The Liverside *e*-Letter

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

May 16, 2005 An *Electronic Letter* for the Clients of L.A. Liversidge, LL.B. 5 pages

Experience Rating Update:

"Administrative Changes" Increase Surcharges and Reduce Rebates

Even Though Accident Rates Still Head Lower

WSIB Experience Rating Changes:
"A solution looking for a problem"

Experience rating reform has been active for several years

Readers of **The Liversidge *e*-Letter** will recall that I have written extensively over the past few years on the pressing issue of experience rating ["ER"] reform, an ongoing process.

ER changes may erode employer confidence

I have long been a critic of the Board's reform plans, suggesting that recent ER reform initiatives can be summed up as "***a solution looking for a problem***" **[see The Liversidge *e*-Letter, September 12, 2003]**. While I am of the opinion that the WSIB managing minds behind these reform initiatives are pressing forward with good intentions, I remain convinced that the legacy of contemporary ER reform will be an erosion of employer confidence in experience rating itself.

A loss of a sense of true partnership will diminish employer "buy-in"; absent "buy-in" ER will not achieve its objects

One of the powerful qualities of ER, present since its inception, flows from the sense of a Board/business partnership. In fact, the modern ER programs were created at the request of employers – they were not simply imposed on business by the Board – and for good reason. Employers and the Board came to mutually understand that the best way to reduce injuries was to create *incentives* aimed at promoting a business case approach to accident prevention.

Key to its success was the willingness and commitment of employers to allocate additional resources *that otherwise would not be expended* towards reducing on-the-job injury. While I have long suggested that the prevention objectives would be bolstered through enhanced communications, ***the Board's own evidence suggests ER likely has delivered.***

According to the Board's own figures, from the time of the proclamation of the Ontario *Occupational Health and Safety Act* in 1979, to the late 1980s, the lost-time injury ["LTI"] rate *actually slightly increased*. Yet, from the late 1980s to the early 2000s, the LTI rate declined ***by over 60%*** **[Source: March 30, 2005 WSIB "Prevention in Ontario" Presentation, Slide No. 76]**. (***Continued page 2***)

Client Executive Briefing

***An interactive executive briefing on leading workplace safety and insurance issues is scheduled for*:**

June 7, 2005

9:30 A.M. to 12:30 P.M.

L.A. Liversidge to provide a full in-depth executive policy advisory report on the results of the WSIB's recent consultation meetings facilitated February – May, 2005

This will be more than an information session:

I will be facilitating an in-depth policy forum **June 7, 2005** to provide an executive briefing of the Board's recently concluded consultation outreach exercise. This will be an ***interactive executive briefing***, and will give clients an up to the minute account of the pressing and leading issues of:

- ***Long-term funding***
- ***Experience Rating***
- ***Occupational Disease***

Invitations will be e-mailed

This meeting will set the backdrop for a second ***policy advocacy meeting*** set for ***June 29, 2005*** which will provide you with the an opportunity to present comment, opinion, and feedback on these leading issues to the Board and Government. **This is a "MUST ATTEND"!**

10 Centre Ave., Willowdale, ON M2M 2L3 Tel: (416) 590-7890 Fax: (416) 590-9601 E-mail: lal@laliversidge.com

(***Continued from page 1***) From 1994, after the full implementation of experience rating to 2003, the LTI rate dropped 43% (from 3.59% to 2.05%) **[Source: WSIB Premium Rate Manuals]**. While prevention is multi-faceted, and no single program can effectively operate in isolation (sound prevention involves regulation, education and incentives), ER has very likely contributed, directly or indirectly, to the decline in accident rates.

WSIB "*administrative changes*" have reduced rebates while increasing surcharges

In the Fall of 2003, as an "interim" reform measure, the WSIB introduced several refinements to ER, suggesting that these adjustments were designed to increase the power of ER, and will result in "increased incentives". "Increased incentives" has always been interpreted by employers as increasing rebates **[see The Liversidge *e*-Letter, September 12, 2003]**. Yet, as it turns out, changes the Board introduced effective for "Accident Year 2004" have *decreased* rebates while *increasing* surcharges.

Employers will have to "run faster" to remain in the same place

As the first ER transaction for Accident Year 2004 will not take place until December, 2005 (based on data as at September 30, 2005), so far, the Board has not been challenged on these adjustments. For the most part, employers are generally unaware of the effect of these changes. I predict though, that as individual employers become aware of the magnitude of these changes, and as they see their rebates erode and surcharges increase, confidence in the ER program will begin to slide. In effect, employers will have to run even faster to stay where they are. That is not, in my view, "increasing incentives".

The Board is proposing additional changes which will reduce rebates further

Layered on top of this, the Board is in the midst of introducing further adjustments likely to be effective for Accident Year 2005 (but which could be applied for Accident Year 2004), which will continue the trend to reduce rebates and increase surcharges. In recent consultations, the Board released the effect of the already in place "*2004 administrative changes*" and the yet to be approved "*2005 recommended changes*". To further complicate this, the Board has developed two alternatives for the 2005 changes.

All the while, the Board is investigating ER effectiveness

In addition, while all of this is going on, the Board has requested that the Institute for Work & Health ["IWH"] investigate the effectiveness of ER on both accident prevention and return to work. ***My best advice to the WSIB:*** *Firstly*, continue to carefully investigate the effectiveness of ER, to ensure that program re-design itself will actually be effective [refer to LAL's "*Five Principles of ER Reform*" , **The Liversidge *e*-Letter, "*Does Experience Rating Need a Massive Overhaul?",* April 2, 2004]**. *Secondly*, do not proceed with any further "administrative changes" while the research is underway. Several employer groups support immediately rolling back the 2004 changes, which may be sound advice, if for no other reason than to shore up confidence in the program, while the Board is continuing its research.

The WSIB "administrative changes" are purportedly designed to reduce a systemic "off-balance"

ER "off-balances" (or as they are now to be called "net-balances"), have always been controversial. However, as ER is designed to motivate employers to perform better than expected (i.e., to have actual costs come in lower than those reflected in the premium rate itself), an "off-balance" is not only to be encouraged, it is to be expected, if the program works.

A "net rebate" is the objective - yet – "net rebates" are viewed in a negative context

Yet, when ER in fact does deliver a "net rebate" (rebates exceed surcharges), the rebate is viewed suspiciously. In the 1990s, when the ER net-rebate was at its most extreme, it actually was partially the result of premium rates that were set too high. *At the same time, the Board balked at returning a portion of a premium that never should have been collected in the first place*! A decade later, the Board has a renewed and zealous focus on net-balances.

The WSIB argues that a large portion of rebates are not "earned"

The Board is of the view that a significant portion of the rebate net-balance is systemic (the result of quirks in the formula), and therefore is not "earned" through better than expected performance. For example, for "Accident Year 2001" (the most recent year that has completed all three ER adjustments), total surcharges were $83.8 million while total rebates were $143.4, leaving a rebate net-balance of $59.6 million.

In the 1990s, much of the net rebate resulted from premiums being set too high

This though, represents a dramatic drop in the rebate net-balance from 1997 when it came in at $260.3 million ($28.2 million in surcharges and $288.5 million in rebates). The Board has admitted that "*a significant reduction in the off-balance was realized through changes to pricing of premium rates starting in 1998*" **[Source: February 11, 2005 WSIB Presentation "Experience Rating Off-balance", Slide No. 53]**. Translated this means that the Board was charging employers too much in premiums in the first place.

The "administrative changes" adjusted various ER cost factors

The 2004 administrative changes altered the "expected insurance", the Second Injury and Enhancement Fund ["SIEF"] allocation, and the reserve factors, which together, combined to reduce the amount of rebates and increase the surcharges.

The 2004 changes result in a *de facto* 3% premium rate hike

Even though employers were told that there was no premium increase for 2004, in actuality, for NEER employers,

as a result of the Board's 2004 administrative changes, net-premiums will rise by at least 3%. Since the 2004 Accident Year will not receive its first ER transaction until December, 2005 (with data as at September 30, 2005), one must use Accident Year 2001 as a representative year (since 2001 is the most recent year that is "closed").

In 2001, on premiums of $1.438 billion, the net rebate was close to $60 million (surcharges - $83.8 million; rebates - $143.4). The 2004 changes, *already implemented*, if applied to Accident Year 2001, would *increase surcharges* to $118.8 million (+42%), and *decrease rebates* to $133.5 (-7%). The net result is a reduction in the net rebate to $14.8 million, a reduction of $44.8 million. ***This has the effect of increasing the net premium by 3.1%***. This means that, in effect, there was no freeze in the average premium for 2004. While there was no "front door" increase (readers will recall that the Board held the 2004 average premium at 2003 levels, a so-called "zero percent increase"), ***the 2004 ER changes will result in a de facto "back door" premium rate hike of over 3%***. The bottom line is that Ontario employers will see premiums rise – not because of a downturn in performance, but as a result of a change in ER arithmetic. From 2000 to 2001, accident frequency per 100 workers dropped from 2.7 to 2.5; down to 2.4 for 2002, and down to 2.3 for 2003 **[Source: WSIB web site "Current Health and Safety Statistics"]**.

Some sectors face more substantial impacts from the already implemented 2004 changes

For some sectors, the 2004 administrative changes will be even more dramatic. ***Automotive assembly*** [Rate Group ("RG") 419], will see ER drive a 20% increase in the net premium; ***automotive parts*** [RG 421] a 5.1% increase; ***hospitals*** [RG 853] a 6.3% increase; ***food sales*** [RG 604] a 6.6% increase; ***restaurants*** [RG 919] a 2.4% increase; ***trucking*** [RG 570] a 2.3% increase, to illustrate just a few examples.

The proposed 2005 changes will drive a net surcharge

The proposed 2005 changes, not yet approved, will continue these type of administrative changes, and will further reduce rebates and increase surcharges. The Board has proposed two potential alternatives to take effect for 2005 (and potentially for 2004). "***Alternative 1***" will further the so-called "systemic corrections" (adjusting the insurance, SIEF, and reserves) and "***Alternative 2***" will also increase the maximum surcharge to three (3) times the maximum rebate, from the current two (2) times. In addition, "***Alternative 2***" will increase the individual claim cost limit to five (5) times the earnings ceiling, from the current four (4) times.

Using 2001 as a representative year, these changes will result in a *further increase* of surcharges and a *further reduction* of rebates

Alternative 1, if applied to Accident Year 2001, would *increase surcharges* $39.0 million to $122.8 million, up from the current $83.8 million, a 46.5% *increase*. Rebates would be *reduced* by $20.5 million to $122.9 million, down from the current $143.4 million, a 14.3% *reduction*. The result is a net surcharge of $9.9 million, ***which represents an increase in employer net premiums of $69.5 million***, **which translates into a *de facto* net premium rate hike of 4.8%**.

Alternative 2, if applied to Accident Year 2001, would *increase surcharges* $56.5 million to $140.3 million, up from the current $83.8 million, a 67% *increase*. Rebates would be *reduced* by $19.1 million to $124.3 million, down from the current $143.4 million, a 13.0% *reduction*. The result is a net surcharge of $16 million, ***which represents an increase in employer net premiums of $75.6 million***, **which translates into a *de facto* net premium rate hike of 5.3%**.

Contemporary ER reform is leading a paradigm shift of the purposes and expectations of ER

It appears to be the case that we are in the midst of a paradigm shift with respect to the purpose and objectives of ER. This, in my view, is fuelled by an inherent conflict between ER being defined as an "incentive program" (i.e., provoking a higher standard of occupational health and safety), versus ER being viewed as an "equity program" (i.e., ensuring that employers "*pay their fair share*").

If the objective being sought is prevention, the goal is to change behaviour; whereas if the objective is equity, the goal is to recognize actual performance.

If trying to change behaviour, the mechanics of the program are of lesser importance than: a) how information is presented; b) how information is understood; and c) how information supports executive decision-making. The intended target, if this is the focus, is the "informed rational employer", who will then channel resources to maximize business self-interest. In pursuing its business self-interest, it should be noted, the company will normally meet, or exceed, its social expectations.

If the focus is equity, information is not as important. In recognizing actual performance, the principal concern is a relative ranking of performers.

The WSIB is addressing two problems with one tool

The fundamental problem facing the WSIB at this point in time is that the Board is trying to address two problems with one tool. I also suggest that there is concurrently a new philosophical slant emerging with respect to occupational health and safety, and this is the "moral" or "social obligation" focus. This gives rise to the question, "***Why should a company be rewarded for doing the right thing?***".

While this is a powerful philosophy, it is one that runs in absolute conflict with the underlying philosophy behind ER, that is, that self-interested employers will adjust their behaviour to maximize their business interests, and which introduces a "business case" approach to workplace safety and insurance.

With respect to the "social obligation" focus, there is theoretically no limit on the investment pertaining to occupational health and safety, whereas, the self-interest model caps investment at the maximum potential benefit that can be realized. However, the "social obligation" model opens the door to the very type of insurance "moral hazard"

(the under-allocation to loss prevention after the purchase of insurance) that gave rise to experience rating in the first place.

My advice to the WSIB – first figure out what ER is expected to achieve

I present the WSIB with this general advice: Before tinkering with ER, simply figure out what ER is expected to achieve. If the system is to be health and safety focused, then the actuarial science behind the program is of lesser importance, providing that the final results are generally fair. More important is the level of understanding and the capacity to put ER to work in executive decision making. If the system is to focus on so-called "fair share" concerns, then the actuarial science is critical but then the system will, by design, lose its motivational element. This is already happening.

The 2004 "administrative changes" significantly reduced the "expected costs" that are experience rated. Without being overly technical, this will simply mean that there is less money in play for each individual firm and thus, the motivational elements of ER are diminished.

WSIB downplays employer actions to reduce injuries and instead focuses on "employer compliance" issues

WSIB data reflects an impressive and unprecedented performance with respect to accident reduction. In the Board's **March 30, 2005 "Prevention Session"** material, as noted, the LTI rate is 40% of what it was 20 years ago **[Presentation, Slide 76]**. Yet, this achievement is not only not highlighted and applauded, the message of the story has been to downplay it, and instead, focus on issues of employer compliance. This approach, in my view, is short-sighted and the Board risks taking the efforts of employers for granted. Eventually, employers will respond, likely passively, with a waning commitment towards ER.

As part of this overall message, even though ER was likely quite influential in reducing LTIs, ER rebates have been coloured in a negative light. There is a dearth of WSIB commentary of the positive elements of ER.

ER rebates should be viewed as a *prevention investment* – instead the WSIB turns its focus to employer compliance

Rather than view ER as an investment that has paid off handsome dividends through lower injury rates, the Board is placing a greater emphasis on "employer compliance". In the context of early and safe return to work, the Board is going to start fining "non-cooperative" employers. "Better than expected" performing employers appear to be presumptively suspect of unintended behaviour vis-à-vis accident reporting and/or return to work, or at the very least, viewed with some disbelief. Remarkably, WSIB officials suggest that the proposed compliance audits should be welcomed by employers, as they create an opportunity to provide convincing proof of compliant behaviour, as if, it would seem, there exists a need "to be proven innocent".

The WSIB gives notice it will take action to uncover evidence of undesirable behaviours

The Board announces that it is in "*a new era that calls for action to be taken to address growing concerns with ER*" **[Slide 9, February 11, 2005 ER Session]**. The Board is eager to uncover "*evidence of undesirable behaviours that are motivated by experience rating incentives*" **[Slide 34, February 11, 2005 ER Session]**. In the March 21, 2005 ER Session **[Slide 30]**, the Board tips its hand and outlines that it is planning on "*Workplace Performance Monitoring and Control*", to audit employer reporting and return to work obligations.

The WSIB shift to a "fair share" focus

Throughout the ER consultation, on several occasions, senior WSIB officials made reference to the idea that "*employers must pay their fair share*". At face value, of course, no one will argue the point. Of course employers must pay their "fair share". Anyone hearing it, or reading it, will nod in agreement. In principle, paying one's "fair share" has the support of everyone. ***But, what does it really mean***?

A more meaningful term is "fair insurance"

"Fair share", as colloquially referenced by the Board, simply means higher premiums for those employers that "use" the system. It is an effective slogan. But, the Ontario WSI is still an insurance program. ER in the past has always been an intelligent balance between employer accountability, employer equity and collective liability. That is why smaller employers are less financially accountable through ER than larger employers. That is also why "fair share" arguments must be addressed only in a dialogue dealing with "fair insurance".

A simple example will show how the idea of "fair share", as practiced by the Board, will only lead to increased employer premiums.

The example: A worker employed by a retail business paying $30,000 in premiums to the WSIB experiences a very unfortunate and serious injury. There are no charges levied against the employer under the *Occupational Health and Safety Act*. There is no fault that can be attributed to either the worker or the employer. Other than this accident, the employer has been "accident free" for six (6) years. The actual cash payouts of the claim approach $200,000. The ER costs are $960,000 [$200k (actual) + $463.6k (future expected costs) + $298.62k (overhead costs). ***The company is surcharged $6,750*** (maximum surcharge under NEER = two (2) times the maximum rebate).

If a $6,750 surcharge is not that employer's "fair share" what is? Even if the Board proceeds to implement the ***2005 Administrative Changes, Alternative 2***, the maximum surcharge for this employer comes in at just over $10,000. The ER costs are still approaching $1 million. ***At what point is the share "fair?*** At $100,000? At $200,000? Of course, one can argue that the $6,750 surcharge is fair as there is system and insurance integrity associated with it. However, as this example illustrates, "fair share" concepts cannot "balance the books" for the individual employer.

"Fair share" arguments are attractive. They imply that surcharged employers are getting away with something, that they are not contributing enough. However, if incentives work to motivate employers to improve performance, it makes much

more sense to *increase* the potential for rebates. Instead, rebates are being reduced and surcharges are being increased, a troublesome mix.

Other significant proposals – Employer "compliance audits"

Beyond the administrative adjustments, the WSIB is also placing on the table consideration to a "workplace performance monitoring and control" audit. This is a significant development and is a clear return to the thinking which we have previously seen in the Ontario workplace safety and insurance regime with respect to "best practices".

Interestingly, in their presentation to labour groups, the WSIB presentation included eleven slides under the heading "*Major Activities Aimed at Addressing Employer Non-Compliance*" **[Slides 31 – 42 of the February 14th Worker Funding Presentation, "*Major Activities Aimed at Addressing Employer Non-Compliance*"]**.

ER "best practices" were introduced by the NDP in 1995

Readers may recall that the NDP, in their workers' compensation reforms of 1995, included "best practices" provisions and linked those to experience rating. While those statutory reforms were never rendered operational, the clear intent was to allow for a "compliance audit" so that rebates would not be automatically provided to an employer unless they also pass the "compliance audit".

Employer opposition to "best practices" being linked to ER is long-standing. In August 1994, the Employers' Council on Workers' Compensation ["ECWC"], in its submissions on Bill 165, argued that the Bill's "best practices" undermined the integrity of ER. The ECWC noted, *"if other than performance based measures are to be included or added under the program, they must be incentive-based only – in other words, they must do the exact opposite of the Government's reforms – they must increase rebate potential or reduce surcharge potential*".[1]

In its response to the discussion paper, "*New Directions for Workers' Compensation Reform*" in March 1996, the ECWC argued, "*the ER programs must remain objective (i.e., cost-based) not subjective (i.e., no template of best practices)"*.[2] The Progressive Conservative Government's workplace safety and insurance reforms removed the "template of best practices" from the ER provisions in the statute. The ECWC noted, "*the ECWC strongly supports performance-based experience rating. The Council disagreed with the Bill 165 inclusion of the template of best practices and we are pleased to see the commitment to remove these implemented"*.[3]

[1] August 23, 1994, ECWC Business Action Committee, "Review and Analysis of Proposed Changes to the *Workers' Compensation Act"*, p. 22

[2] ECWC submission to the Hon. Cam Jackson, Minister Without Portfolio Responsible for Workers' Compensation Reform, "New Directions for Workers' Compensation Reform: A Discussion Paper,", Employers' Council on Workers' Compensation, March 1996, p. 8.

[3] ECWC "Review and Analysis of Proposed Changes to the Workers' Compensation Act" presented to the Hon. Elizabeth Witmer, Minister of Labour, by The Employers' Council on Workers' Compensation, March 6, 1997.

***A better alternative* – return to "first principle" incentive programs**

ER is an "incentive" program. While negative stimuli (penalties, surcharges and audits) may mildly influence behaviour, certainly the potential for gain is far greater with a positive inducement versus the threat of penalty. That is the founding principle behind ER. I do not, however, disagree entirely with the concept of "best practices". Being governed by "best practices", by definition, suggests something positive. A "best practices" approach, *responsibly administered* in a way that buttresses the positive inducement aspects of ER, may be worthy of consideration.

Rather than seek out non-compliant behaviour (this is ineffective and inefficient – the WSIB already has a team of hundreds of Claims Adjudicators to find non-compliance), the program should be designed, and resources allocated in a manner that supports *incentives*. ***Here is my simple proposal***: Provide an opportunity for surcharged employers to reduce or eliminate their ER surcharges by submitting to, and passing, a compliance and Workwell type audit. The benefits are clear and obvious: employers performing not as well as expected will have an opportunity to improve their situation, and the Board would be able to channel resources where they will provide a maximum return – to those employers that need the most assistance.

At the end of the day, below par performance will create a motivational opportunity for improvement. **A win-win**.

Next Issue: WSIB long-term funding - *Are there alternatives to higher premiums?*

In a series of consultation meetings, the WSIB has recently presented its case for increased employer premium rates. The Board argues that cost pressures require a hike in premiums, perhaps as much as 3% per year over the next five (5) years, to keep pace and still retire the unfunded liability ["UL"] (shortfall between the price of future liabilities and the value of the Board's accident fund) by 2014. Readers will recall that the retirement of the UL by 2014 is a long-standing cornerstone of the Board's funding strategy, first developed in 1984. The Board remains firm that the objective of retiring the UFL by the year 2014 is unshakable, if it can be done "responsibly". In one scenario, the Board proposes that the average premium will increase from the current $2.19 up to $2.59 by 2010, a total hike of 18.3%, before it starts to decline.

Employers don't buy it, and counter that premium hikes should be a last resort. Employers argue that there are responsible alternatives to *any* increase in premium rates, and demand that the Board seriously consider those alternatives before exploring any rate hike, even if that means moving off the 2014 target by a few years.

In the next issue of **The Liversidge *e*-Letter**, both positions will be explored.