The Liversidge *e*-Letter

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

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WSIB reviewing "*Funding Framework*"

Unfunded liability on upswing

WSIB unfunded liability skyrockets upwards to about $8 billion!

At the end of 2007, UFL stood at decade high - highest since 1997

In a 10 issue series of **The Liversidge *e*-Letter** last September/October, I discussed the Government's workplace safety and insurance ["WSI"] reforms **[the *Budget Reforms*]** and the likely impact they would have on the future financial viability of the WSI system.

September 6th - *Budget Reforms* add immediate $700-$750 million
September 12th - What the *Budget Reforms* actually did
September 14th - *Budget Reforms* – Indexing beyond inflation?
September 17th - Is the unfunded liability no longer a problem?
September 19th - WSIB says "starting to turn the financial corner"
September 24th - Is the Board playing a long-shot?
October 1st - *Budget Reforms* are about accountability
October 4th – Are premium rates destined to increase?
October 9th – How the reforms should have been developed

My basic thesis was very simple: The *Budget Reforms* cancelled out the indexing adjustments of the NDP (1995 – *the Friedland formula*) and the PCs (1998 – *modified Friedland*) and restored *de facto* full indexing (first introduced by the Liberals in 1985) **[see the September 12th issue of The Liversidge *e*-Letter]**, adding about $2.3 billion to the system's costs (the Board's figures, not mine).

I support full indexing

I suggested however that not only was there nothing wrong with full indexing, I fully support it – ***providing that the system can afford it!*** I argued that "affordability" was measured from the perspective of worker, not employer interests, and that the ultimate yardstick was employment impacts **[see the October 1, 2007 issue of The Liversidge *e*-Letter, "*Budget Reform concerns are about accountability not expenditures*"]**.

My opinion: *Budget Reforms* were bad policy and bad process

In the September 12, 2007 issue of **The Liversidge *e*-Letter**, I said this:

> **Frankly, and I can't sugar coat this, in my opinion the *Budget Reforms* detract from sound, accountable administration of the Ontario WSI system. Some may argue this is "good" politics (a chicken in every pot). But does it lead to more responsible overall WSI administration? I suggest that basic and well established accountability levers are weakened by the *Budget Reforms*.**

It is significant that it was the NDP that cancelled full indexing in 1995

I reminded readers that it was the NDP that cancelled full indexing in 1995. That historical fact speaks volumes. Unless there was linkage between de-indexing *and worker interests*, anything less than full indexing would be the antithesis to the public policy goals of the NDP.

Full funding benefits employers *and* workers alike

I have long argued that wrestling the UFL to the ground is as much in the long-term interests of workers as it is of employers **[see the October 1st issue of The Liversidge *e*-Letter]**. In fact, this is what I said almost four years ago in the July 14, 2004 issue of **The Liversidge *e*-Letter**:

> **The presence of the UFL remains a significant impediment to the development of a labour/management consensus on most issues. It is difficult, as but one example, to explore new means to pre-fund compensation for occupational disease so long as approximately one-third of all employer premiums goes towards the UFL. Employers, since they pay the bills, implicitly understand the power and constraining effect of the UFL. So long as there is an UFL, and so long as it continues to pose a serious financial drain on employer premiums, Ontario must temper change to fit within this fiscal reality. For the foreseeable future, change must be assessed through a financial prism clouded by the ubiquitous UFL.**
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> **Therefore, from a perspective of pure principle, labour should be as supportive of the efforts to wrestle the UFL to the ground as management. Moreover, simply raising premiums to fuel the decline of the UFL is counter-productive if premiums rise to the point of impacting business investment and job creation decisions, an always delicate balance.**

If the UFL was (is) no longer a problem – no worries

As I noted in the September 12th issue of **The Liversidge *e*-Letter**, "*If it's the case that the UFL is no longer a problem, fantastic, uncork the champagne and let's celebrate. Increase benefits and lower premiums*". As

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pretty well everyone has noted for years now, the UFL is the key WSIB performance indicator.

But, all evidence suggested the UFL was still a problem

On September 17, 2007 I reported that the Minister of Labour's own 2004 audit identified the UFL as a looming and continuing problem. In the **May 28, 2004 *Third Party Audit of the Workplace Safety & Insurance Board on behalf of the Minister of Labour***, facilitated by Grant Thornton, this is what was said about the UFL:

> **Addressing the unfunded liability is *fundamental* to achieving financial stability of the WSIB. With a forecasted deficiency of revenue over expenditures increasing the unfunded liability for a third year in a row, *there are continued pressures to maintain or reduce the cost of doing business*. Eliminating the unfunded liability by 2014 will require a combination of increased revenues (from investment income and / or premiums) *and* a reduction of costs over the long term. Achieving cost efficiencies at the corporate and administration level should be a priority and part of the corporate culture of the WSIB. However, this alone will not generate sufficient savings to significantly reduce the unfunded liability. (emphasis added) [MOL 2004 Audit, at page 3]**

Significantly, in his 2005 Annual Report, the **Ontario Auditor General** went so far as to express approval of the Board's 2006 3% average premium increase. The AG noted the comments of the Board's President that **"*we cannot allow this debt load to be passed on to future generations of employers.*"** The AG supported the premium increase noting, **"*this recent action is an important step in addressing the Board's significant unfunded liability and in meeting the intent of the (WSIA) to limit the burden of existing commitments on future employers*."**

The Board itself in the **2005 WSIB Annual Report** noted that **"*premiums have failed to keep up with rising costs such as benefit and health-care costs*"** thus requiring a 3% premium hike for 2006. And, all of this was before the ***Budget Reforms***.

The WSIB was stuck between a rock and a hard place

With the proclamation of the ***Budget Reforms***, WSI administration got a lot tougher. The Board was in a bit of a pickle. It had to implement government policy (with which it agreed) yet still try and keep employer premium rates flat-lined. All the while, the fallout from any failure would be borne almost exclusively by the Board. A dilemma indeed.

The WSIB maintained it can absorb the *Budget Reforms* and still pay off the UFL with no rate hikes

As I reported in the April 4, 2007 issue of **The Liversidge *e*-Letter**, while offering his strong support for the *Budget Reforms*, the Board's Chair said this on the WSIB's commitment to retire the UFL by 2014:

> **At the same time, we are cognizant of our stewardship responsibilities, and want to assure the employers of this province that these proposed improvements will not impact our commitment to the elimination of the unfunded liability by 2014. We must ensure that the system entrusted to us by the employers and workers of this province remains financially viable now and for future generations.**

My opinion – WSIB Board was (is) playing a long-shot

I maintained that while I hoped the Board was right, I was sceptical at best. I remain of the view the Board was "*playing a long-shot*" **[see the September 24, 2007 issue of The Liversidge *e*-Letter, "*Is the Board playing a long-shot*?"]**.

Remember, long before the *Budget Reforms*, WSIB officials argued for rate hikes

I noted that the WSIB administration had for several years leading up to the ***Budget Reforms*** argued that the system was fragile, and premium rate hikes were likely in the cards for several years down the road.

Even for 2008, the Board technically could have increased premiums

Basic performance indicators were not improving – the duration of long-term claims, a serious problem the Board has rightly been harping on for several years, was still on the rise. While the Board toed the line on premiums for 2008, I cautioned that this was not to be construed as strong evidence that the system was out of the soup. In fact, senior Board officials conceded that a rate hike for 2008 was "*technically justifiable*" **[see the September 12, 2007 issue of The Liversidge *e*-Letter]**.

Yet, last year the Board declared it was starting to turn the financial corner

Yet, in its **2006 Annual Report** (released in the summer of 2007), the Board declared that it is **"*starting to turn the financial corner*" [see WSIB 2006 Annual Report, at p. 6]**. The Board heralded its control over administrative costs as one of the reasons behind its new optimism, even though, as I carefully reported in the September 19, 2007 issue of **The Liversidge *e*-Letter**, WSIB administrative costs actually *increased* 2005-2006. More to the point, even if the Board did reduce administrative expenses (which it did not), that would have next to zero impact on the UFL, and would amount to nothing more than removing a few grains of sand from the UFL beach.

2006 was *not* a great news year

In fact, with one exception, there really was no substantial good news in 2006. The Board was still operating on a deficit. Expenses exceeded revenues by about $142 million. I noted that benefits actually rose by a whopping $293 million. **And, was before one cent of the *Budget Reforms* were taken into account**.

But, WSIB investments did very well in 2006

I reported that the one good news story was the Board's phenomenal investment returns in 2006 – a magnificent 16^{+}% investment return and a striking $1.3 billion in investment income.

***Budget Reforms* added to an already stressed system**

But, I argued that the *Budget Reforms* added to an already financially stressed system. I predicted that the ***Budget Reforms*** will render the elimination of the UFL by 2014 with no increases in employer premiums a most difficult task, to say the least.

Yet, the Board remained quite bullish on its capacity to pull it off. I wished them well. I hoped they were right. I would not mind at all eating crow on this one.

I said this on September 24, 2007:

The Board just might pull it off. *I hope they do*. Frankly, in my estimate, the Board is playing a long shot. I hope they beat the odds.

There are a lot of "*ifs*" for the Board to be successful

I said that the Board just might "pull it off" (implement the ***Budget Reforms***; no employer rake hikes; retire the UFL as planned by 2014):

- *if* there are mainly financially "fair weather days" for the next seven years (certainly *possible* but likely?) [***update*:** recession looms];
- *if* the equity markets don't falter and continue to deliver phenomenal returns (*possible* but likely?) [***update*:** they faltered big time];
- *if* there are not continued major job losses in Ontario's manufacturing and particularly the automotive sector (*unlikely*) [***update*:** losses are mounting];
- *if* injuries continue to decline (*likely*) [***update*:** so far so good];
- and, *if* time on claim is substantially reduced (*unlikely*) [***update*:** the Board is getting more worried about this].

All in all, it remains my opinion that the Board is playing a long-shot

But, all in all, I was convinced that the Board was playing a long-shot. It was just too good to be true to expect that the Board could absorb an additional 2.3^+ billion into the system, keep employer premiums flat-lined, and still pay off the UFL by 2014.

The *Budget Reforms* are reminiscent of past governments increasing benefits without the requisite funding (*and we know what that led to – the creation of the UFL!*)

In fact, I suggested that the whole exercise surrounding the ***Budget Reforms*** was reminiscent of the political mindset that prevailed throughout the 1980s to the early 1990s – that benefits could be hiked with no corresponding hikes in employer premiums – the best of both worlds if you will.

Past warnings have not been heeded

I reminded readers of the 1996 observations of the Ontario Cabinet Minster Responsible for Workers' Compensation Reform, when speaking to the enhancements to worker benefits in the late 1980s and early 1990s:

> **However, the costs of these improvements were not balanced by measures to guarantee adequate reserves to meet current and future financial obligations. Understandably, expansion and enrichment in the name of improved equity have proved popular. However, governments in the past have chosen not to address the critical but difficult problem of how to finance these benefit changes.**

On September 6th, in the first of the 10 issue series on the ***Budget Reforms***, I noted:

> **So, let's hope we are not back to the mind-set recognized by Minister Jackson. If we are, it is not only employer premiums that are at risk – future worker benefits may be placed at risk as well. Let's not go "*back to the past*."**

All in all, I considered it unlikely that the Board would be able to pull it off. The system was just too fragile before the ***Budget Reforms***, and adding 2.3^+ billion would likely scuttle any capacity to keep employer premiums flat while still paying off the UFL by 2014.

The Board needs to pull a "*rabbit out of the hat*"

I suggested though that rate hikes still were not likely in the cards, and the Board would likely try to pull a "*rabbit out of the hat*". Repeating a theme I first introduced almost a year ago, this is what I said on October 4, 2007:

> **At the end of the day, the "*rabbit in the hat*" is the more likely outcome**
>
> **So, the "*rabbit in the hat*" approach that I introduced April 4th is the more likely outcome. This is what I said in the April 4, 2007 issue of The Liversidge *e*-Letter:**
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> > ***Just wait a sec* – *maybe there is a back door out of this*. *How about this* – the Board changes the terms of the entire funding strategy. After all, some were asking for this even before these announcements, *so why not agree*? Present premiums are based on a 100% funding target to be achieved by 2014. What if the Board is then able to pay for these amendments and not increase premiums? *Will employers go along with that*? Possibly, but reluctantly. *There just might be a rabbit in that hat after all*.**
>
> **I predict this will be addressed under the guise of a planned review of the *Funding Framework* starting soon (perhaps by year-end or early next). Employers may well get stuck between the classic "*rock and a hard place*", and may grudgingly go along with a delayed funding target. And, as I suggested in the October 1, 2007 issue of The Liversidge *e*-Letter, this will keep the UFL hanging like deadweight around the collective necks of the Board, employers and workers for some time yet. If this comes to pass, progress on the WSI file will be stalled for perhaps a decade or more. *Too bad*. A golden opportunity lost.**

As predicted, the milk might be turning a little sour

As it turns out, I am afraid to report that it looks like I may well have hit the nail on the head. It seems that several of the "ifs" the Board was banking on may not be coming to fruition after all.

The WSIB has advised that as at the end of 2007, the UFL may be over $8 billion

In a February 11, 2008 *Funding Framework* review, the Board advised that for 2007, the UFL ended the year at about $8 billon, and is expected to peak at about $9 billion by 2009. ***Still, the Board remains optimistic in its outlook that not only can it retire the UFL by 2014 with no rate hikes, but within a few years of that target, the Board just may well have accumulated an impressive surplus*!**

To put an $8 billion UFL in some context, that is the highest the UFL has been for a decade. At the end of 1997, the UFL was $8.06 billion. The UFL hit its all time high at the end of 1992 at $11.5 billion. At the end of 2006 (*the good ol'days*?) the UFL was just under $6 billion.

If the recent accounting is accurate, that means that the UFL shot up an incredible 33% in a single year, the biggest single year escalation *ever* (with the exception of 1985 when full indexing was first introduced).

Oh, and one of the reasons for the increase in the UFL? A bad investment year for 2007. *Go figure*.

Next week: More details on the *Funding Framework* review. My predictions: No rate hikes for 2009. But soon the Board will have to pull the "*rabbit out of the hat*" and revamp the funding targets. The question is, who will blink first – the Board or employers? Will employers ask for it or will the Board first suggest it? Before that is answered, I predict that the tension between the Board and employers will build.