MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Iain Lees-Galloway	**Portfolio**	ACC
Title of Cabinet paper	Changes to ACC Funding Settings	**Date to be published**	24 July 2020

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[IN-CONFIDENCE]

Office of the Minister of Finance
Office of the Minister for ACC

Chair, Cabinet Economic Development Committee

CHANGES TO ACC FUNDING SETTINGS

Proposal

1. This paper seeks agreement to change the Accident Compensation Corporation (ACC) funding settings within the current legislative framework.

2. The proposed changes will improve accountability and transparency by reflecting the true cost of accidents; signal the Government's commitment to the longevity of the Scheme by addressing the $5.8 billion funding gap[1] in the Non-Earners' Account (NEA); and raise future living standards by improving intergenerational equity.

3. Decisions on the Levied Accounts are required before Christmas in order to make the proposed changes ahead of the upcoming levy setting round. For the NEA, the funding gap continues to grow as funding is not increased, and the annual cash costs are forecast to exceed the currently approved appropriation in 2021/22. If the appropriation is not increased to cover these costs, ACC would be required to sell their investment assets to fund the shortfall.

Executive Summary

4. ACC funding settings provide a framework that allows for greater certainty, stability and transparency of ACC's funding and the levy-setting process. The Accident Compensation Act 2001 (AC Act) sets out principles of financial responsibility, and Cabinet sets the parameters of the funding policies for both ACC's Non-Earners' (appropriation funded) and Levied Accounts.

5. The current funding policies for all Accounts were set by the previous Government, and do not fully align with this Government's wellbeing approach. We are proposing a package of changes within the current legislative framework to improve accountability and transparency by:

   5.1. reflecting the true cost of accidents
   5.2. signalling the Government's commitment to the longevity of the Scheme by addressing the $5.8 billion funding gap[2] in the Non-Earners' Account (NEA); and
   5.3. raising future living standards by improving intergenerational equity.

[1] This is the gap between the reported liability and the investment assets. Excluding the risk margin it is $4.2 billion.

[2] As above.

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6. We are proposing the following package of changes ahead of Budget 2020 and the upcoming levy setting round:

Status Quo	Proposed Change
NEA cost pressures are considered through the annual Budget process	NEA cost pressures are treated as a forecast adjustment
Current NEA funding will result in an increasing funding gap	Increase NEA funding in 2020/2021 to avoid further reductions to the funding ratio
No limit on potential funding increases	A 7.5% year on year cap on future NEA cost pressure increases
Funding target of 105% of liabilities for the Levied Accounts, including a risk margin	Funding target of 100% of liabilities for the Levied Accounts, excluding a risk margin
Two yearly levy cycle	A one year levy cycle, then three yearly levy cycles

7. If followed, the updated funding policies will increase funding for the NEA, and reduce targeted funding levels in the Levied Accounts.

8. Given the large impact of economic factors on ACC funding levels, and the current low interest rate environment, there is potential for a future wider review of settings involving legislative change as ACC's funds grow in the medium to long term. However, we consider the proposed settings are balanced and fit for purpose, an improvement within the current legislative framework, and address the immediate issue of NEA funding sufficiency. Any future work on a wider review of settings (such as full funding) should be considered following the outcomes of the Health and Disability System Review.

Current Funding Policy Settings

9. ACC funding settings provide a framework that allows for greater certainty, stability and transparency with regard to ACC's funding and the levy-setting process. Principles of financial responsibility are specified in the Accident Compensation Act 2001 (AC Act) to guide the funding and levy setting for ACC's Levied Accounts[3]. These include:

    9.1. the Levied Accounts are to be fully funded (see Appendix One for further information on full funding);

    9.2. the levies for each Account should meet the cost of new-year claims being added to the liability (this helps to send a price signal and reflect the true costs of accidents); and

    9.3. a funding adjustment is to be applied at an appropriate rate if there is a gap between the funding position and the funding target for each of the Accounts;

    9.4. large changes in levies should be avoided.

Levied Accounts

[3] The Accident Compensation Act 2001, s166A.

10. The AC Act requires the Minister for ACC to issue a Funding Policy Statement (FPS) for the Levied Accounts that complies with the principles of financial responsibility above. This was last issued in 2016. The FPS sets out a formula for ACC to calculate recommended levies. At present, levies are set every two years.

11. There are trade-offs between the principles of financial responsibility, and the FPS reflects Ministers' chosen weighting between these. The current FPS contains the following parameters:

    11.1. the average levy rate must be based on new-year costs;

    11.2. each Account must target a funding band between 100% and 110% of liabilities;

    11.3. a funding adjustment to levies which makes up any deficit/surplus in funding levels over a ten year horizon; and

    11.4. a 15% cap on any increase to the average levy rate (currently applied biennially, but could be applied on an annual basis).

12. The funding adjustment amortises any gap between the current funding position and the target over a ten-year period. However the cost of any policy change will directly impact the levy rates in full. This sends a more accurate price signal to Ministers and levy payers. For example, the impact of changes to interest rates are spread over the ten-year horizon, but the impact of the 2017 pay equity policy was immediately included in levy rates.

Non-Earners' Account

13. The Non-Earners' Account (NEA) funding policy was set by Cabinet [SEC-17-MIN-0028 refers] on 15 May 2017. This sets a target funding ratio (assets over reported liabilities) of 88%[4]. The reported liabilities include a risk margin of 12%, and so this target is equivalent to 100% of the central estimate of liabilities (excluding the risk margin).

14. The funding horizon for correcting any funding gap is set at three years when above target, and ten years when below. This means that approximately one third of the funding above target is returned each year when the NEA is above target, and only approximately one tenth of the gap is made up each year when funding is below target.

Changes to Non-Earners' Account Settings

Considerations: Falling funding levels in the NEA

15. The NEA funding ratio has now fallen to 55%[5], compared to the target of 88% (as at September 2019). This represents a funding gap of $5.8 billion[6]. There is room for ACC to make operational changes to begin to close this gap, and ACC have identified savings for 2020/21 representing 3.1% of their current appropriation. However, the funding gap is largely due to the absence of funding increases over

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[4] For post 2001 claims only.

[5] For post 2001 claims only.

[6] This is the gap between the reported liability and the investment assets. Excluding the risk margin it is $4.2 billion.

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previous years (no cost pressure funding increases since 2013), and the low interest rate environment ($269 million since last Budget). The appropriation level is now $285 million below new-year costs (the amount of funding required to cover the cost of the new-year claims being added to the liability). This is a risk to the long term position of the Account.

16. Further, the annual cash costs for the NEA are forecast to exceed the currently approved appropriation in 2021/22. If the appropriation is not increased to cover these costs, ACC would be required to sell their investment assets to fund the shortfall.

17. This is a transparency issue – ACC services are being provided but the costs are not being met by current taxpayers. These deferred payments are not visible to the public or Ministers. The costs are being shifted to future taxpayers which reduces intergenerational equity. It also reduces accountability by diminishing the 'price signal' which lets the public and Ministers know the cost of the services provided.

18. It will become increasingly difficult to make up the funding gap if funding continues to be deferred. It also represents a policy shift away from the full funding model without an explicit or informed decision from Cabinet to do so. Full funding has a number of benefits including improving intergenerational equity, transparency and efficiency.

19. Given the large impact of economic factors on ACC funding levels, and the current low interest rate environment, there is potential for a future wider review of settings involving legislative change as ACC's funds grow in the medium to long term. Investigating the implications of moving away from the full funding model, addressing the impact of economic volatility, or significantly lowering funding targets would have significant implications. These include for levy and appropriation volatility, impact on business, financial markets, the Crown balance sheet, and intergenerational equity. Free and frank opinions [redacted] We consider that scoping any work on these questions should be initiated after the delivery of the final report of the Health and Disability System Review.

Considerations: Living Standards Framework and the NEA

20. The NEA is funded by taxpayers to cover those not earning (largely children and the elderly). Older people have more comorbidities, are at greater risk of accidents such as falls, and take longer to heal and rehabilitate. This means that the aging population represents a significant and growing cost to the ACC Scheme in the future. There will already be a considerable cost to future taxpayers due to the age-related spending on health and superannuation. The decreasing proportion of taxpayers will further exacerbate the impact on the future cohort of taxpayers.

21. Ensuring the NEA is funded also increases financial capital and total Crown net worth, and thus resilience. This allows ACC's investment assets to build, which over the long run can be expected to earn investment returns above the cost of debt to the Crown. This increases value and reduces future taxpayer costs to the

Scheme. In addition, investment assets are used to support both the NZ Government, and business activity and growth. ACC supports the building of human and social capital through injury prevention, rehabilitation and income compensation.

Considerations: Performance Levers and Funding as a Prioritisation Tool

22. With other agencies, funding is used as a performance lever. A decrease in funding will either result in a decrease in services, or more efficient service delivery. This does not apply for ACC, because ACC holds investment assets that weaken the link between funding and efficient service delivery. Deferring funding does not decrease ACC services provided in the short term, nor does it improve the effectiveness of ACC spending, as ACC instead draws from its investments.

23. Therefore, it is especially important to monitor ACC performance, particularly the outcomes and effectiveness of ACC's spending. The Government has more effective levers to influence the costs of the scheme, including ACC's Service Agreement, the Ministers' Letters of Expectations, or policy changes to alter ACC entitlements. ACC provides information on the impact of uncontrollable and controllable drivers of costs, which the Treasury monitor and regularly report on.

Considerations: Fiscal Management Approach (FMA)

24. The FMA is a set of rules that help the Government meet its fiscal strategy, by ensuring Government decisions are consistent with the fiscal strategy, incentivising prioritisation of new spending, and providing transparency over future spending.

25. When the liability for the NEA increases due to new claims or revaluations of the liability, it reduces the Crown operating balance (and OBEGAL for new claims). This expense occurs whether or not the Crown funds the liability. When funding is approved, there is no change to OBEGAL, a negative impact on core Crown net debt, and no change to total Crown net worth. Charging NEA funding against the operating allowance may not be appropriate when it has no impact on the operating expenses that are reported.

26. In addition, under the FMA, spending that is entitlement based (e.g. social welfare benefit expenses) or due to revaluations is typically treated as a forecast adjustment. NEA cost pressures are largely due to ACC entitlements, and revaluations of the liability over which ACC has no control (e.g. due to changes in interest rates).

Recommended Changes: Non-Earners' Account

27. Weighing up the above factors, we propose a funding increase in 2020/21 to meet new-year costs; treating the annual NEA funding requests as a forecast adjustment; and introducing a 7.5% year on year cap on future funding increases.

28. Any new initiatives or policy changes that impact the NEA would continue to be funded through the Budget process, to maintain accountability and transparency when making policy decisions. This would include Budget initiatives with an ACC component.

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Advantages

29. This approach more closely aligns with the funding approach of the New Zealand Superfund, and allows for the possibility of presenting ACC funding alongside Superfund funding in Government communications to the public. This could help emphasise the long-term nature and intergenerational benefits of ACC funding increases.

30. This approach is also likely to increase consistency with the funding policy. It will avoid the selling of investment assets, and start to reduce the funding gap. Following the funding policy for the NEA improves transparency by reflecting to Ministers and the public the cost of accidents; upholds the commitment to full funding; and raises future living standards by improving intergenerational equity.

31. Further, this approach aligns with FMA principles. We consider that funding for the NEA is more appropriately treated as a forecast adjustment, because the changes in forecast expenses relating to the NEA are entitlement based and are adjusted without any further Parliamentary authority. The other levers mentioned above (e.g. ACC's Service Agreement, policy changes) are available to influence the size of this liability.

Fiscal Impact

32. This approach will have no impact on OBEGAL or total Crown net worth. It will also maintain the Government's control of the forecast core Crown net debt path, because forecasts are taken into account when setting Budget allowances and Ministers have the choice to charge the net impact of forecast changes against the operating allowances.

33. This approach will increase the funding provided for the NEA in the forecast period. This increase will either increase current forecasts of core Crown net debt by $1.965 billion over the forecast period, or require reductions in operating allowances. This is because NEA cost pressure bids were previously charged against the Budget operating allowances.

34. In order to reduce the immediate fiscal impact, we propose introducing a 7.5% year on year cap on NEA funding increases. A 7.5% cap will:
    - further phase the funding increases required;
    - provide ongoing assurance to Ministers on the maximum annual fiscal impact whilst addressing the funding gap;
    - further support intergenerational equity by limiting very large increases that could reverse;
    - avoid an *ad hoc* transition period;
    - typically result in the cost of new claims in the Account being met, maintaining the funding position;
    - begin to make up the funding gap from 2021/22 onwards; and
    - more closely align the NEA funding policy with the levied Accounts.

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35. Under current assumptions and with a 7.5% cap, we expect the following impact on net debt:

($m)	2020/21	2021/22	2022/23	2023/24	Total
Net Debt	285	415	557	708	1965

36. The funding increase above includes the maximum amount within the 7.5% cap each year. This means that if these funding changes are approved, ACC will not receive any future additional cost pressure funding for any year within the forecast period.

Recommended Change: Funding Target for the Levied Accounts

37. The AC Act requires the Levied Accounts to be fully funded for the cost of all claims with an adequate level of assets. Legal professional privilege [redacted]

38. The current funding policy has a central funding target level of 105% of reported liabilities, which is on average 18% above the central estimate of the liability. This includes both a risk margin (on average 13% across the levied accounts) and an additional 5% buffer.

39. We recommend setting the funding target for the Levied Accounts at 100% of the liability, excluding the risk margin and the 5% buffer, consistent with the NEA.

Advantages

40. Removing the buffer and risk margin improves the 'price signal' of levies and intergenerational equity, because it moves the funding target closer to the best estimate of the funds required to cover the future cost of claims. It will remove the current bias towards over-funding, which subsidises future levy payers.

41. Targeting the best estimate of claims costs is also consistent with the general principle of taxation that taxes should only raise adequate money to fund necessary costs. Although accounting standards require a risk margin to be reported, the funding target does not need to include it.

42. Removing the risk margins also aligns the funding target for the Levied Accounts with the NEA[7].

Impact on levy rates and OBEGAL

43. ACC's funding position has dropped significantly below the current funding target due to historically low interest rates, and levies are below new-year costs for all Accounts. Current levy rates are low compared to historical averages. In 2013/2014 the average motor vehicle levy was $334.52, whereas the current average levy rate is $113.94 per vehicle.

[7] For post 2001 claims.

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44. Levy increases will be required to bring levies up to a rate that covers new-year costs[8]. A lower funding target will mitigate these increases in the medium and long term. For the Work Account, reducing the funding target would mean slightly lower recommended levels of levy increases than under the current funding target. However Motor Vehicle levies are likely to hit the 15% cap for the next eight years regardless of the target, because current levies are significantly below new-year costs. Cabinet has discretion to set different levies from the recommended rates.

Levy projections as at October 2019	Current levy cycle	2021/22	2022/23	2023/24	2024/25
Work Account (current target)	$0.67	$0.77	$0.77	$0.89	$0.89
Work Account (proposed)	$0.67	$0.75	$0.77	$0.78	$0.79
Earners' Account (current target)	$1.21	$1.39	$1.39	$1.60	$1.60
Earners' Account (proposed)	$1.21	$1.39	$1.51	$1.53	$1.54
Motor Vehicle Account (current target)	$113.94	$136.12	$136.12	$162.60	$162.60
Motor Vehicle Account (proposed)	$113.94	$133.55	$156.53	$183.47	$202.33

45. The following table shows the OBEGAL impact of the proposed levy target:

$m	2019/20	2020/21	2021/22	2022/23
OBEGAL impact of changing the target	0	(63)	(66)	(238)

Risks

46. ACC modelling shows there is no significant increase in risk that any of ACC's Levied Accounts would have insufficient funds to cover entitlements with the proposed lower funding target. Any risk of funding insufficiency is also mitigated by the fact that ACC has government backing, a legislative requirement for full funding and compulsory levies, the ability to fund any shortfalls over time, and no competition. There will also be no implications for ACC's injury prevention spending.

47. Targeting the expected cost of claims would see ACC's balance sheet usually in deficit. This is because accounting standards require a risk margin in reported liabilities, but targeted funding levels would not. Free and frank opinions [redacted]

48. Free and frank opinions [redacted]

Frequency of Levy Rounds

49. The legislation does not specify the frequency of levy rounds, which are currently held every two years. Levy rates are due to be considered in mid-late 2020 to come into effect in 2021.

[8] Current levy rates do not meet new-year costs as we were previously above the targeted funding levels, and the funding adjustment therefore reduced levy rates. Levy rates are now significantly below new-year costs.

50. We intend to set levies for one year only in 2020, and then move to a three yearly levy setting cycle with decisions in the middle of a parliamentary term. This has the advantages of increasing consultation time, enabling use of the same timetable and reference period for every levy round, and administrative cost savings for Treasury, The Ministry of Business, Innovation, and Employment (MBIE), and ACC.

51. A three yearly cycle is likely to require stepped annual levy increases to avoid large levy changes at the end of each cycle. There may also be other operational impacts on ACC and Worksafe. Officials will provide further advice on these implications ahead of decisions at the next levy round in 2020.

Funding Adjustment for levies

52. The Funding Policy Statement (FPS) includes a funding adjustment, which determines how much we increase/decrease levies to make up any funding gap between actual and targeted funding levels. At present, the funding gap is made up over a ten year horizon, which returns approximately one-tenth of the surplus or deficit to the levy rates for each year in any levy round.

53. We intend to clarify how this mechanism works in the FPS, however further analysis is required to ensure that any change to the FPS does not result in unintended consequences. Analysis will include actuarial modelling and stress testing which is expected to be completed in early 2020.

Consultation

54. This paper was prepared by the Treasury and the Ministry of Business, Innovation and Employment (MBIE). The Ministry of Transport, Ministry of Justice, Ministry of Health, Ministry of Social Development, Te Puni Kōkiri, the Inland Revenue Department, New Zealand Customs Service, Ministry for Pacific Peoples, Ministry of Women's Affairs, New Zealand Transport Agency, ACC and WorkSafe were consulted. The Department of the Prime Minister and Cabinet was informed.

55. Business NZ and the New Zealand Council of Trade Unions (NZCTU) have been consulted on the proposal to lower the funding target for the Levied Accounts. The New Zealand Automobile Association was approached for feedback but did not respond. Both Business NZ and NZCTU supported the changes and noted that removing the risk margins and buffers aligned with previous feedback given by both organisations in previous consultations.

56. Business NZ supports full funding and agrees that ACC does not need to hold on to more money than what its best estimate of injury costs is. NZCTU would prefer a shift away from full funding and so supports a change that reduces the amount of money that ACC holds.

57. Both organisations agreed that the unique nature of ACC (a statutory monopoly with legislated ability to collect levies) meant that treating it like a commercial insurance provider with regards to a risk margin was not warranted.

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Financial Implications

58. Treating NEA cost pressures as a forecast change will likely halt the current trend of deferring NEA funding to future Budgets. This approach will either increase current forecasts of core Crown net debt by $1.965 billion over the forecast period, or require reductions in operating allowances. This change will have no impact on OBEGAL.

59. The 7.5% cap will decrease the size of the net debt impact in the short term, by phasing funding increases over a larger number of years:

($m)	2020/21	2021/22	2022/23	2023/24	Total
Net Debt	285	415	557	708	1965

60. Decreasing the funding target for the Levied Accounts is expected to decrease OBEGAL and mitigate future levy increases. This change will have no impact on net debt.

	2019/20	2020/21	2021/22	2022/23
Estimated OBEGAL impact of target change ($m)	0	(63)	(66)	(238)

Levy projections as at October 2019	Current levy cycle	2021/22	2022/23	2023/24	2024/25
Work Account (current)	$0.67	$0.77	$0.77	$0.89	$0.89
Work Account (proposed)	$0.67	$0.75	$0.77	$0.78	$0.79
Earners' Account (current target)	$1.21	$1.39	$1.39	$1.60	$1.60
Earners' Account (proposed)	$1.21	$1.39	$1.51	$1.53	$1.54
Motor Vehicle Account (current target)	$113.94	$136.12	$136.12	$162.60	$162.60
Motor Vehicle Account (proposed)	$113.94	$133.55	$156.53	$183.47	$202.33

Legislative Implications

61. The Funding Policy Statement (FPS) is issued as a Ministerial direction under the Crown Entities Act 2004. To change the FPS, the Minister for ACC must consult with ACC as well as such persons or organisations as the Minister considers appropriate, publish the FPS in the Gazette, and present a copy of it to the House of Representatives, as soon as practicable after it is issued. A draft FPS is included in Appendix Two.

Impact Analysis

62. The Regulatory Impact Analysis (RIA) requirements apply to the funding target proposal in this paper. A Regulatory Impact Statement has been prepared and is attached.

63. MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Summary prepared by MBIE. The Panel considers that the

information and analysis summarised in the Regulatory Impact Summary meets the criteria necessary for Ministers to make informed decisions on proposals in this paper.

Human Rights, Gender, and Disability Implications

64. The proposals in this paper are unlikely to have specific implications for human rights, a gender perspective, or people with disabilities.

Publicity

65. We intend to announce the change to the funding target for the Levied Accounts following Cabinet agreement. This change will also be communicated in the consultation documents of the upcoming levy round.

Proactive Release

66. This paper will be made available to the public on the Treasury and MBIE websites, subject to redactions as appropriate under the Official Information Act 1982.

Recommendations

The Minister of Finance and the Minister for ACC recommend that the Committee:

1. **note** that
    a. the Non-Earners' Account funding position has now fallen to 55% against a target of 88%, which represents around a $5.8 billion funding gap including the risk margin
    b. this raises concerns about transparency, an increasing burden for future taxpayers, and a shift away from the full funding model without an informed, explicit decision from Cabinet
    c. levies are significantly below new-year costs as the Accounts were previously overfunded and levies were therefore charged below new-year costs to reduce the funding position
    d. levy increases will likely be required even if the funding target is reduced, as funding levels have deteriorated significantly since the last levy round, although we expect these increases to be lower on average in the short to medium term with a lower funding target
    e. current levy rates are low compared to historical averages

2. **agree** to treat cost pressures in the Non-Earners' Account as a forecast adjustment, in order to improve transparency, better align with the fiscal management approach, uphold the commitment to funding the Scheme, and improve wellbeing by supporting intergenerational equity

3. **agree** that the Non-Earners' Account funding for 2020/21 should meet new-year costs, estimated at $285 million as at September 2019, to maintain the current funding ratio and avoid the selling of investment assets

4. **agree** to introduce a 7.5% cap on future year on year appropriation increases for the Non-Earners' Account to provide assurance on the maximum annual fiscal impact, and to further support intergenerational equity

5. **note** that as at September 2019, the net debt impact of recommendations 2, 3, and 4 above is estimated to be $1.965 billion over the forecast period

6. **authorise** the Minister of Finance and the Minister for ACC to approve changes to the Non-Earners' Account appropriations as a forecast adjustment, subject to the funding policy [SEC-17-MIN-0028 refers] and recommendations 3 and 4 above

7. **agree** to set the funding target for the Levied Accounts at 100% of liabilities excluding the risk margin, to improve intergenerational equity and send a better price signal

8. **invite** the Minister for ACC to publish an updated Funding Policy Statement in the Gazette to include the change in recommendation 7 above

9. **agree** to set levies for one year only at the upcoming levy decisions in 2020

10. **note** that officials will provide further advice to the Minister of Finance and the Minister for ACC on moving to a three yearly levy setting cycle after the next levy round

11. **note** that officials will provide further advice to the Minister of Finance and the Minister for ACC on Funding Policy Statement amendments to the funding adjustment approach that returns one-tenth of the surplus or deficit to the levy rates for each year in any levy round in early 2020

Authorised for lodgement

Hon Grant Robertson Minister of Finance	Hon Iain Lees-Galloway Minister for ACC

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Appendix One: Full Funding (Save-As-You-Go)

Full funding, or Save-As-You-Go (SAYG) refers to funding the lifetime cost of claims that occur each year, rather than just the annual costs of covering claims (Pay-As-You-Go, PAYG). In practise, calculating the lifetime cost of claims involves a number of assumptions, and full funding can refer to a range of different funding levels.

The AC Act requires the Levied Accounts to be fully funded, but does not specify required funding levels for the NEA. The NEA is fully funded for post 2001 only, and pre-2001 claims are funded on a PAYG basis.

There are a number of advantages of full funding, including:

- **Improving intergenerational equity**: Current levy payers pay for the lifetime cost of claims each year, avoiding cross-subsidisation across generations. For the NEA, the aging, slower to rehabilitate population and the decreasing proportion of taxpayers represents a considerable cost for future taxpayers. Fully funding the NEA reduces this future cost by covering the costs of liabilities as they arise.
- **Transparency**: Full funding makes visible the true cost of services, policies and injuries that extend over multiple years that entail cumulative costs (e.g. social rehabilitation for people with serious injuries). This helps to inform prudent policy making, and signal to levy payers the true cost of injury, incentivising injury prevention.
- **Investment returns**: Full funding enables ACC to invest a portion of its revenue, which generates investment income and in turn reduces pressure on future funding. Investment returns are expected to be higher than risk free discount rates, and so it costs less overall to fund the accounts earlier rather than later. In addition, investment assets are used to support both the NZ Government, and business activity and growth. ACC has had very strong investment returns over the last 20 years, and this income is reduced when ACC funding levels are below target.
- **Insulating levy payers and the Government from shocks**: Large changes in funding levels can be spread across a number of years, helping avoid large levy/appropriation increases, which is highly important to businesses. If funding levels are too low, this would restrict the ability to spread out these costs.
- **Injury prevention**: ACC are able to use funds that are not immediately required on injury prevention, which decreases the incidence and severity of injuries and reduces future costs to the scheme.
- **Balancing the Crown balance sheet**: The ACC liability is included in total Crown net worth, and full funding helps offset this.
- **Resilience**: Full funding signals the Government's commitment to the longevity of the scheme; that it is being maintained in a way that is financially responsible; and that entitlements will be maintained.

If funding is continuously deferred, it represents a policy shift away from the full funding model, without an explicit or informed decision from Cabinet to do so. Investigating the implications of moving to a Pay-As-You-Go model or significantly lowering funding targets would have significant implications for levy and appropriation volatility, impact on business, financial markets, the Crown balance sheet, and intergenerational equity.

Appendix Two: Draft Funding Policy Statement

Funding Policy Statement in Relation to the Funding of ACC's Levied Accounts

This statement has been issued under section 166B of the Accident Compensation Act 2001 ("Act").

In accordance with section 331(3) of the Act, the Accident Compensation Corporation (ACC) must give effect to this statement when recommending the making of regulations prescribing the rates of levies to the Minister for ACC.

Purpose

The purpose of this statement is to set out the Government's policy with respect to the funding of ACC's levied Accounts:

- The Earners' Account (including any part of the Earners' Account required to fund the Treatment Injury Account in accordance with section 228 of the Act);
- the Work Account; and
- the Motor Vehicle Account.

Accident compensation is by nature a long-term activity with liabilities that stretch over decades. In setting levies, it is necessary to consider the long term nature of the claims they will fund as well as provide levy payers with reasonable stability of levy rates over time. This statement informs ACC of the Government's expectations with regard to these two factors. In particular, the statement is intended to improve:

- transparency around funding decisions, by making it clear how today's funding decisions will impact the scheme over future periods; and
- consistency and stability in decisions over time, by imparting a longer-term focus.

Principles of Financial Responsibility in Relation to Accounts

This policy statement is consistent with the principles of financial responsibility outlined in section 166A of the Act. Specifically, section 166A requires the cost of all claims under the levied Accounts to be fully funded. This means adequate assets must be maintained to fund the costs of claims. To achieve full funding when setting levies, section 166A requires the Minister for ACC to have regard to the following principles:

- The levies derived for each levied Account should meet the lifetime costs of claims made during the levy year;
- if an Account has a deficit or surplus of funds to meet the costs of claims incurred in past periods, that surplus or deficit is to be corrected by setting levies at an appropriate level for subsequent years; and
- large changes in levies should be avoided.

It is acknowledged that there may necessarily be trade-offs between the principles of financial responsibility. The statement below reflects the Government's weighting of those principles.

Funding Policy Statement

Consistent with the principles of financial responsibility, ACC must recommend levies for each levied Account according to the following requirements:

a. ACC must base the average levy rate on the expected lifetime cost of claims in relation to injuries occurring in the period for which ACC is recommending levies ("expected lifetime injury costs in the levy period").
b. Each Account must target a funding ratio of 100%. The funding ratio is calculated by dividing total assets, less payables, accrued liabilities, provisions, unearned levy liability and unexpired risk liability by the outstanding claims liability (including additional liability for work-related gradual process claims not yet made but excluding any risk margin).
c. ACC must include an adjustment to the average levy rate that takes the Account's funding ratio to the target defined in (b) smoothly over a ten-year horizon. This is to be achieved by setting the adjustment at a fixed proportion of expected lifetime injury costs in the levy period, and for each such period, over the ten-year horizon.
d. Any increase to the average levy rate for each Account must not exceed 15% (in addition to inflation adjustments for the Motor Vehicle Account).

Dated this xth day of December 2019.

Hon IAIN LEES-GALLOWAY, Minister for ACC.

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