THE TREASURY
Kaitohutohu Kaupapa Rawa

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To: Minister of Finance

AIDE MEMOIRE: UPDATING ACC'S NON-EARNERS' ACCOUNT

This Aide Memoire provides further information for Budget Ministers on ACC.

The Injury Prevention, Rehabilitation and Compensation Act 2001 obliges the Crown to finance ACC entitlements arising from non-motor vehicle injuries to people outside the workforce (children, students, beneficiaries and older people). The Crown's obligation to pay remains whether or not funds are set aside, so paying less in one year merely increases the future obligation. We support fully-funding the non-earners' account (excluding any risk margin) because it is equitable to allocate each year's full cost of claims to taxpayers in that year and funding the entitlements provides financial security to long-term claimants.

In recent years, the cost of claims in the non-earners' account has increased due to:

- **Price increases** – ACC is exposed to medical sector costs, including remuneration for medical personnel and home carers.

- **Quantity increases** – the long duration of some claims means claims enter faster than they exit. As well, demographic changes have increased the number of people at risk of injury and average claim duration has increased. Treatment injury claims (including serious birthing injuries) have increased.

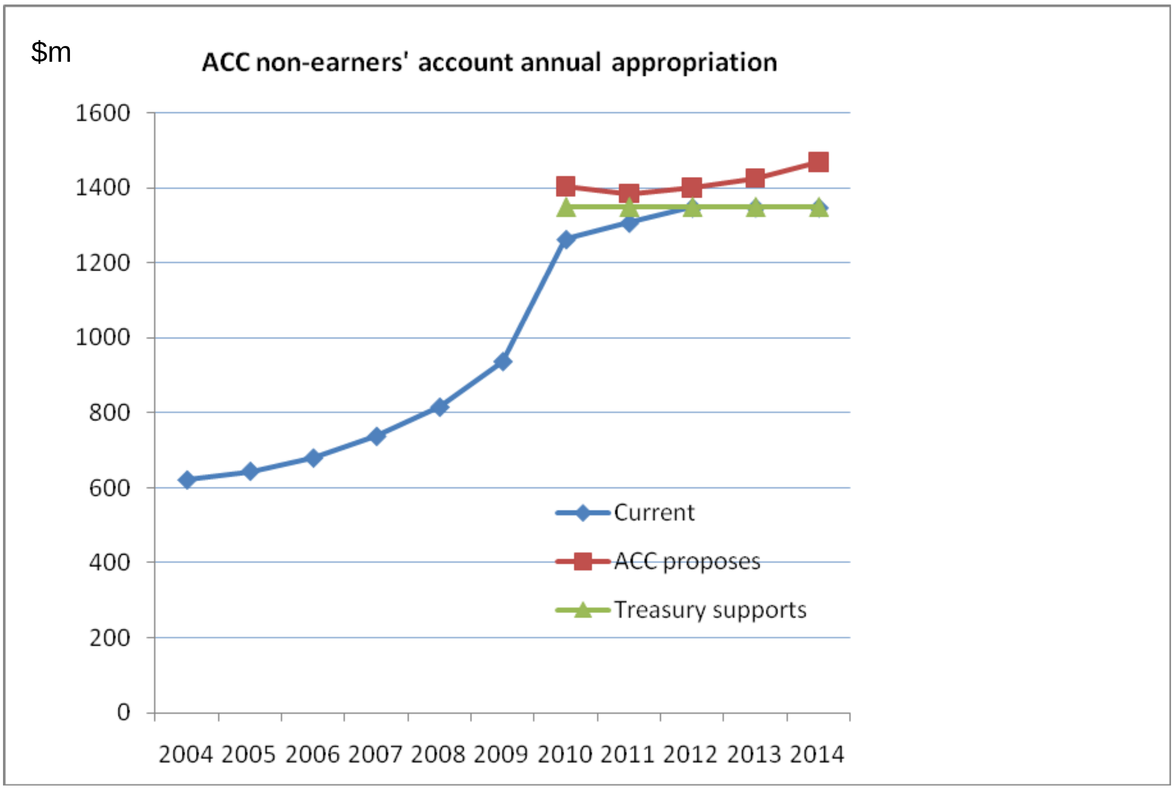
- **Standards improvements** – additional benefits (e.g. fully subsidised physiotherapy) and improved quality of treatment.

- **Valuation assumptions** – this year, the ACC board has addressed what it considers were under-estimates of claim costs. Estimates of costs to pay in future have an effect now because of full-funding.

- **Investment performance** – ACC's long run investment returns have been sound but 2008/09 saw all fund managers earn below-average returns.

The mechanism for full funding the non-earners account involves ACC re-calculating its costs each year and proposing a new baseline. While ACC financing has tended to occur outside of the Budget, the amounts are significant so it is desirable to set the ACC baseline at the same time as Ministers take other Budget allocation each year. Changes to the Crown's obligation to finance ACC claims are counted against each Budget's allocation for new expenditure because increased claims affect the Crown's financial statements in the same way as expenditure in other Votes. Ministers are confirming Budget allocation decisions now so it is appropriate to set the ACC allocation decision now. Cabinet has agreed to indicatively allocate $128 million for ACC's non-earners' account from the $1.1 billion 2010 Budget operating allowance. [Cab Min (09)39/23].

The following graph illustrates the trend in the annual baseline and the baseline changes that ACC has proposed for the period from 2010 to 2014.



The proposed $1.403 billion baseline is applied as follows (analysis by type):

Case management and supporting services	72
Treatment services	734
Acute (hospital) care	246
Other benefits	64
Treatment injury claims	287
Total	$1,403 m

Treasury supports fully funding the ACC liabilities but supports only some components of the current proposal. Compared to paying the full amount, paying a smaller amount to ACC would reduce both Crown debt and the investments held by ACC (which are included in the consolidated Crown balance sheet). The Crown's operating statement is affected by changes in the liability to pay claims, but not by how that liability is financed. The amount of the liability for claims depends on the choice of assumptions on claim volumes, future cost trends, discount rates, and future investment earning rates.

The ACC baseline is mostly to pay for claims lodged in 2009/10. It also allows for the increased valuation of claims lodged between 2001 and 2009, and covers the cost of pre-2001 claims that the Crown pays for on a ‘pay as you go’ basis.

Treasury assessment of ACC’s proposed 2009/10 Baseline Update (analysis by date of claim)

	Baseline	Increase (Treasury supports)	Further Increase (not supported)	ACC’s Proposed baseline	Percentage increase (supported)	Percentage increase (total)
	$m	$m	$m	$m	%	%
2009/10 claims	1,026	0	10	1,036	0.0	1.0
2001-2009 claims	118	79	44	241	67	104
Pre 2001 (PAYG)	119	7		126	5.9	5.9
Total	1,263	86	54	1,403	6.8	11.1

2009/10 claims: The Crown’s actuaries have identified that $6 million of the $10 million increase in 2009/10 costs relates to higher claims handling and other expenses. ACC is reducing its costs and it is not necessary to fund cost increases which may not occur. The balance of $4 million relates to minor cost increases which we consider ACC could absorb against its value for money savings initiatives.

2001-09 claims: The largest component of the proposed baseline increase involves a $123 million re-estimation of the amounts needed to pay for the present and future cost of claims incurred between 2001 and 2009, of which Treasury supports $79 million. The increases are as follows.

	Treasury supports $m	Not Supported $m	Total $m
Current baseline			118
Lower investment income	24		
Lower future investment income	68		
Actual claims expense	(10)		
Expense adjustments	(3)		
Increases in rates set by regulation (e.g. home based care)		23	
Re-stated opening balance		21	
Total proposed changes	79	44	123
			241

Treasury supports the increases arising from past and future expected investment returns because they stem from the financial crisis which is outside ACC's control. Treasury also supports the cost reductions arising from improved claims experience. However, Treasury does not support funding for possible increases in home-based care costs and other Cabinet-approved costs in excess of inflation, or an increase to alter an incorrect allocation of costs between accounts.

Pre-2001 claims: These claims are paid for on a pay-as-you-go basis, unlike the rest of ACC which is on a fully-funded basis. The 5.9% increase sought for 2009/10 is in line with increases in ACC's cost base and we support it for that reason. Retaining these claims on a PAYG basis creates an unfunded liability on the Crown's balance sheet. Ministers may wish to ask for advice on the advantages and disadvantages of fully-funding this portion of ACC's costs, and for trend information on how this item is expected to track in future.

Updating the out-year baselines

Increases in ACC's baseline for out-years is an important driver of the Crown's fiscal position. ACC has proposed a baseline that increases gradually from its proposed $1.402 billion in 2009/10 to $1.468 billion in 2013/14. In particular, the proposed amount for 2013/14, the last out-year of the fiscal forecasts, is $42 million or 3% higher than the 2012/13 proposed baseline. While there is some 'natural increase' in the NEA due to demographic factors, ACC has not supplied clear information that differentiates between volume and cost increases in the outyears. As well, Ministers are not presented with any policy options to manage the rate of increase in the out-years and nor is there information on the target savings from value for money initiatives that ACC has in train.

For these reasons, Treasury does not support building an automatic increase into the baseline at this stage and instead recommends that the baseline for each out-year be set at the same level as the baseline for 2009/10. The effect on the Crown's forecast financial statements of setting a baseline for out-years that is lower than ACC has proposed would be to reduce the amount of Crown debt and reduce the amount of investment assets that ACC is assumed to hold. There would be no effect on the operating statement which depends on the claims liability not how it is financed.

The latest information from ACC shows a sharp increase in year to date investment income and an improving trend in new claims volume. These trends give us some confidence that ACC could live within our preferred level of baseline, but we consider it would be premature to reduce baselines beyond the Treasury-supported levels described above. If ACC can continue to perform significantly better than its baseline assumes, the gain would reduce the unfunded component of its liability and would enable Ministers to reduce the baseline in future years.

Recommendations

Treasury recommends that Ministers:

1 **Note** that Budget allocations include additional financing for ACC's non-earners' claims because they are caused by increases in the estimated claim liability which is on the Crown's operating statement and because inclusion enables the Government to trade off additional services from ACC and additional services from elsewhere.

2 **Note** Cabinet has agreed to indicatively allocate $128 million per annum for financing ACC's non-earners' account from the $1.1 billion operating allowance [Cab Min (09)39/23].

3 **Agree** that a reasonable approach to fully-funding ACC's non-earners' account is to utilise ACC's data as at 30 June 2009 and take some account of performance trends since then.

4 **Note** ACC's proposals are based on data to 30 June 2009 and that performance since then has been better.

5 **Agree** to update the baseline for ACC's non-earners' account as follows:

	2009/10 $m	**2010/11** $m	**2011/12** $m	**2012/13** $m	**2013/14** $m
Increase proposed by ACC	140	78	52	77	120
Less portion not supported by Treasury	(54)	(36)	(51)	(76)	(119)
Tsy supports	86	42	0	0	0
Current baseline	1,263	1,307	1,349	1,349	1,349
New baseline	1.349	1,349	1,349	1,349	1,349
% increase Current baseline	6.8%	3.2%	-	-	-

6 **Note** any reduction between the $128 million set aside from within the $1.1 billion and the allocation approved above can offset pressures elsewhere, with the amounts as follows:

	2009/10 $m	**2010/11** $m	**2011/12** $m	**2012/13** $m	**2013/14** $m
Increase proposed by ACC	140	78	52	77	120
Less indicative allocation	(128)	(128)	(128)	(128)	(128)
Extra / (reduction)	**12**	**(50)**	**(76)**	**(51)**	**(8)**
Increase supported by Treasury	86	42	0	0	0
Less indicative allocation	(128)	(128)	(128)	(128)	(128)
Extra / (reduction)	**(42)**	**(86)**	**(128)**	**(128)**	**(128)**

7 **Note** that there are a mix of favourable and unfavourable risks around ACC's future forecasts, including whether the above baseline over- or under-estimates the extent of ACC's cost reductions and higher investment income.

8 **Direct** Treasury to review ACC's baseline in April 2010 once ACC supplies its actuarial liability valuation and technical report as at 31 December 2009, and to report to the Minister of Finance on the implications of that data on the Crown's fiscal forecasts to be included in Budget 2010.

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