The Treasury

Budget 2015 Information Release

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[8] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

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[14] Not in scope

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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.

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Upcoming decisions on ACC

Date:	19 February 2015	**Report No:**	T2015/297
		File Number:	CM-1-3-1-2-3

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** upcoming ACC decisions that affect OBEGAL or interact with Budget 2015; the impact of recent discount rate changes on these decisions; and our advice not to over-react to these changes	Monday 23 February 2015
Associate Minister of Finance (Hon Steven Joyce)	As above	Monday 23 February 2015
Associate Minister of Finance (Hon Paula Bennett)	As above	Monday 23 February 2015

Contact for Telephone Discussion (if required)

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Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Enclosure: No

Treasury Report: Upcoming decisions on ACC

Executive Summary

There are several upcoming decisions on ACC that affect OBEGAL or interact with Budget 2015, which are expected to be discussed between Budget Ministers on 23 February and with the Minister for ACC on 24 February. These are summarised below.

What		**Expected impacts**		**Expected timing of further advice**
		OBEGAL	**Net debt**	
ACC levy rates after 2015/16 (ACC funding policy)	Decisions on the general direction of ACC levies and the size of levy reductions after 2015/16	Yes – larger levy reductions will have a larger negative impact	No	Late February-early March 2015 Cabinet decisions expected second week of March 2015
ACC Non-Earners' Account	Provisional $180m shortfall in 2015/16 – no significant impact if unfunded	No	Yes (if shortfall is funded)	Early March 2015
[14]				

A recent large drop in discount rates has reduced ACC's funding position, and increased its liability by almost $4b in January 2015. We advise not over-reacting to this change. On ACC levies, for example, there are still choices about the size and timing of 2016/17 reductions: depending on fiscal impacts, the funding position might be further reduced before the ACC funding policy is implemented, enabling levy-payers to receive larger levy reductions. There is no real risk to ACC in reducing funding levels more substantially. Ministers may wish to consider the option of delaying ACC funding policy decisions until preliminary Budget forecasts are available in late March 2015.

Recommended Action

We recommend that you **note** the suggested talking points on upcoming ACC decisions to support your discussions with colleagues.

Ben McBride
Manager, Health

Hon Bill English
Minister of Finance

Treasury Report: Upcoming decisions on ACC

Purpose of Report

1. This report updates you on upcoming decisions on ACC that affect OBEGAL or interact with Budget 2015. It aims to support your discussion with Budget Ministers on 23 February and your meeting with the Minister for ACC on 24 February.

ACC levy rates after 2015/16

2. Further reducing ACC levies on households and businesses is a fiscal priority. Last year, Government signalled possible levy reductions of $700-$900m from 2016. The most recent Budget Policy Statement notes that:

   - Budget 2015 will indicate the Government's intentions around ACC levy reductions, and

   - given the significant impact of levy changes on the economy and Government's accounts, decisions about the general direction of levies beyond 2015/16 will be taken in the context of Budget decisions.[1]

3. We expect that Cabinet will be asked to agree an overall approach to future ACC levies next month. These decisions will be included in final Budget forecasts.

Government has agreed a funding policy for ACC

4. In 2014 Ministers agreed a funding policy for ACC [EGI Min (14) 11/9 refers], including:

   - a funding target (solvency target), which means ACC should aim to hold assets equal to 100-110 per cent of its reported liabilities. This is lower than current solvency levels in the Earners' and Work Accounts, so would require levy reductions; and

   - a 10-year horizon over which under- and over-funding would be corrected. ACC would recommend levy rates so as to make up the expected difference between the actual and the target level of funding over a rolling 10-year period. This would adjust levy rates gradually over time, helping to reduce levy volatility.

5. Once the funding policy is implemented, it will form the basis for ACC's levy recommendations to Ministers. Government will still be able to set levy rates that are different from those recommended by ACC.

The key decision is whether the policy is implemented from 2016/17, or whether funding levels are further reduced first

6. The key decision for Ministers is whether to apply the funding policy from 2016/17 onwards (at the next available opportunity) or to further reduce funding levels, and hence levy rates, before the policy is implemented.

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[1] 2015/16 levy rates have already been decided. Levies will fall by $480m in the 2015/16 levy year. Most of these reductions will come from motor vehicle levies, and will start on 1 July 2015. There will also be a small reduction on levies on employers and the self-employed, starting 1 April 2015.

7. Based on a draft Cabinet paper being prepared by MBIE officials, we understand that the Minister for ACC is likely to seek Cabinet agreement to implement the funding policy from 2016/17. This proposal:

- reflects that funding levels have fallen significantly (mainly due to discount rates), and are currently much closer to the funding target than previously: as at January 2015, solvency was 116 per cent in the Earners' Account and 111 per cent in the Work Account

- is expected to generate levy reductions in the order of $200m, though this number will change before final levy decisions are made.

8. The funding position at January 2015 contrasts with the position last year, when solvency was at or above 130 per cent in the Earners' and Work Accounts and ACC was projected to have around $4.5b in surplus funding by mid-2016. On the basis that the funding policy was then expected to take about 20 years (all else being equal) to get solvency in these accounts down to the target, Ministers had sought further work on how funding could be reduced more quickly [EGI Min (14) 11/9 refers].[2] Data suggests some increase in solvency in February; fluctuations are expected to continue.

9. Our initial feedback on the draft Cabinet paper noted that:

- based on ACC's funding position, we do not support implementing the funding policy in 2016/17. There is a good case for looking at other options, both because we don't want to overreact to short-term changes – there was a significant shift in solvency from December to January, which could reverse – and because of the significance of the decision.

- the paper should reflect the link between ACC levy decisions and the fiscal strategy. We will work with MBIE officials on this.

10. Fundamentally, our view remains that ACC is over-funded, and that options for larger levy reductions in 2016/17 are worth exploring further. There are still choices about the size and timing of levy reductions, which could make the difference between millions of dollars remaining with ACC or being returned to levy-payers. For example, there is no particular reason why the funding policy should be implemented while funding levels remain above the target band: depending on the fiscal impacts, Ministers might wish to consider further levy reductions (e.g., aiming to reduce funding to 105 per cent, the target midpoint) before applying the policy. Though larger reductions could take funding levels below the target, we don't think this risk should be over-stated, since ACC can post-fund any shortfall in levy income. There is equally a risk of keeping levies too high on the basis of short-term changes.

11. Options for levy reductions would need to be assessed against Government's other fiscal priorities (primarily the return to surplus)[3] and Budget spending decisions. We think other factors are also worth considering, such as the potential for higher levy rates to diminish ACC performance incentives.

Next steps

- The Cabinet paper on ACC levies is expected to be considered by Cabinet Committee in the second week of March.

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[2] Ministers subsequently indicated a preference for reducing funding via a period of low, flat levies, but deferred decisions to align with Budget discussions.

[3] Larger levy reductions will have a larger negative OBEGAL impact. OBEGAL impacts can be much larger than the reduction in levy revenue alone, due to potential secondary impacts to investment income and unexpired risk liability.

- The Cabinet paper will also include proposals to discontinue ACC residual levies, which essentially are no longer needed. If Ministers agreed, this would require legislation at Budget.

- Decisions on expected levy reductions would be included in final Budget forecasts, and could be signalled at Budget:

  - Ministers may wish to consider delaying these decisions until preliminary Budget forecasts are available in late March 2015.

  - We recommend that any Budget signal take into account the uncertainty of forecasts. Signalled reductions may well turn out to be too large or too small to generate the desired funding level by the time final levy decisions are made and implemented.

- Consultation on ACC levy rates and final levy decisions will occur later this year.

ACC Non-Earners' Account

12. The cost of injuries to people who are not in paid work is funded by government appropriations (the Non-Earners' Account).

13. Each year, ACC estimates how much funding is required for the Non-Earners' Account, based on an agreed funding policy[4] and reflecting factors such as demographic change; changes in the cost of claims; and changes in economic factors. These estimates can differ significantly from actual requirements: in recent years, funding requirements have tended to be over-estimated (following a period in which they were under-estimated). In 2014/15, they turned out to be around $175m less than expected.

Funding for 2015/16

14. ACC has identified a provisional shortfall of about $180m in the Non-Earners' Account for 2015/16 compared to current approved appropriations ($1,091m). This shortfall is driven mainly by the large drop in discount rates. The amount has yet to be confirmed.

15. There are choices about whether to fund this additional amount:

    - If it was funded, solvency in the Non-Earners' Account would be maintained in line with current forecasts and the current funding policy (though, as noted above, actual funding requirements may turn out to be substantially different from expectations). OBEGAL would not be affected, but net debt would increase.

    - If it was not funded, short-term service provision would be unaffected and we would not expect any significant impacts on ACC. The solvency level in the Non-Earners' Account would fall, so ACC would have a lower level of funds to meet future costs. Funding could be made up in a future year if needed.

16. A key question is whether the additional amount would be counted against the operating allowance. It was not counted in this way last year (i.e., the $175m that ACC no longer required was not added to the allowance). If it was to be counted against the allowance, we would recommend that the additional amount should not be funded.

[4] This policy was agreed by Cabinet in 2006 [SDC Min (06) 6/2 refers]. It is high-level and does not cover every aspect of how funding requirements are calculated (for example, assumptions about investment returns).

Next steps

- Officials will provide advice on funding for the Non-Earners' Account in early March, once numbers have been finalised.

- Officials agree that the funding policy for the Non-Earners' Account needs to be reviewed. A review could identify ways to help reduce the volatility in funding estimates for this appropriation. This is likely to be a longer-term piece of work.

[14]

Possible talking points

20. We recommend that you consider the following talking points when discussing upcoming ACC levy decisions with your colleagues:

    - While ACC's funding position has fallen, the position is volatile, and we should avoid over-reacting to recent discount rate changes.

    - There are still choices about the size and timing of ACC levy reductions:

        - Depending on fiscal impacts, options to further reduce solvency could be considered before the funding policy is implemented. This would enable levy-payers to receive larger levy reductions. There is no real risk to ACC in reducing funding levels more substantially.

21. You may also wish to discuss delaying ACC funding policy decisions until preliminary Budget forecasts are available in late March 2015, particularly if larger levy reductions are to be considered.

[14]