The Liverside *e*-Letter

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

October 16, 2008 An *Electronic Letter* for the Clients of L.A. Liversidge, LL.B. 3 pages

Stay the Course or Change Direction?
Tough Times. Tough Choices.

WSIB unfunded liability shot up 35% *before market melt down*
WSIB not immune from financial crisis
It is time to recalibrate

Should the Board "stay the course" or change direction?

At the Legislature's **Standing Committee on Government Agencies** September 12, 2008, Workplace Safety & Insurance Board ["WSIB" or the "Board"] Chair, the Hon. Steve Mahoney admitted the Board's investments were not performing well, but vowed to "*stay the course*":

> **We have a massive investment fund, varying between $15 billion and $17 billion, depending on how that market is performing, and it's not performing very well. How that impacts, however, on our plan on the unfunded liability is simply that we need to have some courage. *We need to be prepared to stay the course*. [Hansard, September 12, 2008]**

This was before the world-wide market melt-down. The WSIB will be getting beat-up as much as any major investor. As I introduced in the last issue of **The Liversidge *e*-Letter**, while things aren't great, they have been worse, and there is no need to panic. ***I am though of the view that an immediate change in course, along with other significant steps, is called for.*** I am confident the Ontario WSI system will be OK if some hard choices are soon made.

How is the Board doing? A look at the numbers

At the end of 2006, the unfunded liability ["UFL"] stood at $5.997 billion. The WSIB's "funding ratio" (the amount of the assets against the liabilities) sat at 73.2%. The WSIB projected benefit liabilities of $20.3 billion, and declared total liabilities of $22.395 billion against a total $16.398 asset base **[all figures from WSIB 2006 Annual Report]**.

By the end of 2007, WSIB UFL up to $8.1 billion

By the end of 2007, the UFL had increased 35%, up over $2 billion, coming in at $8.1 billion. The benefit liability jumped up $1.46 billion (+7.2%) to $21.760 billion, while the value of the Board's investments fell slightly from $14.311 to $13.754 billion (a decline of over $500 million). The Board's total assets were $15.972 billion against total liabilities of $24.066 billion, resulting in a funding ratio of 66.4%, down from the previous year's 73.2%.

No longer "situation normal"

It is important to recall that the "*stay the course*" approach is based on several assumptions, not the least of which is a continuous 7% investment return. The Board's investments gave less than a zero return last year, before the melt-down. The Board has not released any recent numbers. Financially, things of course right now are pretty dire.

How is the Board likely doing today?

By the end of the 3rd quarter 2008 (as at September 30, 2008), Canadian pension funds are reported as suffering their worst quarterly loss in a decade **[Toronto Star, October 10, 2008, "Pension plans take biggest hit is decade"]**, and that is before the gut-wrenching October numbers. According to the Star, "*many employers will have to either put more funds into their plans to make them whole or seek ways to lower their pension commitments to employees*". Private pension funds have typically been better capitalized than the Board's. According to the Star, from a peak 120% funding ratio in 1999, private funds are in the low 70 percentile at the end of September, 2008. In early October, Ontario's Finance Minister warned "tough times" are ahead for Ontario **[Toronto Star, October 6, 2008, "Budgets may not be balanced: Finance Minister]**. *The Board is neither immune or alone*.

In 2006, WSIB was doing much better

In 2006, the UFL dropped a full half-billion. Even though time on claim was still on the rise and the Board still was operating with a performance based shortfall of $142 million **[WSIB 2006 Annual Report, p. 19]**, the Board was earnestly working hard to turn those trends around. The Board committed to "*improve its financial situation by addressing revenue and cost pressures, improving financial sustainability, and reducing the unfunded liability*" **[WSIB 2006 Annual Report, p. 31]**.

Beginning in 2007 things started to dip

For 2007, the excess of expenses over revenues increased to $1.13 billion **[WSIB 2007 Annual Report, p. 18]**, with $720 million of that driven by the ***Budget Reforms***. In 2007, while noting that the 2007 funding ratio had declined 6.8 percentage points to 66.4% (mainly due to falling investment

50 Acadia Ave., Suite 101, Markham, ON L3R 0B3 Tel: 905-477-2039 Fax: 905-477-4659 E-mail: lal@laliversidge.com

ISSN 1710-5757

returns), "*the WSIB believes that elimination of the unfunded liability by 2014 is still possible, provided improved outcomes consistent with the targets in the WSIB's Five-Year Strategic Plan, 2008-2012*" **[WSIB 2007 Annual Report, p. 21]**.

LOE benefits up $12.3% 2006 to 2007

Loss of earnings ["LOE"] benefits were up almost $100 million, an increase of 12.3% (from $807 million in 2006 to $906 million in 2007) **[WSIB 2007 Annual Report, p. 23]** even though injury rates continued a steady decline, in spite of more money being "invested" in labour market re-entry ["LMR"] programs. LMR costs increased 14.1% to $283 million **[WSIB 2007 Annual Report, p. 24]**. Health care costs jumped 6.7% to $527 million. Benefit liabilities increased $702 million due to the net growth in LOE claims inventory **[WSIB 2007 Annual Report, p. 24]**.

In the 2007 Annual Report, WSIB was already softening its commitment to meet targets

In the **WSIB 2007 Annual Report**, well before the market melt-down, the Board admitted that:

> ***Some key financial factors and risks may affect the WSIB's future results.* One of the significant risk factors is the possibility of a continuing upward trend in claims persistency and delayed return-to-work outcomes. Also, the growth in future occupational disease claims may exceed estimates, and external market factors may impair the WSIB's ability to maintain investment returns at its target of 7 percent [WSIB 2007 Annual Report, p. 31].**

On September 12, 2008, the WSIB was suggesting it would "*stay the course*" **[Hansard, September 12, 2008]**. Of course, this is *before* the market-melt down with its long term world-wide economic implications. **Unquestionably, the economy is a "*game changer*". Massively so**.

Remember, even well before the melt-down, Chair Mahoney always was very clear - keeping premiums flat while retiring the UFL by 2014 would be difficult **[go back as far as the August 1, 2006 issue of The Liversidge *e*-Letter]**.

What is the likely new reality?

Whether or not the Board would have succeeded in "the plan" (no increases in employer premiums; paying off the UFL by 2014; and increasing benefits through indexing) before the melt-down is now a moot point. World-wide events external to the Board have rendered it impossible.

How is the Board likely doing today?

The UFL sat at $8.1 billion at the end of last year, the highest level since 1997. While it is almost impossible to acquire up to date financials from the Board (the WSIB only releases "official" numbers in its Annual Reports, and they are always woefully out of date by the time they are released), some reasonable presumptions allow one to acquire a general sense as to how the Board may be doing.

Assume that the Board's projected liabilities remain constant from 2007, that all non-investment assets are constant from 2007, and that there are no performance based short-falls but that there has been a reduction in the valuation of the Board's investment assets. From the beginning of the year, the TSX index has fallen more than 30%. Presume that the Board does much better than the index (even though it didn't in 2007), and assume that the Board's net decline in investment valuation is (as of October 10, 2008) *minus* 20%.

WSIB funding ratio likely in mid-50 percentile range

That would reduce the Board's funding ratio to the mid-50 percentile range (55% - total liabilities would be $24.066 billion; total assets $13.2212 billion; and the UFL would be just shy of $11 billion). If the Board's investments dropped in line with the TSX (30%), the Board's funding ratio would be just under 50%, a far cry from the recent height of 73% in 2006, but still better than the early 1990s.

What does all this mean? *The Board is down but not out*

First, while the Board is down, it is not out. It has been in a worse place and it has worked its way back. It will have to do the same again. I am confident it can. But this is likely a 10 year or more journey. ***Second***, if the WSIB was facing a funding ratio in the 50 percentile range I am confident that neither the Board would have recommended, or the government would have implemented, benefit enhancements that added, on their own, about $2.3 billion to the UFL and depleted the Board of $720 million. ***Third***, faced with increasing benefit costs, a world-wide financial crisis depleting the Board's asset values, and an imminent downturn in the economy, a "*stay the course*" plan is not on.

This is the time for a reality check

In commenting on the state of the Board's finances in recent years, while I have maintained the need for prudence, I have asserted there is no crisis. ***Well, there is now***. That's not a "Chicken Little" "time to panic" comment. That is reality. But, the system has been in real crisis before (early 1980s and mid-1990s). And it pulled through. It can again.

This time around the going will be tougher

There is however a difference between "*then and now*". In 1994 when the UFL was in the mid-$11 billions, Ontario was just pulling out of the effects of a recession. This time around, the bow of the good ship WSIB is being trimmed into stormy, uncertain seas when the UFL is likely at or nearing record levels, and economic prospects are dimming.

Time to formulate a new approach: LAL's 9 suggestions

Time is of the essence. It is not time to panic but it is the time to be realistic and formulate a new approach. The Board could not envision recent events. But it must respond.

***One*, what the Board can't do – no time for tax hikes, employer premiums must stand pat**

The WSIB cannot even contemplate raising employer premiums. According to Premier McGuinty the "*worst thing you can do in times of an economic slowdown*" would be to raise taxes **[Toronto Star, October 9, 2008, "Rough time ahead, but no tax hikes: McGuinty"]**. The WSIB should immediately announce that it will not increase employer premiums over at least the next three years.

***Two*, defer the January 1, 2009 2.5% benefit hike**

Critical times require critical action. The government should act right away and defer the 2.5% benefit indexing increase scheduled to take effect January 1st. Had the state of WSIB funding been at current levels when these political decisions were taken (i.e., funding in the 50 percentile or lower range), I am confident these proposals never would have seen the light of day. Delaying them would be a difficult but prudent move.

<u>*Three*, establish sound guidelines to future indexing calls</u>

After January 1, 2009, the Ontario Cabinet will set future indexing levels beyond prescribed amounts. This power rests in the sole discretion of the Cabinet. No doubt, when this power was enacted, I am sure the government expected that the Board's funding was on the upswing, not about to plummet. Events intervened. As a signal for stability, the Cabinet should declare that it will not increase indexing until the Board's finances return to at least 2006 levels.

<u>*Four*, the WSIB must provide current information – feedback is important to temper expectations</u>

The Board must more regularly publicly report the "*state of the union*". By the time the official WSIB Annual Report is released every year (late in the summer of the following year), it is ancient history. Especially in these volatile days. The Board must immediately return to its past practice of issuing un-audited quarterly financial records, something I have been suggesting for years. ***By mid-November the Board should issue a special financial report for performance to the end of October, 2008, and at the end of every quarter thereafter***. Over the next several years, the WSI policy outlook will be driven in large measure by the state of the Board's finances. Current meaningful feedback is essential and will allow stakeholders to assess the Board's challenges and priorities. In the early 1990s when the Board was experiencing trying times, the release of quarterly statements went a long way ensuring an ongoing "reality check", forcing stakeholders to temper expectations.

<u>*Five*, WSIB funding plans should be revisited</u>

The current WSIB plan will not be met. It is time to recalibrate. The Board should publicly announce that the UFL will not be zero by 2014, and set a newly defined and reasonably attainable target ($5-6 billion UFL by 2014?). In 1984 the Board developed a 30 year funding target. Another long-term plan is called for.

<u>*Six*, slow down reorganization plans</u>

The WSIB is banking on another reorganization to reduce time on claim (claims persistency). I hate to be a pessimist, but it won't change much. While the Board's conversion on the ***Road to Damascus*** where it realized that it has been on the wrong course for several years is warranted, a massive restructuring will be distractive. The simple fact is that reorganizations tend to exhaust the Board. This happened in the 1980s and 1990s. Deficiencies in the current model should be addressed more incrementally while the system focuses on the true root causes.

<u>*Seven*, review the benefit provisions in the WSIA</u>

I have long held that the reforms of 1998 buttressed by the ***Budget Reforms*** of 2007 are the true culprits increasing time on claim. The problem is not administrative. It is structural. Even during recent years when Ontario was enjoying unprecedented employment levels, time on claim was on the rise. *Why?* Because employers were not working hard enough to get workers back to work? Nonsense. In its recent experience rating series, the **Toronto Star** suggests that employers are actually working *too hard* at getting workers back to work.

The more likely explanation is tougher to accept. The benefit provisions in the WSIA tend to push the envelope for certain cases, especially in industries experiencing layoffs and restructuring, blurring the line between unemployment caused by an injury and unemployment caused by economic reasons. It is time to ensure the WSIB is compensating wage losses arising from injuries, not employment trends.

<u>*Eight*, get back to basics</u>

In 1998 more than the name changed from Workers' Compensation Board to Workplace Safety & Insurance Board. Prevention was added as a strong plank in a revamped mandate. The Board initially interpreted its prevention mandate as being *complementary* to its insurance mandate. I agree with that approach. The Board funded and acted as overseer of the **Safe Workplace Associations** and aligned its insurance mechanisms (experience rating, Safety Groups, etc.) to promote prevention.

More recently the Board has been blurring the roles between the enforcement Ministry of Labour and the more advisory WSIB, with the Board pursuing prevention as a "stand alone" business. This is not, in my view, what was intended by the changes to the WSIA in 1998. ***This is not the time to expand mandates and duplicate resources.*** The Board should get back to basics, focus on its insurance business, and use those levers to promote prevention.

That said, Chair Mahoney has passionately pursued worker safety as a personal mission. That august, heart-felt leadership must continue. There is no stronger advocate of worker safety in Ontario than WSIB Chair Mahoney, and there is no contradiction in continuing to channel that strong voice through the Board's insurance levers (but not through more regulation and red-tape).

<u>*Nine*, it is time for an external review of the WSIB</u>

When I appeared before the **Standing Committee on Government Agencies** in February 2007, I proposed a routine external review mechanism, reporting directly to the Ontario Legislature. This would allow for a perpetual opportunity to address statutory and administrative shortcomings. This simple innovation ensures that WSI reform becomes routine and less partisan while still ensuring political oversight, all the while enhancing stakeholder participation. Such a mechanism is needed more than ever.

As we have seen in recent weeks on the world stage, leadership responds to critical circumstances. I am confident that the WSIB under Mahoney's leadership will be no different, and that the Board and the government will work fast and hard to get in front of this wave. I am certain that they are already "on the job".