12 As owner, the government should instruct its managers to devise commercially structured incentives to employers who assist it to reduce the tail (paragraphs 1.8 and 2.6).

13 The government should openly and transparently fund any desired cross-subsidies (paragraphs 1.10 and 4.7–4.8).

14 The requirement for all insurers to quote to all employers should be reconsidered and at most established as a transitional measure. Instead the government should consider tendering the role of insurer of last resort (paragraphs 1.13 and 4.9–4.10).

15 Further consideration should be given to 'light-handed' regulatory options that would not confer so much business on trustee companies. In particular, consideration should be given to tendering the role of monitoring insurers (section 5, particularly paragraph 5.2).

16 Insurers should not be required to contribute to the Insolvent Insurers Fund. General taxation should be used to fund any such amounts (section 6, particularly paragraph 6.4).

17 Insurers should not be obliged to contribute to any Non-Compliers Fund. Instead the Non-Compliers Fund should be funded from penalties imposed for non-compliance and general taxation (paragraph 6.6).

2 Funding Existing Claims

2.1 The Department of Labour estimates that the discounted future cost of existing claims on the Employers' Account is $5.5 billion.[1] One of the most important decisions associated with the shift to competitive provision of workplace accident insurance is how to fund this liability. The government has proposed that employers fund the costs of the liability over 15 years through an employer levy. As explained below, the NZBR believes that this option will significantly reduce economic efficiency. It should be noted that while employers would initially pay the levy its ultimate incidence would be likely to rest with employees and consumers as firms adjust their operations to maintain competitive returns on investment. Thus our criticism of the proposal is not primarily motivated by a desire to relieve employers of an additional impost.

2.2 The government considered four options for funding the liability involving different balances of employer levy and general taxation.[2] The method favoured by the government, Option A, imposes all the costs of the liability on employers. Employers will be required to cover the liability associated with workplace injuries from 1974 to 1999 ($4.4 billion) and that associated with non-workplace accidents from 1974 to 1992 covered by the Employers' Account ($1.1 billion). Option B would impose the $4.4 billion liability associated with workplace injuries on employers. Option C would require employers to pay a levy for the ongoing costs of workplace accidents from 1992 to 1 April 1999 ($2.2 billion). The rest would be funded from general taxation. Option D would fund the entire liability from general taxation. In

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1 CAB (98) 367, "ACC Reform: Funding of Existing Claims", 18 June 1998.

2 The four options are set out in CAB (98) 367, "ACC Reform: Funding of Existing Claims", 18 June 1998.

the terms of established government policy, any proposals for a new tax should be subject to the Generic Tax Policy Process.

2.3 The NZBR supports Option D. The second-best option is Option C. The method of funding the $5.5 billion liability has no effect on incentives affecting workplace safety. Imposing costs on employers for past accidents will not encourage them to avoid future accidents. The unfunded liability is a sunk cost. If the government's goal is to fund the liability as efficiently as possible, it should raise the funds in a way that least distorts decision-making. The deadweight costs of taxation are generally minimised by using broad-based taxation. This suggests that the funds should be raised from income and consumption taxes. New Zealand's tax system does not currently include payroll taxes. If the deadweight losses of payroll taxes were lower than those associated with income taxes and consumption taxes, the government should raise revenue with a payroll tax, irrespective of the ACS issue. Payroll taxes are also likely to be less efficient than a hypothetical tax on labour income which the treasurer and minister of finance (Rt Hon Bill Birch) has suggested in correspondence with the NZBR may have some desirable properties as a tax. This is because a payroll tax misses important parts of labour income – for example, problems arise in determining whether self-employed income (such as farm income) is a return on labour or on capital. Instead, the minister's concerns about the burden of tax would point to the desirability of a flat(ter) income tax and reduced government expenditure. The fact that the government has not previously argued that payroll taxes are efficient and does not even now propose a *permanent* payroll tax on efficiency grounds suggests its current proposal is unprincipled and opportunistic. An earlier payroll tax, introduced by the then Hon R D Muldoon as minister of finance in 1970, was scrapped by the third Labour government in 1973 and it has never been revived. Imposing (or retaining) a payroll tax seems particularly inappropriate when unemployment is rising.

2.4 The Treasury supports Option A, under which employers pay the full liability over 15 years through a risk-related levy. The Treasury argues that employer funding of the liability would:

> … place greater incentives on employers and industry organisations to apply pressure on ACC to rehabilitate injured employees faster and more cost effectively, especially where employers can point to better management by insurers under competition.[3]

From an optimal tax viewpoint a variable payroll tax is even more inefficient and distortionary. It will discriminate against the employment of labour in firms that officials deem to be of high risk on the basis of historic costs, suchas firms in the construction and forestry industries. There is no efficiency reason to impose a greater proportion of the tax on employees in higher risk industries. Such industries are unlikely to have more opportunities than low risk industries for returning claimants to work. There are much better options for rehabilitating claimants as discussed in paragraph 1.8. The employer levy will remove much of the incentive on the government to reduce the tail.

2.5 Individual employers will have extremely limited ability and incentives to monitor management of the tail. If they spend time and money monitoring the size of the unfunded liability, the benefits will be shared among all employers. The government should focus on improving its own monitoring ability. It should not impose an inefficient tax on employers (and indirectly, employees) because of weaknesses in accountability for dealing with long-term claimants.

2.6 The government should tender out the case management of the tail to private sector providers. It would not be difficult to design the contract to provide case managers with incentives to ensure that only claimants who met the eligibility requirements under the Bill continued to receive compensation. We note that in responding to the NZBR's criticisms of the government's decision to impose a payroll tax, the treasurer and minister of finance did not attempt to justify it in terms of Treasury's position.

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[3] Officials Paper to Cabinet Strategy Committee, Funding of Existing Claims, 12 June 1998, p 6.

3 Entitlements

3.1 Part 5 of the Bill sets out who is liable to provide statutory entitlements to eligible persons. Schedule 1 to the Bill describes the statutory entitlements. The retention of mandatory entitlements in the Bill prevents employers and employees who might prefer to insure for a lower level of risk from doing so. Mandating entitlements above the level desired by employers and employees forces employers to pay for something that is not valued by their employees. The cost is likely to be passes on either through reductions in the wages of existing employees – reducing the attractiveness of employment at the firm – or through adjustments in the numbers employed, leading to higher unemployment. Accident insurance premia are a cost of hiring labour for employers and will be taken into account when employers consider whether to hire additional staff.

3.2 The mandatory entitlements in the Bill are set so high that many employers and employees are likely to prefer to opt out of some of them. For example, insurers' use of measures such as employee co-payments will be limited by regulations. Deductibles and co-payments are common methods used to reduce adverse selection and moral hazard in insurance markets. Restricting their use is likely to increase premiums unnecessarily. Weekly compensation is set at 80 percent of the insured's weekly earnings. In other insurance markets, such as that for income replacement cover, insurers tend to offer a range of deductibles, co-payments and stand-down periods with corresponding variations in premiums. Constraining the development of the accident insurance market by mandating entitlements at the current level will mean that a range of policies that are welfare-enhancing for both employers and employees will be ruled out. Consideration should be given to allowing employers to opt out of the mandatory level of cover prescribed in the Bill, possibly subject to obtaining the agreement of all the employees of the firm.

3.3 Section 151 in the Bill provides that:

> (1) An employer or a self-employed person or a private domestic worker may agree with an insurer that the employer, self-employed person, or private domestic worker will discharge any of the insurer's obligations under an accident insurance contract with that person.
>
> (2) The agreement does not affect the liability of the insurer to a person to whom the insurer is required to provide cover and statutory entitlements under the accident insurance contract.

The first of these provisions is commendable as it makes it possible for employers to self-insure for a particular level of claims if they have an insurance contract that will cover liabilities in the event of employer default. For many employers, this represents an improvement over the ARCIC's Accredited Employer programme.

4 Competitive Provision of Accident Insurance

4.1 Part 7 of the Bill sets out the requirement for employers to enter into accident insurance contracts with registered insurers for work injuries suffered by employees. Motor vehicle injuries and non-workplace injuries will continue to be covered by the Accident Compensation Corporation, the non-competitive government insurer. As stated in the introduction to this submission, the NZBR welcomes the opening of the Employers' Account to competition but would like to see competition extended to include all non-workplace accidents. We propose the inclusion of the following section at the end of Part 10 of the Bill, which deals with non-competitive provision of accident insurance:

> The Crown will allow insurers to offer contracts for all types of accident insurance from 1 July 2001 and will allow individuals to opt out of cover provided by the statutory manager.

We note that officials from the Department of Labour and Treasury recommended a similar approach to extending competition for all earners'

out-of-work accidents in April, subject to further work on affordability, compliance, and transitional issues.[4]

4.2 Limiting competition to the provision of workplace accident insurance will unnecessarily restrict the scope for premium reductions and efficiency gains. Without the restrictions in the Bill, insurers would be likely to offer bundled cover to employers for a range of accidents.

4.3 The Bill's approach to self-employed accident insurance illustrates the problems created by cross-subsidisation in the Earners' Account for non-workplace accidents. Sections 143 – 146 allow self-employed persons to take out private insurance contracts for workplace and non-workplace cover. The Self-Employed Account (established under Part 10 of the Bill) will provide risk-rated workplace accident cover for self-employed persons who suffer work injuries in their self-employment and who do not have an accident insurance contract (section 259). Non-workplace cover provided through the Earners' Account will continue to be a flat rate per dollar of income.

4.4 Self-employed who pay higher than actuarially fair levels of Earners' Account premia are likely to opt out of the Earners' Account and take private insurance cover. Unless there is an increase in the flat rate premium levied on those earners remaining in the Account, there is a risk that an unfunded liability will arise in the Earners' Account. It is important that the Earners' Account be fully funded from premiums if the full gains from introducing competition are to be realised.

4.5 Instead of merely allowing the self-employed to opt out of the Earners' and Self-Employed Accounts, the government should allow the self-employed to opt out of having any accident insurance at all. There is no reason to require a certain level of accident insurance among the self-employed. Individuals are able to assess the relative costs and benefits of insurance and can assess their ability to control workplace risks. A self-employed person who did not

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4 STR (98) 70, "Introducing Competition to Delivery of the ACC Scheme: Summary", 17 April 1998.

take out insurance would be eligible to receive the invalid's benefit. Requiring the self-employed to insure to a particular minimum level reduces welfare. If they would prefer to insure at a higher level than the mandatory entitlement, they would do so voluntarily. If the mandatory level is higher than they would prefer, by definition they would gain from being permitted to opt out. Accordingly, the NZBR recommends that the Bill be amended so that the self-employed may take a lower level of cover than the mandated level and so that the government guarantee of entitlements for the self-employed extends only to the level of cover in an insurance contract that they choose.

4.6 Should the government not permit earners to opt out, boundary problems between non-earners and low income earners are likely to prove increasingly troublesome if low income earners are currently being subsidised by higher income earners and such cross-subsidies are progressively reduced. One interim option here would be to adjust the income threshold that defines the boundary between earners and non-earners so that earners with minimal earnings are covered by the Non-Earners' Account.

4.7 The Earners' Account is the only area of income-linked accident insurance cover that is currently not risk-rated in any way. Cross-subsidies in the account are likely to be substantial, particularly from high income to low income individuals (because of fixed costs of cover) and in favour of young males, who tend to be at greater risk of non-workplace sporting accidents.[5] There are strong arguments for risk-rating the Earners' Account so that people face the full costs of their risky behaviour. Arguments in favour of removing cross-subsidies for dangerous businesses are now widely accepted, and are reflected in the rest of the Accident Insurance Bill. Similar arguments apply in respect of non-work accidents.

4.8 If the government believes that there are offsetting social benefits from subsidising some risky non-work behaviour (eg high risk sport), an explicit

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[5] Officials estimate that participation in sports may raise claims costs relative to the average Earners' Account level by an average of 35 percent. See STR (98) 160, "ACC Reform: Self Employed Issues", 17 July 1998.

subsidy from general taxation revenue is preferable. This would make the current cross-subsidies transparent, improve the efficiency of funding the subsidies, and allow competitive pressure on premia without adverse political consequences. Whether the government decides to reduce the existing cross-subsidies or not, it should stop underwriting Earners' Account insurance policies and contract out the management of claims in the Account to a private provider of rehabilitative services. As discussed in section 2, the Corporation faces only weak incentives to return claimants to work under current arrangements.

4.9 Section 152 of the Bill requires insurers to provide insurance to any employer, self-employed person or private domestic worker. Although the section makes it clear that the insurer may set the terms and conditions (including premium), the combination of a requirement to quote and the obligation on all employers to take out accident insurance at mandatory levels may create significant pressure to regulate prices. Employers will be required to accept a quote from one of the range of providers, regardless of the level. Some employers who have historically benefited from the cross-subsidies in the ACS may face the prospect of being forced out of business when they incur the true costs of their risky activities. Some such employers are likely to protest that they have been forced to take out unwanted insurance and that they and their employees would prefer to face the risk of accidents than pay the quoted price. Political pressure to regulate prices is likely to be strong. In the case of new risky ventures, the absence of a safety track record may force insurers to quote such high premiums as to cause the venture to be still-born. Permitting self-insurance in such circumstances could improve welfare.

4.10 Instead of requiring all insurers to quote to all employers, the government could consider tendering the role of insurer of last resort. Requiring all insurers to quote is administratively simple, but it obscures one of the costs of mandating a high level of insurance cover.

5 Prudential Supervision of Insurers

5.1 Part 8 of the Bill sets out the regulatory framework and prudential regime for insurers in the accident insurance market. The combination of compulsory accident insurance for employers and a government guarantee of obligations means that a mechanism is needed to reduce the risk that insolvent insurers will enter the accident insurance market, default on their obligations and expose the government to the cost of ongoing claims. Without a government guarantee, policyholders have strong incentives to monitor their insurers and trade off lower premia against the increased probability that the insurer will default. The existence of a government guarantee significantly lessens these incentives to monitor insurer performance.

5.2 The NZBR believes that the prudential framework for accident insurers set out in Part 8 of the Accident Insurance Bill will reduce the scope for competition and efficiency gains that could have been achieved had the government chosen not to guarantee obligations. The key mistake is the decision to provide a government guarantee. Given the decision to mandate cover and to provide a guarantee, the NZBR favours reliance on rating-related prudential requirements. Rather than confer so much business on a limited number of trustee companies, the NZBR believes that further consideration should be given to alternative arrangements that would allow the government to obtain the professional assessments it seeks while exposing it to the costs of obtaining these assessments. When successive governments must explicitly appropriate funds each year for an activity, they are arguably more likely to examine the rationale for the policies driving those expenditures than when they have used regulations to impose those costs on others. Since only the government can remove the source of the moral hazard problems (ie the guarantee), it is desirable that it be continually confronted with the costs that arise from the guarantee. That said, the NZBR supports the intent of the Bill to avoid many of the problems of heavy-handed regulation while keeping the risk to the government of insurer failure low. We agree with officials that trustees will have stronger incentives than regulators to tailor monitoring to the level of risk they perceive in an insurer,

but it is surely possible to tender out such a monitoring role while maintaining such an incentive structure.[6] Actuaries could bid for such work, in competition with trustee companies.

5.3 The NZBR supports the proposal to examine the prudential supervision regime in 2003. However, we believe that the review should extend to the existence of the guarantee and the mandatory entitlements. The guarantee creates enormous moral hazard with little offsetting benefit. Unjustified distinctions exist between illness and accidents. Other forms of insurance are not compulsory and are not guaranteed by the government. The government does not mandate income replacement insurance for illness, not does it guarantee such insurance contracts in the event of insurer failure. Employees who value income replacement insurance due to workplace accidents could negotiate such arrangements with their employers.

6 Insolvent Insurers Fund and Non-Compliers Fund

6.1 The Accident Insurance Bill establishes an Insolvent Insurers Fund (section 203) and a Non-Compliers Fund (section 223). These funds are proposed because the government is guaranteeing entitlements and is requiring employers to take out accident insurance cover. Part 9 of the Bill sets out requirements for employer, government and insurer contributions to the two funds.

6.2 The NZBR supports the limited requirement in section 208 for an employer who was a party to a contract with an insolvent insurer to contribute to the Insolvent Insurers Fund. This increases an employer's incentive to monitor the financial performance of its accident insurer. However, the NZBR does not support the requirement in section 209 for all insurers to contribute annually to the Insolvent Insurers Fund.

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6 Officials Paper to Cabinet Strategy Committee, *ACC Reform: Accident Insurer Market Regulation*, 13 July 1998, p 10.

6.3 The Insolvent Insurers Fund is proposed because the government has guaranteed entitlements if an insurer fails. This, combined with a level of entitlements above that preferred by employers and employees, creates a risk of government liability if employers do not monitor their insurers and the insurer fails. Section 208 gives employers an incentive to monitor financial performance and switch insurer if they have concerns about solvency. In contrast, section 209 imposes a cost on insurers without a corresponding improvement in incentives. Insurers will have little incentive or ability to influence insurer performance. Unlike employers, insurers will not be able to avoid the levy if they suspect that an insurer will fail. The insurer levy proposed in section 209 is a tax on prudence. It will raise the costs of participating in the market for accident insurance.

6.4 Instead of requiring insurers to contribute to the Insolvent Insurers Fund, the government should fund any such amounts through general taxation. If New Zealand's income and consumption tax structure is considered (approximately) optimal, funding the guarantee through general taxation revenue will be the most efficient method.

6.5 The NZBR supports sections 216 and 233 of the Bill, which enable the Regulator to contract out the management of the provision of entitlements under the Insolvent Insurers Fund (s216) or the Non-Compliers Fund (s233), or to reinsure the liabilities of the Funds.

6.6 There is no efficiency-related reason for requiring insurers to contribute to the Non-Compliers Fund, as set out in section 227 of the Bill. Fundamentally it is the government's responsibility to enforce its own laws. It has chosen to make the purchase of insurance mandatory. Insurers cannot make good any failure by the government to enforce its own rules. Taxing insurers for the cost of government failure is arbitrary, discriminatory and iniquitous. The NZBR recommends that the Non-Compliers Fund be funded from penalties imposed in respect of non-compliance and from general taxation.

7 The establishment of an insurer as a state-owned enterprise (SOE)

7.1 Given the government's decision to continue to provide accident insurance to employers in a competitive market, the NZBR supports the establishment of the insurer as a separate SOE. Governance arrangements in the SOE model reflect commercial operating conditions better than alternative arrangements. However, the NZBR does not believe that it is possible for a fully competitively neutral market to develop as long as a government-owned insurer operates in the market.

7.2 Many employers are likely to perceive the government-owned insurer as having an implicit government guarantee. It is not clear how the government plans to charge the SOE for this implicit guarantee. One option would be for the insurer to ask a rating agency to provide a rating based on non-government ownership. Alternatively, the board could tender a contract under which the successful bidder undertook to fulfill the Crown's obligations if the government-owned company incurred debts.

7.3 Establishing the competitive government-owned insurer as a SOE with a balance sheet, shares held by a minister and a profit objective will enable its board to monitor performance more readily than in the past. Political pressure on the company is likely to be great, and there is a risk that the government-owned firm will set prices below the actuarially fair level, for example if the shareholders are concerned about public reaction to significant premium increases for businesses that have historically been cross-subsidised.

7.4 The NZBR recommends that a section be inserted into the Bill that requires the government to carry out a scoping study on ownership options for the SOE in July 2000. The government has sold nearly all its other insurance companies in the last 15 years. Beyond any transitional period there is no reason for a government-owned insurer to be a participant in the accident insurance market and any such companies should be sold or closed to new business as soon as possible.