The Treasury

Budget 2013 Information Release

Release Document

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Reference: T2013/689 CM-1-3-1-1-4

THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 26 March 2013

To: Minister of Finance
(Hon Bill English)

Deadline: None
(if any)

Aide Memoire: Funding for the ACC Non Earners Account for Budget 2013

Purpose

This aide memoire provides our recommendation on funding for the ACC Non Earners' Account for Budget 2013. We have prepared our advice in consultation with the Ministry of Business, Innovation and Employment and ACC, and support the Ministry's recommendation.

The Minister for ACC has forwarded the Ministry's paper to you. We understand that the Minister has agreed with the Ministry's recommendation.

ACC's recommended funding level

The table below shows the level of funding sought by ACC, which includes a reduction in 2013/14 and 2014/15 from what was approved at Budget 2012.

Table 1: Funding sought by ACC for Budget 2013/14

$M	2013/14	2014/15	2015/16	2016/17	Total
Current baseline	1,181	1,181	1,181	1,181	4,724
ACC recommendation	1,113	1,134	1,210	1,290	4,747
Difference from current baseline	(67.9)	(46.6)	29.7	109.0	24.2

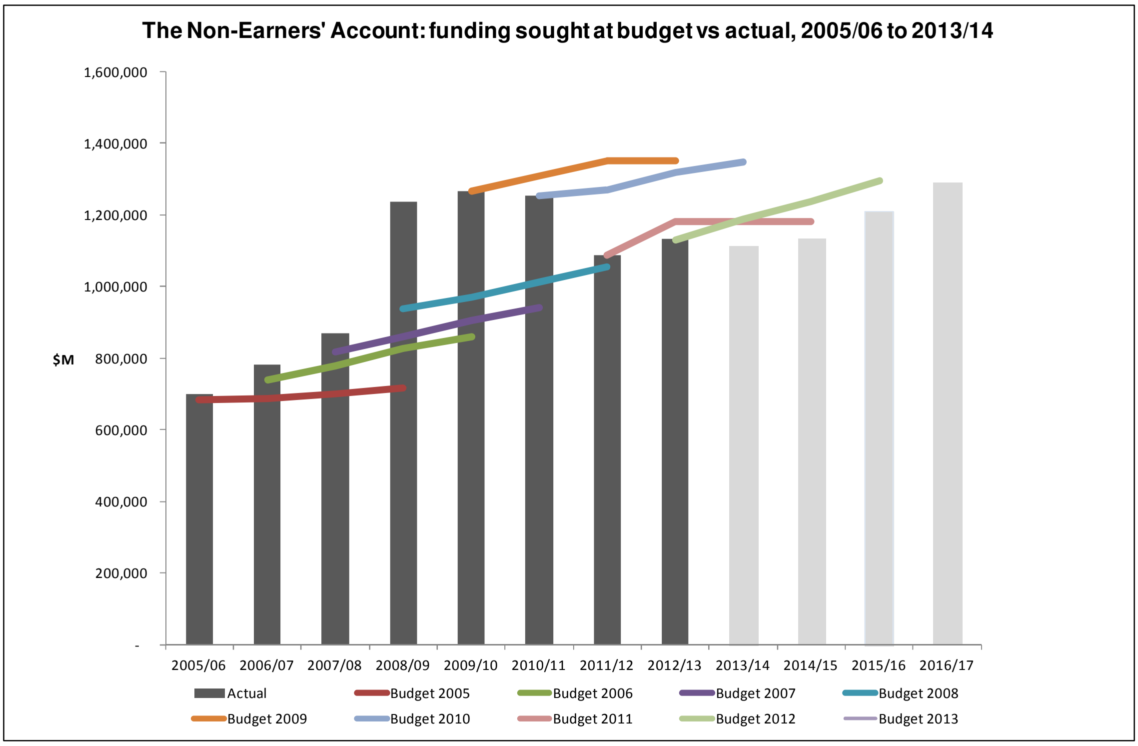
The reduction in funding sought by ACC reflects lower than expected claims costs and better than expected investment returns. In our view, the latest valuation indicates that there is still some softness in ACC's baselines given that ACC's actuaries, PWC, are still using long term average claim costs, which have been higher than experience over the last four years, in their assumptions. Beyond the first year, ACC is also using risk free rates rather than the expected rate of return, which means that ACC is still underestimating its investment income.

ACC's actuaries have developed much more sophisticated modelling of its major payment types to improve the accuracy of its projected costs. The Ministry notes in its paper that the actuaries contracted by Treasury to provide quality assurance of the valuation and Non Earners' Account funding did not consider that there was sufficient information to reach a conclusion on whether ACC's out year funding levels were reasonable. It should be noted that the actuaries are not concerned with ACC's decision to develop the new modelling approach. Rather the actuaries wanted to see greater documentation of the approach to assure them of its appropriateness, which did not prove possible in the time allowed. We do not expect this to be an issue during levy consultation or at next year's budget.

Trends in Non Earners' Account funding

The following graph shows the funding sought at Budget time for the Non Earners' Account since Budget 2005. It shows that from 2005 to 2008 ACC was substantially underestimating the amount of funding that would be required. Since 2009, ACC has been overestimating the funding required.

Figure 1: Funding sought for the Non Earners' Account 2005 to 2013



We would make two additional points about this graph:

- ACC is a maturing scheme, and therefore the liability is expected to continue to grow. Funding for the Non Earners' Account is also expected to increase year on year due to population growth and ongoing growth in health service costs, which has historically grown faster than inflation. All things being equal, we would normally expect out year funding levels to be higher than the first and second year funding levels.

- At some point the level of over funding over the last few years in the Non Earners' Account shown in the graph will have been corrected and therefore we should not expect to be able to reduce funding levels significantly below those sought by ACC. ACC's development of more accurate models for projecting future costs will assist in this process.

Funding for the Non Earners' Account

As noted in its paper, the Ministry recommended that the Minister support ACC's recommended funding levels for 2013/14 and 2014/15 but leave funding for 2015/16 and 2016/17 at the existing levels. This would result in an overall saving of $114.5m over four years, as shown in the table below:

Table 2: Recommended funding levels for the Non Earners' Account

$M	2013/14	2014/15	2015/16	2016/17	TOTAL
Current baseline	1,181	1,181	1,181	1,181	4,724
ACC recommendation	1,113	1,134	1,210	1,290	4,747
MBIE (and Treasury) recommendation	1,113	1,134	1,181	1,181	4,609
Difference between MBIE recommendation and current baseline	(67.9)	(46.6)	-	-	(114.5)

We support the Ministry's recommendations. While we still consider that there is still some over funding in the Non Earners' Account baseline which supports lower funding levels in the first two years, this needs to be balanced against growing concerns we have about what the change in ACC priorities in response to the concerns of privacy mean for ongoing sustainability in ACC performance.

As we have previously advised, ACC has a history of over correcting in response to changes in Ministerial and Board priorities. A fundamental change in service delivery model has been signalled as a priority for the new ACC chief executive by the ACC Board chair. ACC's current service delivery model is recognised as near or at world's best practice, and is a key factor in its turnaround in performance since 2009. At this point we are not clear what changes will be made to the service delivery model, but will be concerned if it departs significantly from what is in currently in place.

Over the last 6 months there have been a number of emerging trends in scheme wide measures that could have a significant financial impact in 2 to 4 years. These include:

- **new claims registered and accepted, and the conversion rate for new weekly compensation and other entitlement claims.** In the 12 months to

February 2013 there was a significant increase in new claims registered and accepted (4.9% for the Earners Account, 3.2% for Non Earners' Account). In addition the conversion rates for new weekly compensation and other entitlement claims increased. Put together this means that ACC is receiving more claims, ACC is accepting more claims and a higher proportion of the increased number of accepted claims are going on to receive weekly compensation and other entitlements. In time this will result in an increase in costs and be reflected in an increase in the liability.

- While ACC's short to medium term rehabilitation performance remains very strong, there has been a **significant deterioration in its management of long term claims**. In the 6 months to the 31 December 2012, ACC achieved a net reduction on the long-term claims pool of 79. This trend has continued in the first few months of this year. In comparison ACC achieved net reductions of 1,009 in the 12 months to June 2012, 1,260 in the 12 months to June 2011, and, 1,543 in the 12 months to June 2010. ACC's financial results are very sensitive to its rehabilitation performance and any deterioration in rehabilitation performance could, over the medium term (i.e. 3 years +), lead to a substantial deterioration in financial performance.

For these reasons we do not consider it prudent to go below the level of funding recommended by MBIE.

Additional options for further reductions in funding for the Non Earners' Appropriation

The following table outlines some additional options, should Ministers wish to reduce the level of funding further. These options are as follows:

- Option 1: ACC's funding level for 2013/14 and 2014/15, but rolls forward 2014/15 for 2015/16 and 2016/17.
- Option 2: ACC recommendation with expected rate of return
- Option 3: Option 2 with the baseline for 2014/15 rolled forward

$M	2013/14	2014/15	2015/16	2016/17	Total
Current baseline	1,181	1,181	1,181	1,181	4,724
Option 1	1,113	1,134	1,134	1,134	4,515
difference from current baseline	(67.9)	(46.6)	(46.6)	(46.6)	(208)
Option 2	1,048	1,086	1,173	1,261	4,568
difference from current baseline	(132)	(95)	(7)	80	(154)
Option 3	1,048	1,086	1,086	1,086	4,306
difference from current baseline	(132)	(95)	(95)	(95)	(417)

Ben McBride, Team Leader, Labour Market & Welfare, 04 917 6184
Nic Blakeley, Manager, Labour Market & Welfare, 04 917 6896