The Liversidge *e*-Letter

An *Executive Briefing* on Emerging Workplace Safety and Insurance Issues

August 25, 2004 **An *Electronic Letter* for the Clients of L.A. Liversidge, LL.B.** **4 pages**

2005 WSIB Premium Rate Consultation:
Average Rate Could Rise Between 4.5% and 8.2%

August 18, 2004 Premium Rate Consultation: WSIB Senior Executive Group meets with Senior Business Lobby: Premium Rates Likely to Rise

Financial pressures force a focus on higher premiums

On August 18, 2004, the leadership group of the Ontario Workplace Safety & Insurance Board ["WSIB" or the "Board"] met with senior representatives of Ontario's employer trade associations to discuss the financial pressures facing the workplace safety and insurance system ["WSI"], and specifically, to address premium rate options for 2005. Leading the discussions were Ms. Jill Hutcheon (Acting Chair), along with Ms. Malen Ng (Chief Financial Officer), Mr. Brock Horseman (Chief Operations Officer), Mr. Roy Mould (Chief Prevention & Corporate Strategy Officer), Mr. Rob Hinrichs (Chief Actuary), Mr. Harry Gibbs (Vice-President, Investments), Ms. Jane McCarthy (Vice-President, Health Services), with the meeting facilitated by Mr. Leon Korbee (Vice-President, Communications).

WSIB leadership committed to avoid future funding crisis

Unlike last year (July 2003), there were no decisions taken at the meeting, nor was a business consensus advanced or sought. The meeting was primarily information focused, with Board officials providing a very extensive and detailed overview of the current state of affairs. As I introduced in the **July 14, 2004 issue of The Liversidge *e*-Letter**, it is my assessment that while the Ontario WSI system at present faces many challenges, and all is not perfect, the WSI system is not in a state of crisis by any measurement (unlike past eras). I posited (and still do) that while financial pressures persist, a financial crisis does not. I argued that "*while a financial misstep could again place the scheme in a state of crisis, we are not there now, nor is the system likely to repeat the questionable policies and approaches of the past*". It is clear that the Board's leadership is committed to ensuring that a future financial crisis is avoided, and that the system does not slip "off-target" (100% funding by 2014).
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Early Notice: Fall 2004 L.A. Liversidge Client Update and Executive Briefing:

October 19, 2004

Set aside October 19, 2004 (morning) in your calendar now.

You do not want to miss this update

Over the next few months the following will happen:

- ✓ **A new Chair *and* a new President will be appointed to the WSIB.**
- ✓ **A new WSIB Board of Directors will be in place.**
- ✓ **The WSIB will have consulted on 2005 premium rates and premium levels likely will be set.**
- ✓ **The WSIB funding strategy will be reviewed.**
- ✓ **Direction set for experience rating reform.**
- ✓ **Consultation on the ODAP Report completed.**
- ✓ **The Minister's audit will continue its impacts, as the Board becomes more accountable.**

In short, the system will be transformed from what we see today.

2004 will prove to be a milestone year.

To ensure you stay up-to-date, attend this briefing, exclusive and complimentary to L.A. Liversidge clients.

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WSIB Acting Chair strongly commits to ongoing dialogue on financial issues

Ms. Hutcheon provided an unequivocal commitment to a comprehensive consultation (beyond addressing 2005 premium rates) to focus on pressing and emerging financial issues, including investment strategy, administrative costs, rising health care costs (and presumably other issues identified by employers over the last two years, such as labour market re-entry costs). Ms. Hutcheon was clear – the Board, at its most senior levels, will initiate this dialogue.

The historical context

Mr. Hinrichs, WSIB Chief Actuary, provided a brief historical context of the current state of the system. During the period 1984 to 1993, both the unfunded liability ["UFL"] (the short-fall between the Board's assets and its future benefit commitments) and premium rates rose dramatically. From 1994 – 2001, this trend reversed and both rates and the UFL declined substantially. Recently (2002 – 2003) both the UFL and premium rates have trended upwards, *albeit* rates have gone up only marginally.

In the late 1980s and early 1990s, the economy slowed and liabilities outpaced investments, resulting in an increase of the UFL from $2.0 billion to $11.5 billion. Concurrently, premium rates shot upwards from $1.88 to a high of $3.20 (and then a modest decline to $3.01).

From 1995 - 2000, with a booming economy, lower lost time accident rates ["LTIs"] and average investment returns of 15%, the Board's investment portfolio increased 85% whereas liabilities declined 8%. The UFL was reduced dramatically to $5.7 billion and premium rates declined to $2.13. These were "good times" (but hopefully not "*the good ole days*", *ed.*) and in hindsight (according to both Mr. Hinrichs and Ms. Ng), premium rates may have declined too far too fast (although employers may disagree, *ed.*).

During 2001 and 2002, investment returns were negative and future costs (liabilities) were on a sharp upward incline. Health care costs ["HCC"] continued a significant increase (a trend which began a few years earlier) and occupational disease claims (very expensive) were on the rise. As a result, liabilities outpaced investments. By the end of 2003, the UFL had increased by 25% to $7.1 billion, and premium rates rose (in 2003) from $2.13 to $2.19 (the average rate was held flat for 2004). Future costs placed increased pressure on the WSIB funding strategy.

WSIB investment returns

Mr. Gibbs, Vice-President, Investments, advised that over the last 10 years, the Board's fund has earned 8.3% per annum (1.3% better than the 7% benchmark).

Year	WSIB Returns	Benchmarks
1994	-1.7%	1.8%
1995	18.4%	17.3%
1996	16.6%	17.4%
1997	16.3%	15.0%
1998	11.4%	13.8%
1999	12.8%	14.4%
2000	8.0%	1.1%
2001	-1.5%	-6.7%
2002	-6.2%	-11.5%
2003	12.8%	12.3%

Health Care

Mr. Horseman and Ms. McCarthy both provided an overview of health care pressures facing the WSI system, noting that HCC are a world-wide issue. HCC rose from $229 million (in 1998) to $386 (in 2003), a 69% increase over 5 years. The total $386 HCC portfolio is comprised of several significant elements. While payments to hospitals and doctors are understandably the largest components ($66.9 and $66.5 million respectively, or 35% of the total 2003 HCC), items such as hearing aids ($36.5 million), medical devices ($23.5 million), personal care allowances ($22.2 million), travel and accommodation ($20.8 million), and independent living allowances ($11.2 million) represent almost one-third of the total HCC.

The Board committed to be diligent in improving the effectiveness and efficiency of its health care programs and services, and will be initiating a review of key health care investments, with the terms of reference and timelines for those reviews to be developed in the future.

Prevention

Mr. Mould advised that the Board (and Ministry of Labour) have set as a target a 20% reduction in LTIs over the next four years, which, according to the Board, will result in a $200 million expenditure saving for the Board. It is interesting to note that the Ministry of Labour ["MOL"], in a press release issued just July 8, 2004, quotes Labour Minister Bentley as advising that the expected 20% LTI reduction will represent savings to the WSIB "*of an estimated $300 million*". This is a significant variance since $100 million in benefit costs represents about $0.07 of the total average premium rate (LAL comment).

Administrative costs

Ms. Ng, the Board's Chief Financial Officer, referenced the Ministry of Labour's WSIB Audit [see **June 16, 2004 issue of The Liversidge *e*-Letter**] and noted that while continual improvement is underway, the audit noted that the Board has already made improvements in its operational efficiency and effectiveness. For 2003, the total WSIB administrative costs were $673 million, comprised of $501 million for administration and other expenses and $172 for "legislative obligations and commitments".

Of the $501 million for administration, $335 million was consumed in employee salary and benefits. Of the "legislative obligations" (over which the Board has no control), which include funding the Occupational Health and Safety Act ($43 million), the Workplace Safety & Insurance Appeals Tribunal ($18 million), the offices of the Worker ($8 million) and Employer ($3 million) Advisers. Of the other "commitments" the Board funded the health and safety associations ($87 million), along with the Institute for Work and Health ($5 million) and provided various grants ($7 million). While the legislative obligations and commitments rose $12 million 2002 to 2003 (+7.5%), WSIB direct administrative costs declined $23 million (-4.4%).

For 2003, the WSIB administration costs, according to the AWCBC definition, represents $0.35 of the premium rate. Ms. Ng advised that the Board is launching an aggressive 2005 business planning and budgeting process and will be completing program reviews.

The unfunded liability

Mr. Hinrichs, WSIB Chief Actuary, advised that there are major pressures on the UFL, which include losses from 2001 in investment earnings [still to be fully recognized], costs of legislative obligations and a net growth in benefits liability.

Funding Strategy for 2005 premium rates

Mr. Hinrichs explained that if the Ontario WSI was not saddled with an UFL, for 2004, the annual premium would have been $1.41 (instead of $2.19 - $0.78 is collected for the UFL). However, even without the UFL, 2005 premium rates would still rise because of increased new claims costs and experience losses from past years. Therefore, based on the Board's projections, with no UFL, the 2005 premium rate would rise $0.07 due to these pressures. New claims costs increased from $0.94 to $1.02, and legislated obligations (the hiring of 200 new MOL health and safety inspectors) will increase the legislative obligations $0.01, and the experience gains and losses will increase the rate $0.05 (while WSIB expects compensation will decrease by $0.07).

Four 2005 premium rate scenarios outlined for discussion

Four scenarios or options were introduced for discussion. It was explained however that there are several potential looming risks on the horizon which may negatively influence WSIB projections and which include:

Health Care Cost Escalation: a 1% increase would increase benefit liabilities by about $170 million;

Investment Return Assumption: a 1% decrease (e.g. from 7% to 6%) would increase benefit liabilities by about $1.25 billion;

Mortality Changes: a flat reduction of 5% would increase benefit liabilities by about $125 million;

Inflation Assumption: a 1% higher rate (e.g. 4% instead of 3%) with no other changes, would increase benefit liabilities by about $700 million.;

Occupational Disease: a 10% increase in number of cases would increase benefits liabilities by about $500 million by 2014. (Rough estimate based on very rough data.);

Loss of Earnings (LOE): a 10% increase in number of cases at full indexing would increase benefit liabilities by about $500 million.

The message was clear – the WSIB must consider these potential risks in setting 2005 premium rates.

***Example #1*: $2.19 average premium rate – no increase**

This is considered to be a very risky option, and Mr. Hinrichs strongly intimated that the Board will not likely recommend this option. With no hike in the average 2005 premium rate (over 2004), the UFL will rise in 2005 and there is a strong chance of future premium rate hikes. The UFL component will likely require significant increases in the future. Based on this projection however, and on the basis that WSIB assumptions hold true (a risk as explained earlier), the UFL will still be zero in the year 2014.

***Example #2*: $2.29 average premium rate – 4.5% increase**

This is still considered to be somewhat risky (risk assessment of "medium"), and even with a 4.5% increase in the average premium rate, the UFL will rise slightly in 2005. The UFL rate component will rise to $0.81 and remain stable until 2011. There is a "moderate" chance of future premium hikes with this option. As with all of the options, the UFL will still be zero in the year 2014.

***Example #3*: $2.33 average premium rate – 6.4% increase**

There remains a "moderate" chance of future premium rate hikes, and this is considered to have a "medium" overall risk. The UFL component will be set at $0.85 and will be level to 2010. The UFL itself will decrease slightly in 2005 and will be zero in the year 2014.

***Example #4*: $2.37 average premium rate – 8.2% increase**

Even with an 8.2% average premium rate hike, there is still a "moderate" chance of future premium rate hikes, and the proposal still attracts a "medium" risk assessment. The UFL will decrease in 2005 and the UFL rate component will be set at $0.89 and be level to 2008.

The process from here

Time to influence the Board is short. The WSIB Board of Directors is expected to approve a recommendation from the WSIB management on September 10, 2004. The new Chair has not been appointed as yet, and it is expected that additions will be made to the BOD. While there is, at present, a legal quorum of the BOD, it is my opinion that the BOD, as presently constituted, would be ill-advised to decide on 2005 premium rates until at the very least, a new Chair is in place. However, if no Chair is appointed within the next few weeks, the current BOD may have to act one way or another.

LAL's case for a zero % increase

While the "zero option" has inherent risks, so do the other options. Simply put, there are no guarantees with any of the options. However, last summer (2003), the Board's BOD, its Chair and the WSIB Chief Actuary were comfortable to accept the zero increase option.

What has changed since 2003?

Circumstances have improved from 2003 – Investment returns are up

The Board's investment performance has improved dramatically for one, with a 12.8% return realized in 2003 compared with negative net returns in 2002 and 2001.

<u>WSIB administration subjected to MOL audit</u>

Next, the Board's administration is likely to be much tighter, thanks to the MOL audit. One can reasonably expect that every possible efficiency will be wrung out of the WSIB over the next few years.

<u>An even stronger commitment to OH&S has been made</u>

Third, even stronger commitments to OH&S enforcement, by both the Board and the MOL, are expected to bring huge WSI returns through fewer accidents, and thusly, lower costs.

<u>The economy is expected to grow</u>

Fourth, the economy is still expected to grow, increasing the premium base.

<u>There is every reason to be *more* optimistic than last year</u>

All in all, there are several reasons to be far more optimistic than the Board was in 2003 when the average premium rate was held at a zero increase.

What has not changed since 2003?

<u>The long-term funding strategy discussion has not yet materialized (although firmly promised)</u>

The promised (and needed) dialogue on the long-term funding strategy has not as yet materialized. No one is to blame for this – the Board clearly had (has) every intention to embark upon those discussions. It still does. Circumstances and events simply got in the way.

However, the need for those discussions and an intense "roll up your sleeves" approach to strategic long-term thinking, similar to that which was experienced twenty years ago when the long-term funding strategy was first developed, is more critical than ever, and is, in my opinion, more important than setting 2005 premium rates.

HCC continue to rise and it is likely that occupational disease claims and other intrinsic costs are looming and very significant.

<u>Every WSIB option still leads to a zero unfunded by 2014</u>

Remember, with every WSIB option, "all roads" still lead to 100% funding by the year 2014, and a greatly reduced average premium rate within ten years.

<u>The 2004 rate decision was not considered to be a rate-hike deferral – it was a prudent and responsible position</u>

By all accounts, the projections accepted last year are holding true this year. Last year, a "zero increase" for 2004 premium rates was not considered by the business representatives to simply be a deferral of a premium rate hike to a future year – it was a responsible, considered move by the Board's Administration, the WSIB BOD, its Chair and the business community, supported by both the Board's own actuary and a leading actuarial consultant retained by business for last year's consultation.

<u>A slight incline in the UFL was expected</u>

In deciding that there would be no increase for 2004, it was fully expected that the UFL would increase slightly. It did and will again. But, even with a zero increase in the premium rate, the UFL is expected to be zero by 2014.

<u>The debate – at its core – is about "*acceptable risk*"</u>

What is truly at issue is the risk that employers and the WSI system is willing to absorb with respect to *potential* future increases (if projections and assumptions do not hold true).

<u>There is a risk with all of the options</u>

Yet, *there is a risk with all of the options presented*. In no case can the WSIB responsibly predict that even if the average rate increases, and even if it increases by as much as 8.2%, that there is no risk of potential future premium hikes. With no premium increase next year, the risk is simply greater. So, the debate is about the acceptable level of risk.

<u>A new Chair and new members to the WSIB BOD are yet to be appointed</u>

Significantly, at the time of these discussions, the WSIB BOD is rather depleted, and there is no permanent Chair – there are only three BOD members currently serving (the legislative minimum), plus the Acting Chair. It is expected that a new Chair will be appointed (imminently), and the BOD will have new members added. The MOL audit recommended adding many more members to the rolls of the WSIB BOD and the present legislation allows for a maximum of seven (7) members.

It is reasonable to expect that the funding strategy debate is one that the WSIB BOD will wish to lead, directly by assuming direct stewardship over the consultation process (as has been done in the past on core policy issues), or indirectly through the Board's internal governance process. Either way, the new Chair and new BOD members will be playing *the* key and vital role.

The long-term funding strategy discussion, expected to address all of the core issues, including the overall funding targets, is a key component, and may lead to significant changes that may well have the power to radically alter future projections and the funding model itself. On December 9, 2003, the WSIB Chair and President, advised that he will be contacting employer stakeholders "*in the near future to arrange a convenient time to … continue our dialogue…*" This dialogue has not yet begun, but as noted, the Board remains strongly committed.

<u>**Deferring premium rate adjustments is a prudent move**</u>

Deferring any premium rate adjustments until these discussions are well underway is, in my opinion, a prudent course of action (although WSIB officials may well disagree). Ms. Hutcheon (who will be directly involved in these discussions in one capacity or another, no matter her role after a Chair is appointed) has recognized the importance of these discussions and has provided an unwavering commitment for them to proceed. <u>***My best advice***</u> : *Continue last year's strategy, hold 2005 premium levels at 2004 levels, start the long-term funding discussions as soon as a new Chair is in place, and be ready for the big decisions next Spring*. <u>***The next best***</u>*: A 3% increase in the average rate which will cover (almost) the increased new claims cost (see page 3.*