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MELVILLE JESSUP WEAVER
CONSULTING ACTUARIES TOWERS PERRIN ALLIANCE PARTNER

September 2008

ACC – Significant cost pressures pushing up levies

1. Summary

This newsletter comments on the proposed ACC levies for the 2009/10 year, as set out in the ACC Consultative Documents that were released on 11 September 2008. A number of the following charts are taken directly from the Consultative Document.

Submissions on the proposed levies are due by 8 October 2008 and the final rates may well differ from those in the Consultative Document.

Major cost increases for 2009/10

The table below shows the large increase in expected claims costs for the 2009/10 year.

Account	Levy year 2008/09 $m	Levy year 2009/10 $m	Increase %
Work	520	596	14.6
Earners	953	1,287	35.0
Motor	397	447	12.6

ACC has reduced the impact of the increases by its funding policy, which smoothes the period over which the full costs are bought to bear. The resulting proposed levy rates are:

Work and Residual Claims Accounts

Average Work Account levy reduced from 72 to 70 cents per $100 liable earnings. Average Residual Claims Account levy increased from 54 to 56 cents per $100 liable earnings. The combined levy remains at $1.26 cents. The levies are GST exclusive.

Earners' Account

Increase from $1.40 to $1.70 per $100 liable earnings, inclusive of GST. This now includes 8.9 cents to fund pre-1999 claims.

Motor Vehicle Account

Increase in combined average motor vehicle levy from $254.63 to $287.00, excluding GST. The licensing fee increases from $136 to $168 and the petrol levy from 9.34 to 9.90 cents per litre.

Comment

The increases in the levies for all but the Work Account and Residual Claims Account are substantial for the 2009/10 year, and the outlook for all the accounts is not good.

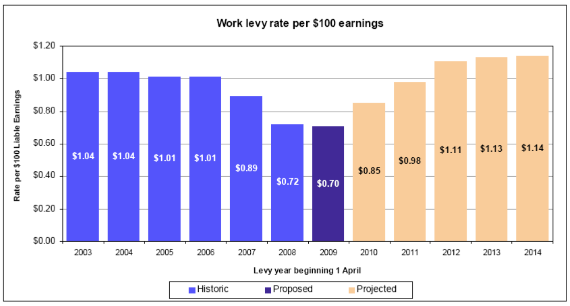
The effect of the large increases in costs shown in the table above are further illustrated when we compare the levies for 2013 projected this year with those for 2013 projected last year. See the chart below.

Account	Increase
Combined work and residual claims	35%
Earners	88%
Motor	24%

The level of the projected increases is cause for concern.

2. Work Account

The chart below shows the levies from the year beginning April 2003 projected through to 2014. The levy was relatively stable from 2003 through to 2006 and since then has fallen.



Forecast future increase

The concern when viewing the levies is the marked increase to $1.14 for the year beginning April 2014. A review of the make up of the 70 cent 2009/10 levy provides information on why the levy will increase over time.

Cost of claims	0.83
Scheme costs	0.16
Funding adjustment	-0.32
WSMP discount funding	0.03
Average 2009/10 work levy rate	0.70

The Scheme costs cover claims handling costs, injury prevention costs, collection costs and ACC administration costs. The funding adjustment combines a risk margin of 7 cents for the current year claims and a release of 39 cents from the existing account reserve.

The reserve is worth $499 million, a reduction on the June 2007 position of $1,088 million, due in part to a reduction in the investment earnings for the June 2008 year. Without the current surplus the levy would increase to $1.09.

Cost pressures

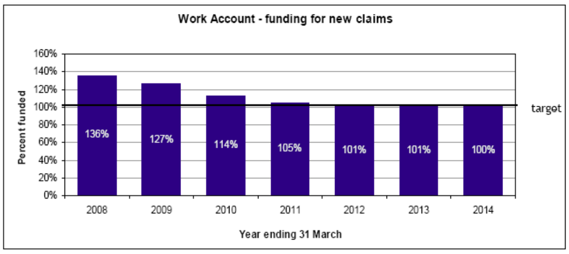
As noted in the first table, the expected cost of current claims rises sharply in 2009/10. This is due to an increase of 13.9% in the cost of the average entitlement claim, which moves from $15,190 to $17,307. The factors driving this are:

- The 2008 amendment to the Act which introduced a number of changes, the cost of which is a 6 cent levy increase. Those changes comprise:
    - extending cover for work related mental injury that results from witnessing a sudden traumatic event in the course of employment,
    - increased access to vocational rehabilitation, and
    - increased weekly compensation where a person's employment status is non-permanent.
- Increased costs of medical and hospital treatment. For example there are significant increases in surgery related labour, equipment and facility costs in 2008.
- Increased costs of social rehabilitation for both serious and non serious claims. For example the number of claims classified as serious and requiring more treatment has increased and the cost of home based care has increased.

Factors which are keeping costs down are:

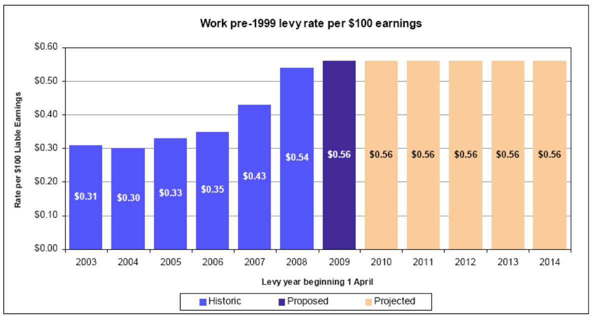
- an 8% increase in the expected liable earnings figure, which may be optimistic if the economy dips seriously, and
- the expected number of claims, which is expected to increase but only marginally.

The impact of the funding adjustment is illustrated in the chart below, which shows that the surplus is used up in the period to 2014.



3. Residual Claims Account

The levy has again increased and is now 56 cents compared to 54 cents in the current year. The intention remains to fund these claims on a level premium basis.



The particular factor driving the proposed increase is a revision of the estimated cost of the hearing loss claims - while the average cost is reduced, the number of expected claims has increased.

The levy for 2014 is payable for the period April to June 2014.

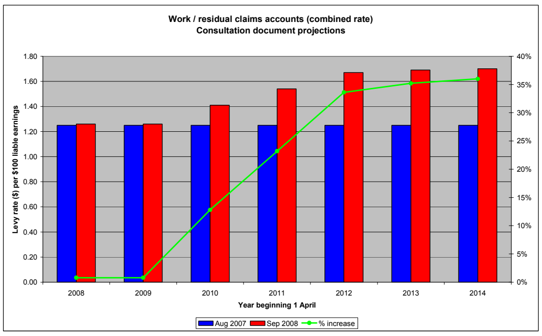
There have always been questions about whether the levy paid in a year related to that year or, as it was based on the past year's liable earnings, was it payable in arrears. At a meeting in Auckland on 15 September, ACC confirmed that the former applies, so that the levy paid in a year is for that year.

Comment on gradual process claims

The driver of the increase in the RCA levy is the cost of the gradual process claims and the allocation of part of the cost based on exposure to the hazard for period pre-1999. This approach needs to be revised and either the cost of gradual process claims need to be met in the year of notification or a separate levy charged for these claims. There are good arguments supporting either option.

4. Work/Residual Accounts- Combined rate

There has clearly been a change in the funding policy adopted for this year. In previous years ACC has looked to have a smooth levy through to 2014 when combining both accounts. The chart below combines the two levies and overlays the results on the projected combined rate in the 2008/09 Consultative document.



The results show a major increase in costs beginning April 2010.

5. Partnership Programme

There are no changes to the structure of the ACC PP: the table below summarises the changes in the ACC PP costs.

Item	2008/09	2009/10
Administration fee	4.60%	4.30%
Primary health costs	1.40%	1.50%
Bulk funded health costs	4.80%	4.10%
PDP discounts *		
1 year	52.50%	50.80%
2 year	57.40%	57.10%
Stop loss limits for FSCP *		
Minimum	224.00%	230.00%
Maximum	350.00%	355.00%
HCCC for FSCP		
Minimum		$0.25m
Maximum		$2.50m

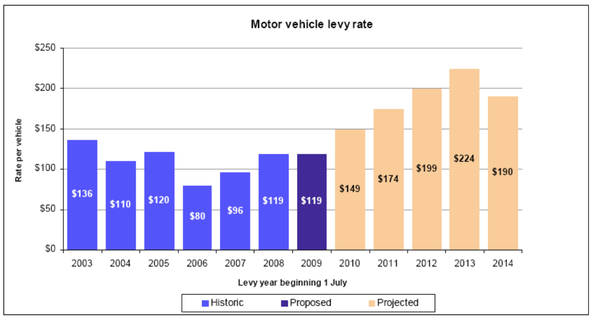
* net of WSMP discount

6. Motor Account

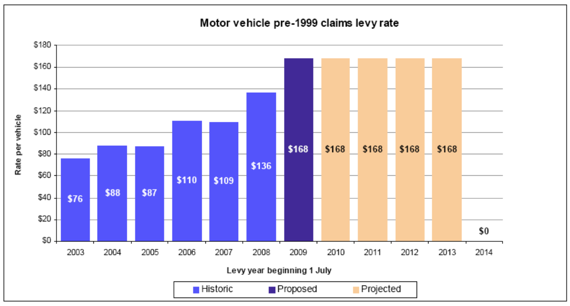
For the average motorist with a petrol driven car, the Motor Vehicle Account is funded by a licensing fee levy and a levy on each litre of petrol, with the former funding the pre 1999 claims and the latter funding the current year claims. For the current year the licensing fee is $136 and the petrol levy is 9.3 cents per litre.

The charts below show the levies for the 2009/10 claims and the pre-1999 claims. Previously ACC have only focused on the combined levy. Note that while there is only the one account, ACC splits the account into current year claims and pre 1999 claims.

Current year claims



Pre 1999 claims



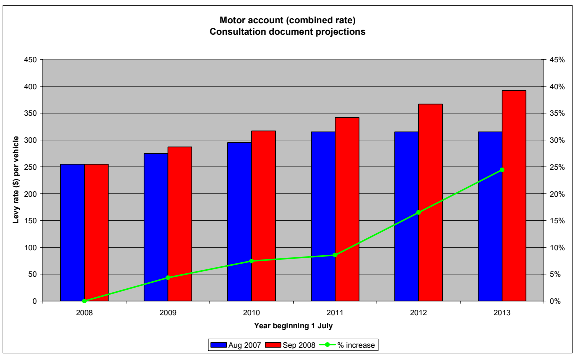
The charts show:

- The levy remains the same at $119 for current claims, paid for by the petrol levy.
- The levy for pre-1999 claims has increased from $136 to $168. The increase can be put down to the major cost increases in the treatment of the longer term serious claims and the reclassification of certain claims as serious claims.

While the same cost factors are driving the increase in the levies for the Motor Account as applies to the Work Account, the cost of an average claim in the Motor Account is greater at $56,635 compared to $17,307. (The Motor Account has 40% of the serious claims lodged each year.)

ACC has only been able to keep the levy for the current claims at $119 by deciding to run down its reserves for the 2009/10 year. The consequence is seen through the high increases in the following years. As again illustrated by the first table, the cost for current claims has increased by 12.6% for the year. The problem with the increase in costs is highlighted further in the chart below which compares the combined motor vehicle rates from the 2009/10 Consultative Document with rates included in the 2008/09 Consultative Document.

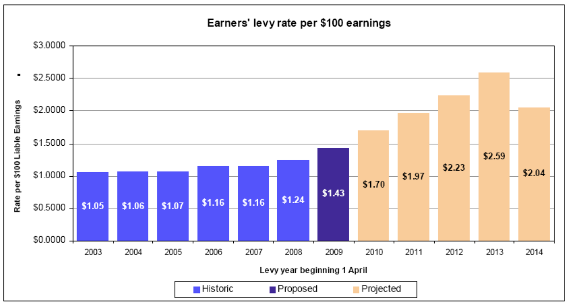
The small increase in the levy for current claims recognises that the increase in the cost of petrol is reducing petrol usage and is also reducing costs due to fewer accidents occurring.



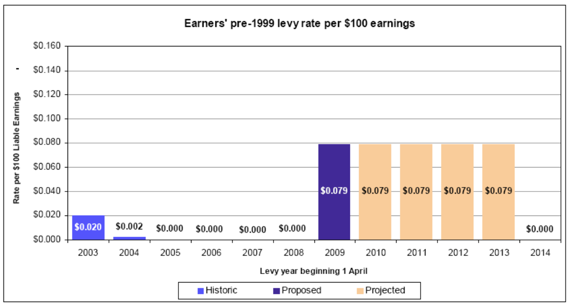
7. Earners' Account

This is the account which appears to have the most serious cost problems. The charts below show the levies (excluding GST) for the 2009/10 claims and the pre-1999 claims. Previously ACC have only published one rate. (As with the Motor Account, while there is only one account, ACC splits the account into current year claims and pre 1999 claims.)

Current claims



Pre 1999 claims

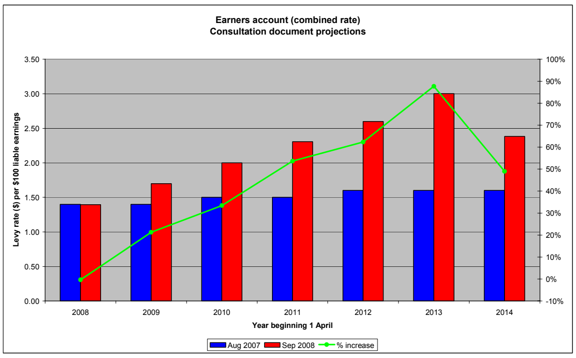


The charts show:

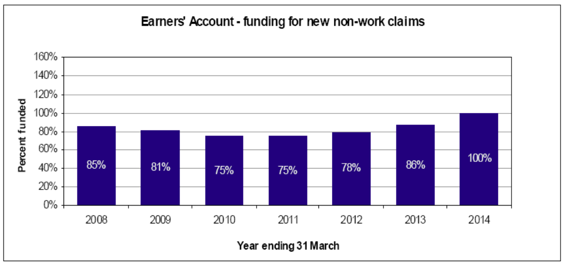
- The levy rate for current claims is due to rise from $1.24 to $1.43.
- It will then increase further to $2.59 in 2013 before reducing to $2.04 in 2014.
- There are clearly problems with the pre 1999 claims, as there is now a levy of 7.9 cents payable through to 2013.

While the same cost factors as for the other accounts are driving the increase in the levies for the Earners Account, we note the frequency of entitlement claims is up by 3.5% and the average claim costs have risen from $13,964 to $17,820, a 27.6% increase.

As with the Motor Account, ACC has only been able to keep the cost of the levy down by deciding to run down its reserves for the 2009/10 year and spread the cost increases over a 5 year period. This is highlighted in the following chart, which compares the combined Earners Account rate for the 2009/10 year with rates included in the 2008/09 Consultative Document.



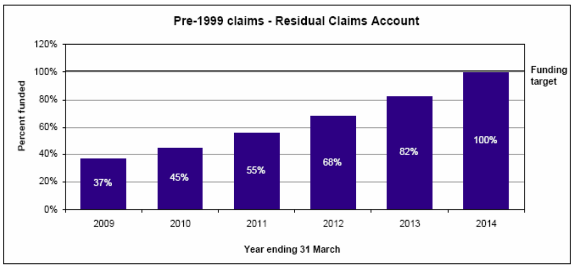
The chart below illustrates the funding position for the current claims up to 2014, showing that the current claims are 86% funded as at June 2008.



8. Funding position as at June 2008

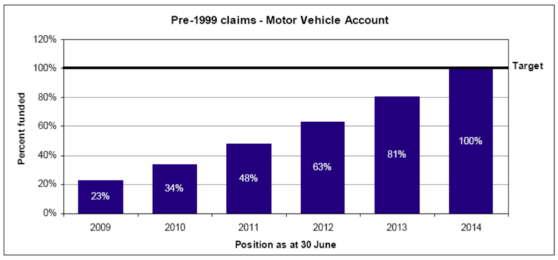
The tables below illustrate the projected funding levels of the pre 1999 claims for the three accounts from June 2008 to 2014. The funding levels are lower than might be expected at this stage of the funding cycle and lower than as at June 2007.

Residual Claims



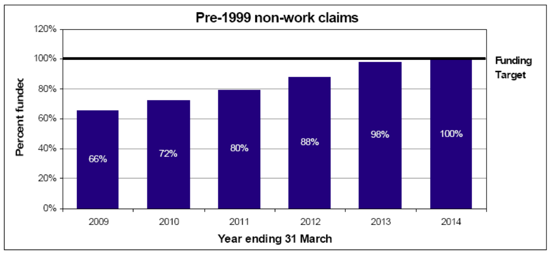
The account is currently 37% funded.

Motor Vehicle



The account is currently 23% funded.

Earners



The account is currently 66% funded.

9. General Comments

It is clear ACC has problems with its claims costs.

Scheme expansion

The increases in cover for the Work Account are projected to cost 6 cents and the hope is that ACC will manage this scheme expansion within this projected claims cost figure.

Claim costs

ACC needs to carefully review its expenditure and be certain that money spent on, for example, surgical procedures will produce the right rehabilitation outcomes.

Social rehabilitation costs

A question is whether the level of care target, which appears to have moved up, is possibly now too high.

Claims entitlement

With the increase in claims frequency in the Earners Account, there may be some cost shifting from the public health system. It is possible that some conditions may be being treated as accidents, as the medical profession is aware that accessing treatment in the public health system can sometimes be slow.

Long term claimants

Evidence suggests that the longer term claims are not being moved back to work as expected and claimants are remaining longer than expected on benefit.

Claims management

There is the question as to whether ACC needs to seriously review its total claims management approach in order to improve the current outcomes.

Changing the target date for funding pre-1999 claims

With the increase in the current year costs and increases in the cost of pre 1999 claims there will be calls to push the 2014 funding target date back and spread the increased costs over a longer period. This may be required, but should only be implemented after full consideration of the issue of how to best address the serious claims costs issues ACC is experiencing.

Injury prevention

The projected expenditure on injury prevention in all the accounts looks low, given both the increase in claims costs and when judged against the fact that one of ACC's main responsibilities under the Injury Prevention, Rehabilitation, and Compensation Act 2001 is to prevent injuries. ACC will need to work with other Government agencies on injury prevention.

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