MEMORANDUM

FROM: I. David Marshall, President & CEO

DATE: JUNE 6, 2011

SUBJECT: POSITION PAPERS FOR THE HARRY ARTHURS FUNDING REVIEW

We respectfully submit three position papers from the management of WSIB which are intended as input to Harry Arthurs Funding Review. As a group, the three papers deal with the issues of whether or not full funding is desirable for WSIB, if so, how it could be achieved, and finally, how the WSIB could address the limitations of its current Rate Setting and Experience Rating programs.

The first, entitled *Perspectives on the Unfunded Liability at WSIB,* provides analysis and commentary on the pros and cons of maintaining an Unfunded Liability in the WSIB Insurance Fund. It presents the opinion of the WSIB management team. It concludes that the interests of injured workers, employers and good public policy is best served by full funding of WSIB's Insurance Plan. It also suggests that the magnitude of the challenge and the uncertainties which lie in the future would dictate that WSIB should aim to reach a substantial level of funding within the five to eight year timeframe and then move incrementally above that to 100%.

The second paper is entitled *Concept Design Paper for Funding of the Workplace Safety and Insurance Board (WSIB).* It has been prepared by Richard Larouche of Eckler Ltd. This paper proposes a means to achieving full funding for the WSIB. It proposes that the existing liability of the WSIB be ring fenced and retired with a defined premium similar to retiring a mortgage. New claims each year should be fully funded going forward. A scenario is also provided to show the impact on funding and premium rates of increasing benefits for injured workers by way of fully indexing partially-disabled worker pensions. The paper describes how such a plan would work and what funding policies should be adopted to implement it.

The third paper, entitled A *Pricing System Conceptual Design for Moving Forward*, has been prepared by Bruce Neville of Nexus Actuarial Consultants Ltd. This paper seeks to deal with the issue that the current classification, rate group and premium setting process at the WSIB, including the Experience Rating process, have become cumbersome, non responsive to changes in the economy and workplace, and lack the trust and confidence of employers. Basic principles of a sound Rate Setting system and Experience Rating system are outlined. The existing system is critiqued against these criteria, and a new

and better system is proposed and also compared to the basic principles. The proposed system design eliminates Rate Groups and Experience Rating and goes directly to assessing employers a premium rate linked to their claims experience. The proposed system elegantly incorporates the principles of collective liability and provides a structured series of messages to employers if their cost behaviour deviates from norms. Employers are encouraged to take corrective action without the need for a cumbersome Experience Rating system or behaviours not in the best interests of workers.

The papers form a collection. The first, as to the choice of full or partial funding, is foundational. A decision must be made one way or another on this issue. The second and third are means to implement whatever that decision may be. They are, none the less, critical to future operations of the WSIB and have significant impacts on stakeholders. We need to understand and isolate the dynamics of carrying a large Unfunded Liability of the past, from the current operations and efficiency of the Board. Absent this, the two elements get combined and result in confusing messages and unfocussed action. Similarly, we need to bring up to date the Rate Group, Premium Rate setting and Experience Rating systems of the Board. The current processes have their roots deep in history and are not responsive to current conditions. As we move forward, it is absolutely essential that such fundamental issues as how employers get classified and how they bear collective or individual liability are both fair and seen to be fair.

The papers are submitted with the intent of eliciting scrutiny and debate. Their goal is to improve the system for workers and employers. We welcome views and comment.

Sincerely,

I. David Marshall

Perspectives on the WSIB's UFL

wsib cspaat ONTARIO

Workplace Safety & Insurance Board
Commission de la sécurité professionnelle et de l'assurance contre les accidents du travail

June 2011

Introduction

This paper is designed as input to the Harry Arthurs Funding Review currently in progress. It speaks to the topic of the advisability or otherwise of carrying an Unfunded Liability in the WSIB Insurance Fund. WSIB has three major interests as they relate to the funding of the compensation Insurance Fund. The first is that both current and future benefits for injured workers are protected. The second is that employers are treated as fairly as possible in the collection of premiums. And, the third is that the administration of the fund is efficient and seen to be fair. We are also concerned that where future benefits for injured workers are deemed to be justified that these are not rendered prohibitively expensive due to the existence of past liabilities. The degree to which the Insurance Plan is funded has a significant bearing on all these objectives.

This issue has been a challenge for Ontario's workplace insurance system ever since its beginnings in 1914. Sir William Meredith, the father of Ontario's system confessed that he couldn't come to a conclusion as to whether partial funding or full funding should govern the operation of the Insurance Fund. In fact, Meredith himself acknowledged the important role that the Board would have in answering the full funding debate: *"It is better to leave that to be determined by the Board which is to have the collection and administration of the accident fund as experience and further investigation may dictate."* (Meredith Report, Province of Ontario, 1913)[1]

The Board has now had some 100 years of experience with managing the Insurance Fund. This paper serves to communicate the lessons learned from this experience. One thing is certain, the existence of unfunded future liabilities transfers costs from one generation of employers to another. This has serious consequences for the perceived fairness and affordability of benefits by future employers. This in turn has a direct impact on the willingness of employers to support improvements in worker benefits. The deferral of costs to a future time also serves to reduce vital checks and balances on the proper administration of benefits.

Much has changed over the 100 years since Meredith made his report, which launched the Insurance Scheme in Ontario. Old industries have declined and new ones have arisen that were not even thought of in Meredith's day. Many of the new industries have moved outside the scope of the *Workplace Safety and Insurance Act*, leaving the older industries to carry on the Insurance Scheme. Old industries themselves have adopted new methods of production and new forms of organization, often outsourcing key functions to specialized corporations. Free Trade has developed, giving rise to global competition. These factors, no less the problems posed by transferring costs from one set of employers to another, are explored in the paper below. A modern day perspective on the issue of partial vs. full funding is described from a public policy perspective, an employer perspective, and an injured worker perspective.

Background

The WSIB was created to manage the process of delivering legislated benefits to workers who have been injured during the course of their employment. Employers pay premiums into an Insurance Fund, and the WSIB administers these funds to deliver payments to workers who become injured or ill as a result of their employment. The system is entirely funded by employers. There is no Government Funding. The WSIB is governed by the *Workplace Safety and Insurance Act* (WSIA). Its mandate includes the promotion of safe workplaces and the avoidance of injuries. Not all employers are covered by the WSIA. Only certain designated employers are covered. Designated employers include both private sector companies and federal, provincial and local governments. These employers represent about 70 per cent of the labour force in Ontario. The underlying principle of insurance coverage under the WSIA is twofold.

1 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 6.

Workers are to receive fair compensation for their work-related injuries or illnesses. They cannot sue their employer. In exchange, they are to receive benefits defined by the Government in legislation and they are entitled to be paid regardless of whether their employers continue in business or not. From an employer's perspective, the employer pays an insurance premium into an Insurance Fund managed by the WSIB. Employers share responsibility collectively for the obligations of the Insurance Fund. They are entitled to be charged a premium, which is fair and seen to be fair. It is important to understand that workers compensation for workplace injuries or illness is not paid for through a tax on the general population of Ontario. It is paid for by a selected group of employers through a collective liability insurance plan. The premiums are not a tax. If the WSIB did not exist, employers would have to carry insurance in some other way.

In the absence of a tort system to decide what is fair compensation for work-related injuries or illnesses, the Government decides what the compensation package should be. The Government has a responsibility to workers in this regard. But it also has a responsibility to employers with regard to the burden it places on them; and to consider, as far as possible, the affordability of the benefits. If the perceived burden worker benefits place on employers gets out of balance - that is that they are perceived to be too expensive - pressure is brought on the government to reduce benefits. If workers are perceived to be receiving inadequate benefits, there is pressure to increase them.

The WSIB is charged with the financial responsibility of administering the Insurance Fund in a prudent and responsible manner. There are various accountabilities placed on WSIB in relation to fiscal prudence. The more important ones are:

- Firstly, sufficient funding must be maintained to cover both current and future benefit costs
- Secondly, future employers should not be unfairly burdened with the cost of benefits generated by past employers

This second responsibility has significant ramifications for the administration of the Fund and the perceived fairness of the premiums paid by employers.

The WSIB Insurance Fund has carried an Unfunded Liability for future worker benefits for at least the past 35 years. The Funding Ratio during this time has been as low as 32 per cent and as high as 81 per cent. In carrying a large Unfunded Liability, Ontario is an outlier among Canadian provinces. It is not clear why Ontario has persisted in carrying a UFL while virtually all the other provinces have adopted a policy of being fully funded and have largely met this goal. This paper explores the pros and cons of having a partially-funded Insurance Fund at WSIB.

How funding liabilities arise at the WSIB – The degree to which the Insurance Scheme is funded.

Claims from injured workers result in compensation streams that are not restricted to the year in which a claim is filed. Legislated benefits require the WSIB to pay injured workers medical and other expenses and compensation benefits up to 85 per cent of their pre-injury earnings, net of income tax, for as long as workers remain without work or reach age 65. There are further responsibilities to contribute to a pension plan for the workers, which pays out after the workers reach age 65. There are also obligations to pay survivor benefits in the case of the worker fatalities due to workplace accidents. Benefit obligations – or liabilities – therefore arise which span several years, often decades into the future. As at the end of fiscal 2010, some 200,000 workers were receiving benefits from the Insurance Fund. The future liability for payment of these benefits was estimated to be $45 billion. This future liability has been discounted at 7 per cent to arrive at a net present value liability in 2010 dollar terms of almost $27.2 billion. The amount of money in the Insurance Fund as at December 31, 2010, was $14.8 billion giving rise to a deficiency or unfunded liability of

$12.4 billion. Conversely, the WSIB Insurance Fund is said to be only 54 per cent funded.

History of the Unfunded Liability at WSIB and Root Causes

The WSIB Insurance Fund has not been fully funded for at least the past 35 years – see Appendix 1 for a schedule showing the history of the Fund. The root cause lies in a fundamental divergence of beliefs about the wisdom or necessity to maintain full funding of the Insurance Scheme. It is fair to say that the principal arguments for and against maintaining full funding of the Insurance Plan were quite plainly set out by The Hon. Sir William Ralph Meredith who is regarded as the father of Workers Compensation systems in Canada. Meredith's commentary in his Final Report to his draft Workers Compensation Bill of 1913, described the issue this way:

> *"There was much discussion as to the basis on which the assessments to provide the compensation should be made. The German law provides for assessing only for the amounts required to meet the payments of compensation which fall due during the year next preceding that in which the assessments are made, with an added percentage to provide a reserve fund to meet deficiencies in the accident fund in the event of an unusual catastrophe or a depression in trade, but no assessment is made beyond that to meet the deferred payments of compensation, i.e., the payments which are to become due in future years. This plan (is) popularly called the current cost plan"*[2]

Meredith then weighs the pros and cons of the current cost method of funding the Insurance Scheme and cites various experts whom he consulted.

> *"Mr. Dawson favours it as not only expedient because it does not involve making the heavy assessments which would have to be made at the outset if the capitalized value of the deferred payments had to be provided for by the assessments, but also as "not unfair to the employers in future years, or economically unsound."* [3]

Meredith goes on…

> *"On the other hand the current cost plan is vigorously denounced by Mr. Sherman, who contends that it is manifestly unfair to the employer of the future because it shifts upon his shoulders part of the burden of compensating for accidents which have happened before he became an employer, and that it results in low assessments in the early years of the operation of the law, and necessarily increases in the later years, until in a measurable period of time they become a burden too oppressive for the employer of the future to bear."*[4]

And…

> *"In support of his view Mr. Sherman referred to the rates in Germany, which he said, "now average about double what they were at the beginning," and he added that "it is calculated that they will not reach their stable maximum for some twenty years more. How much more they will then be no one knows, but the majority guess is they will then double."* [5]

In the end, Meredith couldn't make up his mind. He concludes…

> *"I am not convinced that the German plan affords an adequate safeguard against the dangers which Mr. Sherman anticipates, nor am I satisfied that it does not do so. I have, therefore, concluded that … it is better to leave that to be determined by the Board which is to have the collection and administration of the accident*

2 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 5.

3 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 5.

4 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 5.

5 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 5.

fund as experience and further investigations may dictate."[6]

So here we have the main arguments for and against collecting premiums from employers to fund both current and future liabilities of the Insurance Scheme – full funding or partial funding for only the foreseeable and generally short term needs of the scheme. The arguments can be summed up and updated to the current century as follows.

Arguments in Favour of Partial Funding

There are persuasive arguments in favour of partial funding. While persuasive, we believe that under close examination, these arguments fall short from a public policy perspective, from a worker's perspective and from an employer's perspective. The main arguments in favour of partial funding of the Insurance Plan are that:

- **It requires too high a premium levy to fund the full capitalized value of future claims.** This is updated today by the supplemental argument that the extra premium needed to fully fund the present value of future liabilities is best left in the hands of employers who can deploy it more profitably than handing it over to a Government-run Insurance Scheme. Alternatively, the lower premium can be used to justify increased benefits without unduly burdening employers.
- **Shifting the burden of cost for current claims to future employers is not unfair or economically unsound.** This argument is largely dependent on an assumption of a relatively stable body of employers and a continuous expansion of the payroll base. A variation of this argument is the notion of arriving at a stable premium rate which does not change much over time hence does not necessarily burden future employers more than it does current employers. This is also sometimes referred to as the current Canada Pension Plan (CPP) method of funding future liabilities. (See Appendix 2 for an extract from Annual Report of the Canada Pension Plan 2008-2009 which also provides important insights into the risks of partial funding and its impact on future premiums.)
- **As long as there is enough cash to meet benefit payments as they arise, there may be no need to fully fund future liabilities**. Partial funding is sufficient as long as the Insurance Fund meets the test of being able to pay obligations when they become due.

Meredith raised some of the above arguments in weighing the pros and cons of partial funding.

There are three additional arguments that Meredith did not raise but which the Injured Worker community has raised.

- The first argument states that by placing too high a bar for funding the Insurance Scheme, the burden on employers serves to restrict any increase in benefits for workers, even where increases are manifestly fair and required. Employers tend to stoke the fears of injured worker advocates by asserting from time to time that there should be no increases to benefits while an unfunded liability exists in the Insurance Fund. But, by contrast, employers also fear that Governments get tempted to increase benefits – and hence, costs – when the funding level rises.
- A full-funding requirement would result in variable and uncertain premium assessments as the future liability rose or fell. A steady-state-funding premium would, the argument goes, remove the debate about sufficiency and allows the Government and employers to do what is right in terms of worker benefits.
- The Government-run Workers Compensation scheme in Ontario is not a private insurance company. It need never go out of business. It

6 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 6.

has unlimited taxing powers to ensure that sufficient funds exist to pay workers benefits indefinitely into the future. Hence, there is no need to fully fund, or even mostly fund, the system at all times. Under this scenario, a funding level of 50 per cent would be adequate.

Arguments in favour of full funding

Meredith, while asserting that he really didn't know which was best, current costs or full funding of the Insurance Scheme, did suggest that this question should be revisited by the Insurance Board after it had some experience with administering the plan. Ontario and most of the other Canadian provinces have now had some 100 years of experience administering of workplace Insurance Schemes. The overwhelming conclusion among the Canadian provinces has been that full funding is greatly preferable to partial funding of the Insurance Plan.

Ontario is conspicuously absent from this group. And, it would appear, absent for no good and valid public policy reason. On the contrary, Ontario has consistently asserted that it is committed to the principle of full funding and has in fact put in place plans from time to time to reach full funding. Ontario has never made the case that being partially funded is a preferable and financially sound public policy objective. The fact that it has not so far succeeded in achieving full funding does not take away from its desire to do so. The reasons lie at least partially in Ontario's ambivalence about the merits or otherwise of taxing employers too much – leading to caps for periods of time or even reductions in premium levies, while at the same time expanding benefits. This has led to poor administrative practices and an unfunded liability that has largely risen or fallen without much active control. The following is an analysis of the main arguments in favour of pursuing a full funding policy for Ontario.

A fully-funded insurance plan does not impose an undue burden on employers

Ontario, with its partially-funded Insurance Plan, has a higher premium today than most of the other Canadian provinces, even accounting for the different employer mix in other provinces. And, this despite the fact that Ontario has the lowest rate of injury per 100 workers of any province. If Ontario had to fully fund just its new claims cost plus administrative expense, its premiums could be one of the lowest in Canada. Contrary to conventional belief, fully funding Ontario's cost of claims would not pose an undue burden on employers.

One might ask if the position of the other provinces in maintaining full funding of their Insurance Schemes is the result of expediency, i.e., that they had fully-funded plans anyway and simply confirmed this position. Several provinces have dipped below full funding for several years in the past and have brought themselves back to full funding, or are currently engaged in that effort, and have done so not without some considerable effort. As you can see from the Table below, the average funding level of all ten provinces and the two territories was just over 100 per cent at the end of 2009 which is the last reporting period for which information is available. More importantly the other Canadian provinces were able to recover from the stock market downturn of 2008 much more readily than Ontario has. The commitment to full funding indicates that virtually all the provinces and territories other than Ontario have found persuasive public policy and financial reasons to do so. Nor have employers in these other jurisdictions found this to be excessively burdensome.

To be comparable with the other provinces, Ontario's liabilities should be presented at a 6 per cent discount rate which is the rate used by most of the other provinces. In this case Ontario's funding ratio would drop by a further 3 per cent – bringing it to close to 50 per cent for 2008 and 2009. This presents an even more unfavourable comparison

Jurisdictional Comparison: Funding Ratios

Province	2007*	2008*	2009*
Alberta	132.95	111.74	128.38
British Columbia	139.90	115.51	123.50
Manitoba	130.00	106.57	114.87
New Brunswick	105.40	87.68	101.60
Newfoundland and Labrador	96.38	77.27	87.50
Northwest Territories/Nunavut	123.00	117.00	116.0
Nova Scotia	75.30	59.91	62.40
Prince Edward Island	110.26	89.19	103.77
Quebec	99.30	69.86	73.60
Saskatchewan	121.91	101.80	114.91
Yukon	120.50	105.15	122.50
Canada (exclude Ontario) **	117.32	93.15	100.98
Ontario	66.40	53.52	54.21

Source :
* Key Statistical Measures from AWCBC
** Derived using the published information from AWCBC

with the condition of the Insurance Funds of the other provinces.

Importantly, each of the provinces with fully-funded, or nearly fully-funded plans, adopt funding policies that allow for a smoothing or graduated recovery from unexpected declines in their assets. This provides for more stable and less variable premiums. Some spread the recovery through increased premiums over eight or even ten years, thus avoiding sudden increases or decreases in premiums for employers. Some provinces go so far as maintaining a surplus to deal with unexpected losses. B.C. and Alberta, two provinces which maintain a surplus for example, came through the 2008 Stock Market correction without falling below 100 per cent funding of their Insurance Plans and without the need to increase premiums for employers. A reading of the tables below shows that in general the higher the funding level of the province, the lower the premium rate and vice versa. Employers today point to provinces with fully-funded Insurance Schemes and hold them up as examples of lower operating cost and greater competitive advantage than Ontario.

Ontario's partially-funded plan has not resulted in more financial room to grant additional worker benefits. Benefits and premium levels have gone up or down based on political pressures of the day.

The argument that ignoring the Unfunded Liability may somehow permit governments to increase benefits is not borne out by the facts. There is broad convergence of benefits across Canadian provinces. While there are variations in the particulars of certain benefit types, the overall package delivers broadly similar benefits to workers in all the Canadian provinces. It is hard to argue that Ontario has succeeded in providing greater benefits to its injured workers as a result of maintaining only a partially-funded system while the other provinces have maintained fully-funded plans. Clearly this has not been the case. There are examples when Ontario has increased benefits when the level of Funding was low, as in 1985 when the Funding ratio had dropped substantially and stood at just 32 per cent. There are also examples when Ontario has reduced benefits when the funding level was low, as in 1995 when the funding level was 40 per cent. As well, Ontario has increased benefits when the Funding Ratio was relatively high, as in 2007 when the ratio was 66 per cent. It seems clear that successive governments have responded to the political pressures of the day by either capping premium rates or increasing or decreasing benefits without much regard to the level of funding of the Insurance Scheme. The relative disregard for the fiscal consequences of increasing or decreasing either premiums or benefits has introduced a range of poor practices and extra costs into the system which are described in more detail below.

In a situation of rapidly changing economic activity, partially funding the Insurance Plan does result in unfair and economically unsound transfers of costs to future generations of employers. It transfers costs from older forms of manufacturing to newer forms and to newer types of businesses.

The basic premise of fully funding an Insurance Scheme is that it matches the cost of doing

business, not only with the employers who generate the cost of claims but also with the period in which the claims are generated. It avoids laying off costs to future generations or subsidizing current costs of production by transferring costs to future generations. This may not be such an issue if you have a relatively stable employer base and a relatively stable growth pattern into the future. However, the composition of work and the organization of workplaces have changed radically since Meredith's day. Corporations come and go much more rapidly than they ever have. Economic activity is deconstructed into specialized companies and organized through networks of companies that outsource work to third parties. Certain industries like manufacturing are declining while others are growing. In Ontario today, each year some 20,000 out of 240,000 employers close their accounts with the WSIB and 20,000 new ones are formed and register with the Insurance Scheme. It can be argued that some of these are the same principals registering in new names but there are still many thousands of genuinely new employers who are registering with the WSIB each year. Each of these employers has to pick up costs for which they were not responsible and from which they derived no benefit. Even the employers who remain in the system for long periods are conducting their business in entirely new and different ways, making their current operation irrelevant to their former operation from which past claim costs arose.

The unfairness of moving costs from one generation to another, particularly when the composition and business practices of future generations of employers is substantially different to their predecessors, is well illustrated by the problem of Occupational Disease claims. These have a long latency period from time-of-damage to time-of-recognition-and-payment. Employers complain that these costs were generated in the past by practices that have now changed or by employers who are now no longer in business. Employers of today assert that they should not be charged for these costs. The same principle applies to industrial accident costs that were generated in the past by production methods that are no longer being used or by employers who are no longer in business.

At the same time, the covered labour force in Ontario is both aging and shrinking. This means that employers will have to generate the profits from fewer workers to pay for past claims, making the payments more burdensome on a relative basis. Conversely, employers will have to lay off workers and look to generating profits from fewer workers. Either way you look at it, it is best to respond to changing economic conditions by matching costs with outputs for the employers who are engaged in a given economic activity, and in the period in which that activity takes place, to the extent these costs can reasonably be determined. Subsidizing past employers with the gains of future employers has no basis in sound economic policy, particularly when the organization, nature and size of future economic activity differs significantly as time goes on. Furthermore, there is at least some risk that economic circumstances will not continuously improve indefinitely into the future. Employers trying to recover from a recessionary period will surely be more challenged to pay back past debts. As well, there may be future risks that are unforeseen today, that will place their own additional burden on future employers – the recognition of additional compensable injury types like work induced mental stress, for example, or the added costs of compensating injuries to a rapidly aging workforce.

Finally, since a substantial portion of employers – representing some 30 per cent of Ontario's workforce – are not covered by the WSIB, the relative growth of this sector, which is dominated by knowledge industries, compared to the sectors covered by the WSIB, which are dominated by manufacturing, construction, and primary industries poses a real threat to the stability of the system. As the employer base of covered employers declines relative to the whole, the burden of carrying past claims becomes more onerous. Furthermore, the possibility of covering all or most of the workforce in Ontario (full coverage) becomes more and more remote if the non covered employers would be

asked to pick up major costs from totally unrelated employers of the past

Deferring costs from one generation to another generation of employers removes an essential check and balance on financial behaviour, introducing administrative gaming and extra costs

If employers are not to be faced with the true cost of their activities, the temptation, indeed the natural reaction, is to seek to defer these costs. This is done through a variety of means, using, for example, administrative – but none the less legal – loopholes in the Plan to get relief for current costs and defer them via the Unfunded Liability to future generations. Workers lobby, pushing for generous interpretations of legislated benefits and advocate for the elimination of administrative schemes that charge costs back to employers, claiming that, if employers have to bear these costs, they will manipulate them to the disadvantage of workers.

Staff administering the Insurance Plan are not held to account for disciplined administration of benefits because there is always the escape route of charging costs unpalatable to employers into the Unfunded Liability and letting future employers deal with the issue. The avoidance activities of employers and workers and the laxness that enters the administration of the Insurance Scheme are a direct result of the absence of the check-and-balance provided by charging current employers the true cost of benefits. Cumulatively, these factors, if left unchecked over time, inevitably deliver a poorly run Insurance Scheme. The result is a Plan that accumulates systemic imbalances, is much more expensive than it needs to be, and unfairly burdens future employers.

Analyses of past costs tabled with the Funding Review show that over the period 1999-2010 fully $7.4 billion has been added to the Unfunded Liability as a result of stakeholder behaviours and lax administration, which could well have been avoided if these costs had been borne by employers at the time they were incurred. These costs comprise generally: employer refunds of premiums that exceeded surcharges and were not recovered through increased premiums, costs that exceeded estimates (experience gains and losses), and increases in liability resulting from longer durations of claims since 1998 that could have been corrected earlier if they had been fully charged back to employers.

The table below presents a summary of the main drivers of change to the Unfunded Liability for the last 12 years:

Table 1.2 - Drivers of Change to Unfunded Liability (in millions of $)

Period	1999-2010	
Unfunded Liability (UFL) as of December 31, 1998	(7,098)	
Premiums allocated to reduce the UFL	11,499	Net Premiums: 5,189
Interest to carry UFL	(6,310)	
Investment returns lower than expected	(2,324)	Economic Assumptions: (1,291)
Indexation lower than expected	1,033	
Employer incentives	(1,101)	
Other experience (gains) losses	(2,200)	
Assumption changes	(4,122)	
Provision for Occupational Diseases in the latency stage	(600)	
Legislative, policy and personal income tax changes	(1,677)	
Accounting policy changes	545	
Unfunded Liability (UFL) as of December 31, 2010	(12,355)	

Deferring costs from one period to another does not lower premiums. In fact, the practice results in higher premiums for future employers and less ability for future employers to expand business and hire new workers.

The rationale is that if you don't charge full costs to employers as they arise, employers will be able to deploy the deferred charge to increase profits and presumably hire more workers than they otherwise would have been able to afford. In this, Mr. Tecumseh Sherman and Mr. Wegenast were prescient in advising Meredith a hundred years ago of the dangers of charging too little today and paying for it tomorrow.

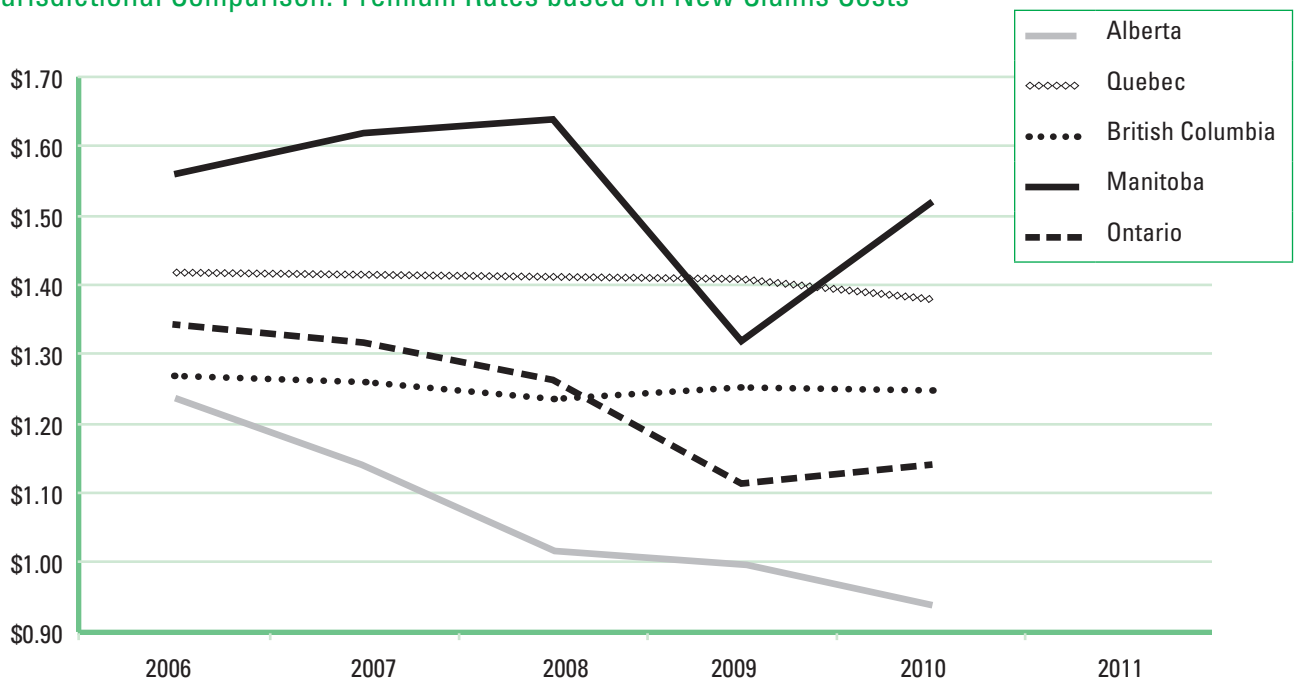
Mr. Sherman's advice is quoted by Meredith this way

> *".. the current cost plan is vigorously denounced by Mr. Sherman, who contends that it is manifestly unfair to the employer of the future because it shifts upon his shoulders part of the burden of compensating for accidents which have happened before he became an employer, and that it results in low assessments in the early years of the operation of the law, and necessarily increases in the later years, until in a measurable period of time they become a burden too oppressive for the employer of the future to bear."*[7]

The Ontario experience has exactly mirrored the patterns described above. A low premium to begin with, rising as the burden of past costs began to get added to current costs and finally a stranded premium that is much higher than justified by current costs with no way to reduce it unless past costs are somehow paid off. In terms of benefit costs, Ontario's businesses today are paying a 40 per cent to 50 per cent higher premiums than they would otherwise need to pay if they did not have to carry past claims costs. This is a high price for current employers and workers to pay. In fact, in terms of the claims that current employers are experiencing, Ontario is one of the lowest-cost provinces in which to operate. The graph with the attached table below shows that measured in new claims costs or NCC, Ontario is one of the lowest-cost provinces in Canada.

7 Sir William Meredith, *The Meredith Report, Province of Ontario, Final Report*, p. 5.

Jurisdictional Comparison: Premium Rates based on New Claims Costs



Jurisdictional Comparison: Premium Rates based on New Claims Costs

Year	Ontario**	Alberta	British Columbia	Manitoba	New Brunswick	Newfound-land	Northwest Territories	Nova Scotia	Prince Edward Island	Quebec	Saskatch-ewan	Yukon
2006	$1.34	$1.24	$1.27	$1.56	$1.41	$2.10	U/A	$1.42	$1.86	$1.42	$1.45	$1.17
2007	$1.32	$1.14	$1.26	$1.62	$1.45	$2.10	$1.24	$1.66	$1.88	$1.41	$1.43	$1.48
2008	$1.26	$1.02	$1.24	$1.64	$1.44	$2.10	U/A	$1.73	$1.86	$1.41	$1.27	$1.68
2009	$1.12	$1.00	$1.25	$1.32	$1.41	$1.86	U/A	$1.72	$1.89	$1.41	$1.24	$1.72
2010	$1.14	$0.94	$1.25	$1.52	$1.40	$1.82	$1.30	$1.73	$1.12	$1.38	$1.21	$1.69
2011	$1.22											

Source: Association of Workers' Compensation Boards of Canada

*Portion of the average rate that is deemed necessary to finance the total benefit costs incurred for injuries that are expected to occur in the reference year and for diseases that were reported/diagnosed in that year, for assessable employers.

**Recalculated New Claims Cost based on latest estimate of projected 2011 assumptions including 6 per cent discount rate (not published with AWCBC)

Yet the following table shows that Ontario's average premium rate is one of the highest.

2010 Average Provisional Premium Rate

Province	Rate
Alberta	$1.32
British Columbia	$1.56
Manitoba	$1.60
New Brunswick	$2.08
Newfoundland/Labrador	$2.75
Nova Scotia	$2.65
Prince Edward Island	$2.15
Quebec	$2.19
Saskatchewan	$1.63
Ontario	$2.30

Composite average premium rate (excluding Ontario)	**$1.99**
Composite average premium rate (including Ontario)	**$2.02**

The main reason for this is that Ontario employers have to carry the liability for past claims. In order to pay the interest element on the current Unfunded Liability, employers had to pay some $800 million into the Insurance Fund in 2010 alone. Interest payments over the period 1999-2010 were $6 billion. Clearly, Ontario's current employers are bearing a heavy burden of past costs and are not able to invest in new business activities or increase employment to the same extent they otherwise might have the exact opposite of the original intention of not collecting enough premiums in the first place.

Partial funding is not a preferred option unless it can't be avoided. It provides no cover for economic shocks and relies excessively on unlimited taxation powers which could face practical limitations.

Advocates of the merits of partial funding of the Insurance Scheme point to the experience of the Canada Pension Plan, which is only partially funded and is considered to be financially sound. Several aspects of this example bear examination. First of all, the $9.80 per $100 CPP Payroll premium is very high relative to the benefit provided because the fund had only 15 per cent in available assets

to invest relative to its liabilities in 2009[8]. Second, the Fund itself recognizes the limitations of being underfunded, and has set a goal to raise its funding level over the next decades. The attached extract from the CPP Annual Report of 2009 clearly sets out the limits of the Government's ability to raise premium rates indefinitely. The CPP reaction to its funding dilemma was to raise rates somewhat, but also to cut benefits once the level of rates got too high. Finally, the Fund is resolved to not aggravate the problems of underfunding by insisting that any new benefits be fully funded in the future. It is fair to say that the Canada Pension Plan funding formula is a function of the circumstances it finds itself in, and not the outcome of a preferred public policy option.

Also, as the level of the Unfunded Liability rises, despite the unlimited assessment powers of the Insurance Fund, there comes a point where auditors will insist for the sake of prudence, that the province underwrite the risk by taking the liability onto its own books. This has the effect of spreading the risk among all taxpayers in the province. In Ontario, with its very large Unfunded Liability potentially growing to $14 billion, the step of consolidating the liability with the province's debts could have an impact on the credit rating and cost of borrowing for the province.

Impact of actuarial and accounting standards

Finally, it is important to recognize that WSIB does not operate in a vacuum in terms of its decisions on funding. Financial and actuarial reporting standards have the effect of highlighting funding and solvency issues in the Insurance Fund.

International Financial Reporting Standards and actuarial rules dictate how liabilities and other financial matters are to be determined and disclosed and have real financial consequences. For example, in the absence of a clear full funding policy, there may be little rationale for assuming a discount rate on future unfunded payments higher than a government bond rate. This in turn would drive up the Fund's Liabilities and drive down the Funded Ratio by 10 per cent or more and well below 50 per cent – a truly unbearable level which as a minimum would drive up premium rates. The Auditor General in turn must be satisfied with the external audit opinions on WSIB's Insurance Fund and can also decide whether in his opinion the Fund is being managed in a sufficiently prudent manner. The Auditor General can qualify his opinion on the financial statements of the province if he believes that the Fund is not being managed in a sufficiently prudent manner. He can also report his concerns to the Ontario legislature, as he did in 2009, which in turn influences how the Government reacts.

Summary

The overall picture that emerges from consideration of the above factors is that sound public policy and fiscal prudence would dictate that fully funding the Workplace Insurance Scheme in Ontario is preferable to underfunding it for the following reasons:

1. **It is poor public policy to provide a subsidy to current employers at the expense of future employers.** There is no way to evaluate whether such a subsidy yields positive economic outcomes. In an environment where the organization and nature of economic activity is changing rapidly the practice of shifting substantial costs from the present to the future acts as a disruption to future growth patterns. This in turn negatively impacts future employment and wealth formation. Interest payments to carry past costs are a non-trivial burden on employers.

   There may be future risks and future economic challenges for employers that can more easily be met if there is no burden of past debts to carry.

8 Financial Institutions Canada, *Actuarial Report on the Canada Pension Plan 25*, as at December 31, 2009, p. 70.

2. **From an employer point of view the justification that by not collecting sufficient premiums to pay current and future costs of claims the Insurance Scheme can charge a lower premium to employers is false.** After a sufficient amount of time, premiums will rise to the point where they are much higher than future claims would justify. This has already happened in Ontario.

3. **From an employer point of view the other justification for charging less being that employers can use the difference to better advantage than handing it to the Insurance Plan is highly suspect.** The uncollected premiums are not free money. In Ontario today they come with an interest rate of 7 per cent. Businesses must not only earn more than 7 per cent to justify borrowing from the Insurance Fund but also determine that they cannot borrow at lower rates on the open market and then set aside and not consume the interest payments they must make to the Insurance Fund in the future.

4. **From both an injured-worker, as well as an employer point of view, pursuing a policy of having just sufficient funds in the Insurance Plan to pay benefits as they come due provides a false sense of security.** A plan that is not fully funded is at a great disadvantage when unexpected economic downturns arise. When major and unexpected downturns in the value of the fund occur there will be pressure to reduce benefits. Partial funding also misses another important imperative of an Insurance Plan. A sound Insurance Plan must not only be able to meet payments but also to allocate costs efficiently and fairly amongst employers. This test is not met by transferring large costs to future employers.

5. **From an injured worker point of view the argument that a low level of funding is feasible because the Insurance Plan has unlimited assessment powers to pay for costs does have practical limits.** When premiums get too high, there is inevitable pressure to reduce benefits. This is true no matter what the level of funding is. If employers are carrying a heavy burden of premium to pay for past costs, the "head room" to increase benefits is correspondingly reduced. And this is aggravated if employers feel that they are getting no value from having to pay past claims costs. Employers tend to lump their overall costs into a single payment and come to the conclusion that "benefits are too high" irrespective of the fact that current benefit costs are in fact not high but that their premium is inflated by the need to pay for the past.

   Inevitably, as premiums rise and the unfunded liability rises two things will happen. Firstly, benefits will come under attack. This has already happened to the workers compensation system in Ontario as well as to other state regulated types of coverage, for example, auto insurance. Secondly, there will be pressure to consolidate the Unfunded Liability with the debts of the province as a whole, which could put pressure on the credit rating and cost of borrowing of the province

6. **From a public-policy and injured-worker point of view, trying to keep premiums low in order to make room to increase benefits is not a realistic goal.** In the first place, premiums cannot be kept low unless the fund is fully funded. This has been proven in Ontario. Secondly, increasing benefits while not charging their full cost is akin to spending on credit. While deficit spending may be justified, for the Government as a whole during times of recession, it is not an advisable policy for an Insurance Plan. Even the Canada Pension Plan has as a goal the need to fully fund via additional premiums, any new increases to benefits. And the CPP has found, just like the WSIB in Ontario, that a large part of current premiums gets consumed in paying for past claims leaving little room to reduce premiums. If additional benefits are justified, they should be enacted on their own merits, not on some

scheme to defer their cost to a future time. This only adds to the cost in the long run.

7. **From an employer point of view, fully funding the Insurance Scheme does not necessarily cause large and unpredictable changes to premiums.** Large losses, for example, through a downturn in the investment markets, can be cushioned by spreading their recovery over several years. This is a common and commonly applied practice in provinces which maintain full funding of their Insurance Plans. Conversely, provinces with surpluses in their plans do from time to time declare dividends or refunds of premiums to their employers.

8. **In terms of sound administration, charging premiums that do not reflect true costs creates a disruption of normal checks and balances.** Freed from facing the consequences of the cost of their actions, employers, workers, the government and the administrators of the Fund fall into practices that inevitably raise costs to the system as a whole and introduce imbalances that become systemic. This is an entirely negative and avoidable effect.

Conclusion

Ontario's employers today are paying a higher premium than almost any other province even though the injury rate in Ontario is the lowest in Canada. Despite this, Ontario's worker's Insurance Plan is the worst funded of any of the other provinces. Our projections show that unless urgent action is taken, this situation is projected to get much worse going forward. It appears to us that the interests of injured workers, employers or Public Policy are not well served by a continuation of this situation. Absent taking definitive action to improve its financial position, it is also difficult to see how WSIB could continue in its status as a self funding Trust Organization within the province of Ontario.

Certainly as managers of the Plan, we have seen the practical results of not anchoring the Insurance Plan in a fully-funded model. It is our view that injured workers benefits are at risk. Employers believe, with justification, that their premiums are too high. The administration of the Fund is burdened with managing cost pressures with no clear anchor point to inform decisions. The present low level of funding of the Insurance Plan allows little room to deal with any substantial downturn in the economy or cope with substantial increases to benefits.

It is our considered view that the WSIB Insurance Fund must be fully funded, that is 100 per cent funded and that this goal should be specified in legislation. There is no justification for continuing to be an outlier to the other Canadian provinces and territories in this regard.

Given the large number of unforeseen events which could impact future viability of the Plan, it would be prudent to set both short-term and long term goals and to proceed on a staged basis. The first stage should be to get the WSIB to a substantial level of funding as soon as possible by setting an aggressive five year target – say 65 per cent to 70 per cent funding within five years. A full evaluation of the Fund's position should be undertaken at say 2017 or 2018 and then further five year plans set. The goal should be to reach 100 per cent funding no later than 2027. To reach the goal of full funding, administration of the Fund would need to be made more rigorous. And, as is the case for the Canada Pension Plan, costs of each year and any new benefits would have to be fully funded going forward so that the Unfunded Liability does not grow. The WSIB must strive to avoid any annual deficits going forward. These conditions, while challenging, seem both necessary and prudent for putting Ontario's Insurance Plan on a sound footing. The alternatives present far more risk and far more economic distortion.

The operations of the WSIB have a substantial impact on the welfare of the majority of workers and the competitiveness of employers in the province of Ontario. On average, in recent times, some 200,000 workers (about 5 per cent of the 4

million workers covered by the Insurance Plan) are receiving compensation for work-related injuries or illnesses. These workers, collectively, are owed some $45 billion in compensation. Employers pay billions of dollars in insurance premiums each year. By any measure these are substantial impacts on workers and employers in the province. How the Insurance Plan is administered is clearly of vital importance to the economic and social health of the province. Careful consideration of underlying forces that influence better-or-worse management of the Plan is therefore a matter of great importance. This paper is designed to provide input to the Funding Review which is charged with the responsibility of making recommendations on, among other matters, the level of Funding which is appropriate for Ontario's Insurance Plan. The analysis and conclusions are provided in a public forum so that stakeholders may freely judge and comment on them.

APPENDIX 1

WSIB Funding History

Year	Rate	Average Premium Rate		UFL Reported ($ millions)	Funding Ratio	Economic Events	Legislative Impact
		% Change	Investment Return				
1974	$1.41		N/A	$310	67.8%		Annual indexation (ad hoc) – 1974 to 1985
1975	$1.45	2.8%	N/A	$518	59.0%		
1976	$1.75	20.7%	N/A	$504	64.3%		
1977	$1.92	9.7%	N/A	$374	75.4%		
1978	$1.97	2.6%	N/A	$384	78.2%		
1979	$1.82	-7.6%	N/A	$405	80.0%		
1980	$1.65	-9.3%	N/A	$398	81.3%		
1981	$1.69	2.4%	N/A	$816	69.3%		
1982	$1.77	4.7%	N/A	$1,428	57.4%	1982 Recession – 18 months; GDP dropped 6.7%; high interest rates	
1983	$1.88	6.2%	N/A	$2,025	49.3%		
1984	$2.17	15.4%	N/A	$2,710	44.3%		
1985	$2.31	6.5%	N/A	$5,381	31.7%		Bill 81 – Legislated full indexation & included in UFL
1986	$2.65	14.7%	N/A	$6,207	32.4%		
1987	$2.88	8.7%	N/A	$6,691	35.6%		
1988	$3.02	4.9%	N/A	$7,350	38.0%		
1989	$3.12	3.3%	N/A	$8,469	40.0%		
1990	$3.18	1.9%	1.6%	$9,088	40.8%	1990/91 Recession – began Q2, lasted 12 months; high interest rates, restrictive monetary policy	Bill 162 – Move to wage loss system
1991	$3.20	0.6%	18.2%	$10,347	38.3%		
1992	$3.16	-1.3%	7.9%	$11,028	37.4%		
1993	$2.95	-6.6%	19.4%	$11,532	36.6%		
1994	$3.01	2.0%	-1.7%	$11,402	37.4%		
1995	$3.00	-0.3%	18.4%	$10,892	40.0%		Bill 165 – Friedland formula for indexation introduced (decrease)
1996	$3.00	0.0%	16.6%	$10,460	42.9%		
1997	$2.85	-5.0%	16.3%	$8,057	52.0%		
1998	$2.59	-9.1%	11.1%	$7,098	56.8%		Bill 99 – move to self-reliance RTW; modified Friedland formula (decrease)
1999	$2.42	-6.6%	12.8%	$6,402	62.1%		
2000	$2.29	-5.4%	8.0%	$5,675	66.8%	2000 Tech bubble burst – high interest rates, sold off high tech stocks, slowed business spending	
2001	$2.13	-7.0%	-1.5%	$5,657	67.2%		
2002	$2.13	0.0%	-6.2%	$6,591	63.8%		
2003	$2.19	2.8%	12.8%	$7,135	62.4%		
2004	$2.19	0.0%	8.5%	$6,420	68.0%		
2005	$2.19	0.0%	10.5%	$6,510	69.1%		
2006	$2.26	3.2%	16.2%	$5,997	73.2%		
2007	$2.26	0.0%	-0.7%	$8,094	66.4%	2007 – market declines began	Bill 187 – 2.5% indexation for partial disability 2007/09 Bill 221 – presumptive legislation for firefighters
2008	$2.26	0.0%	-15.5%	$11,469	53.5%	2008/09 Recession – causes significant employment decline	
2009	$2.26	0.0%	13.0%	$11,751	54.2%		Bill 119 – extension of construction sector coverage Bill 221 – extension of benefits to volunteer firefighters Bill 187 – 0.5% indexation for partial disability 2010
2010	$2.30	1.8%	9.6%	$12,355	54.5%		

APPENDIX 2

Annual Report of the Canada Pension Plan 2008–09 (excerpt)

Funding Approach

When it was introduced in 1966, the CPP was designed as a pay-as-you-go plan, with a small reserve. This meant that the benefits for one generation would be paid largely from the contributions of later generations. This approach made sense under the economic, financial and demographic circumstances of the time. The period was characterized by rapid growth in wages and labour force participation, and low rates of return on investments.

However, demographic and economic developments as well as changes to benefits in the following three decades resulted in significantly higher costs. When federal and provincial Finance ministers began their five-year statutory review of the CPP finances in 1996, contribution rates, already legislated to rise to 10.1 percent by 2016, were expected to have to rise again—to 14.2 percent by 2030—to continue to finance the Plan on a pay-as-you-go basis. Continuing to finance the Plan on a pay-as-you-go basis would have meant imposing a heavy financial burden on Canadians in the workforce 25 years down the road. This was deemed unacceptable by the federal and provincial governments.

Therefore, amendments were put into effect in 1998 to gradually raise the level of CPP funding by: increasing contribution rates over the short term; reducing the growth of benefits over the long term; and investing cash flows in the private markets through the CPP Investment Board (CPPIB), to achieve higher rates of return. A further amendment was included to ensure that federal and provincial Finance ministers consider the full funding of any new or increased benefits provided under the Plan. The reform package agreed to by the federal and provincial governments in 1997 included significant changes to the Plan's financing and funding provisions. The package included:

- the introduction of steady-state funding to replace pay-as-you-go financing, in order to build a reserve of assets, equivalent over time to about five and a half years of benefit expenditures, or about 25 percent of the Plan's liabilities. Investment earnings from this pool of assets would help to pay benefits when the large cohort of baby boomers retires.
- the introduction of incremental full funding, where changes to the CPP that increase or add new benefits would be fully funded. In other words, their costs would be paid as the benefit was earned and any costs associated with benefits that were paid but not earned would be amortized and paid for over a defined period of time, consistent with common actuarial practice.
- both of these funding objectives were introduced to improve fairness and equity across generations. The move to steady-state funding eases some of the contribution burden on future generations. Under full funding, each generation that receives benefit enrichments is more likely to pay for it in full and not pass on the cost to future generations. These full funding requirements were made operational through new regulations that came into effect with the adoption of Bill C-36 on March 3, 2008.

Financing

According to the Chief Actuary's Twenty-third Actuarial Report, the level of contributions is expected to exceed the level of benefits paid until 2019. Funds not immediately required to pay benefits will be transferred to the CPPIB for investment. Plan assets are expected to accumulate rapidly over this period and, over time, will help pay for benefits as more and more baby boomers begin to collect their retirement pensions. In 2020

and thereafter, when most baby boomers will have retired, and benefits paid begin to exceed contributions, investment revenues from the accumulated assets will provide the funds necessary to make up the difference. However, contributions will remain the main source of funding for benefits.

The amended financing policy moved the CPP away from pay-as-you-go financing (with a small reserve) towards fuller funding. According to the Twenty-third Actuarial Report, the Plan was 15 percent funded (with an unfunded liability of $620 billion as at December 31, 2006) and projected to be 25 percent funded by 2025 (i.e., Plan assets are expected to cover about 25 percent of obligations), compared to about 7 percent funded at the time of the 1997 agreement.

Moving to full funding instead of steady-state funding would have eventually eliminated the unfunded liability, but would have created intergenerational unfairness. During the transition, contributors of some generations would have had to pay much higher contributions than others; they would have had to pay for the benefits of current retirees and for the development of a reserve to cover their own pensions. Continuing with a pay-as-you-go approach also would have been unfair, as it would have meant a sharp increase in the contribution rate over the coming decades. The fuller funding approach is more equitable for each generation.

A meaningful measure of the future financial health of the CPP is the adequacy and sustainability of the 9.9 percent contribution rate rather than the funding level at any particular point in time. According to the Twenty-third Actuarial Report, as at December 31, 2006, despite the projected substantial increase in benefits to be paid as a result of an aging population, the Plan is expected to be able to meet its obligation throughout the projection period. A partially funded CPP not only balances the two approaches to funding, it also contributes to diversifying the funding of Canada's retirement income system, which also includes:

- the Old Age Security (OAS) program, funded by federal government general revenues; and
- private savings, including tax-deferred, fully funded, employer-sponsored pension plans and registered retirement savings plans (RRSPs).

A diversified funding approach allows Canada's retirement income system to be less vulnerable to changes in economic and demographic conditions than systems in countries that use a single funding approach. In addition, the Canadian approach to pension provision, based on a mix of public and private pensions, is an effective way to provide for retirement income needs.

and better system is proposed and also compared to the basic principles. The proposed system design eliminates Rate Groups and Experience Rating and goes directly to assessing employers a premium rate linked to their claims experience. The proposed system elegantly incorporates the principles of collective liability and provides a structured series of messages to employers if their cost behaviour deviates from norms. Employers are encouraged to take corrective action without the need for a cumbersome Experience Rating system or behaviours not in the best interests of workers.

The papers form a collection. The first, as to the choice of full or partial funding, is foundational. A decision must be made one way or another on this issue. The second and third are means to implement whatever that decision may be. They are, none the less, critical to future operations of the WSIB and have significant impacts on stakeholders. We need to understand and isolate the dynamics of carrying a large Unfunded Liability of the past, from the current operations and efficiency of the Board. Absent this, the two elements get combined and result in confusing messages and unfocussed action. Similarly, we need to bring up to date the Rate Group, Premium Rate setting and Experience Rating systems of the Board. The current processes have their roots deep in history and are not responsive to current conditions. As we move forward, it is absolutely essential that such fundamental issues as how employers get classified and how they bear collective or individual liability are both fair and seen to be fair.

The papers are submitted with the intent of eliciting scrutiny and debate. Their goal is to improve the system for workers and employers. We welcome views and comment.

Sincerely,

I. David Marshall

Eckler

CONCEPT DESIGN PAPER FOR FUNDING OF THE WORKPLACE SAFETY AND INSURANCE BOARD (WSIB)

June 6, 2011

Prepared by:

Eckler

CONSULTANTS + ACTUARIES

Eckler Ltd.
110 Sheppard Avenue East, Suite 900
Toronto, Ontario
M2N 7A3

Eckler

Table of Contents

Section 1: Executive Summary

At only 54.5% funding at the end of 2010, with no funding policy and persistent annual operating deficits, the WSIB is an outlier among its Canadian peers which have found ways and means to either be 100% funded (or more) or have plans in place to achieve full funding. Despite this difference, the WSIB continues like other boards to be a viable trust agency technically operating at arm's length from the Government of Ontario. It provides benefits to injured workers under the *Workplace Safety and Insurance Act -Ontario, 1997 (WSIA)* and collects premiums from covered employers in Ontario, but at rates that are higher than most other jurisdictions due to the cost of carrying its unfunded liability.

In addition, the Auditor General of Ontario commented in its 2009 annual report on the financial pressures facing the WSIB and has challenged why the WSIB's finances should not be consolidated with the finances of the Government of Ontario. The Harry Arthur's Funding Review is trying to answer what is sufficient funding and what is a reasonable timeframe to achieve it.

This paper provides a vision to stop the bleeding of annual operating deficits and to achieve full funding within a reasonable timeframe. It does so without negatively impacting the amounts payable to injured workers, now or in the future. The vision attempts to turn the page on the WSIB's past and provides for a new tomorrow where full funding is achievable within 15 - 20 years and average premium rates do not go through the roof, peaking in the $2.60 - $2.75 range.

Ring-Fencing Past Claims and Starting Up A New Entity

A concept known as ring-fencing would isolate the past claims, say as of the end of 2011, from any new claims incurred in 2012 or later years. Ring-fencing would require separate reporting of old and new claims and would provide better transparency and control than is possible under the current amalgamated approach of reporting and financing. The concept is not new, and is described in more detail in this paper. It would require a funding policy.

The ring-fencing approach would work as follows.

Past claims (2011 and earlier) would be allowed to run their natural course and premiums for these past claims would be specifically allocated to the ring-fenced account. The separate account and financial reporting should provide sufficient transparency and control on the retirement of the UFL associated with the past claims. However, an additional consideration may be to set up a separate legal entity to better ensure the long-term success of funding the past claims. An important element would be to ensure that the benefit liabilities and associated premium rate are sufficient to achieve a reasonable expectation of success that the past claims would be fully funded within 15 to 20 years. For example, any gains or losses on the past claims would remain in the ring-fenced account and there should be some advance anticipation of possible losses with subsequent releases if funding is clearly over-achieving its goal. As shown later in the report, an ultimate premium rate of about 90 cents would retire the UFL within this timeframe.

At the same time, a new financial reporting entity (« New » WSIB) would be set up for all new workplace injuries from 2012 and later years. Premiums for new claims (plus expenses) of about $1.75 - $1.90 would be specifically allocated to the "New" WSIB. Once again, a separate account and reporting entity would report on the funding of the new claims, and any gains or losses on these claims would remain in the "New" WSIB. Essentially, with respect to the new claims, the WSIB would operate as if it were a fully funded workers compensation board.

It is important to note that both the ring-fenced past claims and the new claims would be administered similarly without any modification to the *WSIA*, thus ensuring that the legal obligations to all injured workers, regardless of the dates of their injuries, would be met.

Section 2: Introduction

The objective of this document is to contribute to the current debate about the financial situation of the Workplace Safety and Insurance Board (WSIB) through an actuarial perspective, assisting the decision makers to understand the complex financial risks and to arrive at a well-thought plan. The current approach for funding the WSIB will be reviewed, and a conceptual design to the funding system will be proposed for the future. The characteristics of the revised approach have been elaborated in considering the dynamics of risk and its financial impact on the long term funding of the WSIB and the premiums that will be paid by Ontario employers.

General

In accordance with the *WSIA*, the WSIB provides benefits and services to workers who are injured at work; these benefits and services are financed by premiums paid by covered employers. A distinction must be made between Schedule 1 and Schedule 2 employers.

Premiums for Schedule 1 employers are based on collective liability and they are collected each year to cover the current and future costs associated with workplace injuries anticipated to occur during the year. The remainder of any premiums not used to pay current costs is set aside in the Insurance Fund, to provide for future costs. Ideally the amount in the Insurance Fund would be sufficient to provide for future costs of claims that occurred in the past. In this case, the WSIB would be considered fully funded. However, because actual experience is different than what was assumed in establishing premiums, the Insurance Fund may at various times be inadequate or excessive relative to expected future costs.

Schedule 2 employers are individually responsible for the benefits and services to their injured employees. Accordingly, those employers reimbursed the WSIB for the payments made and administration costs. Premiums are based on individual liability for each employer and those employers account for their own liabilities. There is no provision in the WSIB's financial statements with respect to Schedule 2 employers. These employers have not contributed to the unfunded liability nor have or will participate to the replenishment of the WSIB.

Current Financial Situation

The WSIB Consolidated Balance Sheet as at 31 December 2009 and 2010 was as follows:

Table 2.1 - Consolidated Balance Sheet (in millions of $)

Year	2010	2009
Assets		
Net Investments[1]	13,306	12,720
Other Assets	1,502	1,211
Total	**14,808**	**13,931**
Liabilities		
Benefit Liabilities	24,350	23,250
Loss of Retirement Income Fund	1,193	1,054
Other Liabilities	1,620	1,378
Total	**27,163**	**25,682**
Unfunded Liability	**(12,355)**	**(11,751)**
Funding Ratio	**54.5%**	**54.2%**

[1] Total investments less Employees' Pension Plan interest in pooled investments.

Annually, the WSIB's actuary prepares the valuation of the Schedule 1 Insurance Fund benefit liabilities. This valuation estimates the provision required for the future payments of benefits and future administration costs on account of workplace injuries that occurred before the valuation date. As of December 31, 2010, the total benefit liabilities were estimated at $24,350 million. As indicated in the Consolidated Balance Sheet in Table 1.1 above, at the end of 2010, the assets of the WSIB were not sufficient to cover its liabilities and the board was 54.5% funded, with an unfunded liability estimated at $12,355 million.

There are many factors that contributed to a significant deterioration of the unfunded liability since 1999. The following table presents a summary of the main drivers of change to the Unfunded Liability for the last 12 years:

Table 2.2 - Drivers of Change to Unfunded Liability (in millions of $)

Period	1999-2010
Unfunded Liability (UFL) as of December 31, 1998	**(7,098)**
Premiums allocated to reduce the UFL	11,499
Interest to carry UFL	(6,310)
Investment returns lower than expected	(2,324)
Indexation lower than expected	1,033
Employer incentives	(1,101)
Other experience (gains) losses	(2,200)
Assumption changes	(4,122)
Provision for Occupational Diseases in the latency stage	(600)
Legislative, policy and personal income tax changes	(1,677)
Accounting policy changes	545
Unfunded Liability (UFL) as of December 31, 2010	**(12,355)**

Net Premiums: 5,189

Economic Assumptions: (1,291)

The unfunded liability increased by $5,257 million over the 12-year period, a deterioration of $10,446 million when considering net premiums paid by employers. More than 60% of this amount represents assumption changes and experience losses other than those related to the financial and economic markets (investment returns and indexation), reflecting the fact that average premium rates were set too low and assumptions proved to be too optimistic in determining the benefit liabilities, possibly the result of significant changes made to the benefits with enactment of the *WSIA* (Bill 99). Other material sources of losses were the employer incentives and the legislative, policy and personal income tax changes.

The $5,257 million increase of the UFL despite additional premiums paid by employers of $11,499 million over the 12-year period might have had a negative impact on the credibility of the financial projections prepared by the WSIB.

The new section 96 of the *WSIA* introduced by Bill 135 in 2010 requires the WSIB to maintain an insurance fund to pay for current benefits and to provide for future benefits under the insurance plan. Subject to the regulations, the fund must be maintained so that the amount of the fund is sufficient to allow the Board to meet its obligations under the Act to make payments under the insurance plan for current benefits as they become due and to provide for future benefits. The *WSIA* at present does not define "sufficiency".

Problems with Current Funding

Some problems created by the current funding situation of the WSIB can be expressed as follows:

- Can injured workers and beneficiaries feel secure when only $0.55 per $1.00 of their benefits is funded? Could the benefits be cut in the future?

- Lack of understanding by employers of how they could provide such UFL premiums while the WSIB's financial situation deteriorates.
- At the same time, the number of claims is decreasing steadily and the premium rates increase. How could this be explained?
- Current and future employers will have to pay for past accidents: is it fair?
- When will all this end?
- Who is responsible? Employers? Workers? Government? WSIB? Nobody wants to take responsibility for the current situation.

In summary, there is a lack of understanding and of financial security, a sentiment of unfairness by employers, the WSIB has a credibility to build and appears to have not been transparent enough in the past.

This Document

As indicated in next section, we suggest considering separately the financing of future injuries, the "new claims", and the significant unfunded liability, the "past claims". We review the key principles that would guide the development of the funding approach.

In Section 4, we address, in the development of a funding policy for the "new claims", the premium requirements. In Section 5, the financing of the accumulated unfunded liability as at December 31, 2011 is considered, while the impact of adopting a partial funding approach is illustrated in Section 6.

In the subsequent sections, we review the current funding approach and we provide some comments on a number of other elements, such as the investment policy and the accounting requirements.

Finally, we have estimated the impact of fully indexing the benefits which are currently partially-indexed, and the results are presented in Appendix A.

Section 3: Guiding Principles for Funding

The Canadian workers' compensation system is based on the principles stated about a century ago by Sir William Meredith: collective liability, wage-loss approach to calculating benefits, no fault insurance, universal coverage, industry funding, state administration and security of payment.

A modern-day research paper on the funding of workers' compensation boards in Canada ("*Funding of Public Personal Injury Compensation Plans*") provides information on how boards structure and meet their funding requirements; this paper is available on the Canadian Institute of Actuaries website at *www.actuaries.ca/members/publications/2011/211038e.pdf*.

The funding of a public organization like the WSIB should be done in considering its unique nature: a monopoly providing statutory benefits, functioning like an insurer.

Essentially, the WSIB is responsible for providing benefits and services to workers who are injured at work, and to collect premiums from covered employers to finance the system. The financing should follow well-defined rules, which are acceptable to all stakeholders: employers, workers and government. These rules are generally set in a document known as the "funding policy" and are established in considering a number of principles. The WSIB should commit to its funding policy, have a disciplined approach in this regard and report in full transparency to all stakeholders. In return, the stakeholders should not intervene in the execution of this policy.

In order to adequately address the current financial situation of the WSIB, we suggest considering separately the financing of future injuries, the "new claims", and the significant unfunded liability, the "past claims". We will first develop a funding policy of a « New » WSIB in 2012, and then consider the financing of the accumulated unfunded liability as at December 31, 2011.

Guiding Principles for a Funding Policy for the « New » WSIB

The following key principles could guide the development of a funding policy for the "new claims":

- Fairness: that premiums paid by the current generations of employers are well aligned to the costs generated by these generations of employers.
- Collective liability: that the principle of no-fault insurance and collective liability among employers is respected.
- Predictability of premiums: that the system generates a level of predictability and stability in premium costs that employers can rely on.
- Financial security: that the injured workers and beneficiaries are reasonably assured that the benefits will be paid as promised.
- Ease of administration, ease of understanding and transparency: that the funding system operates efficiently and effectively, and that it is simple enough in design that most employers and injured workers can see that the principles of fairness, collective liability, predictability of premiums and financial security are operating effectively.

The funding policy will provide guidance to management of the WSIB in maintaining a financially stable system that appropriately balances these sometimes competing principles.

Fairness involves reflecting all costs related to current accidents to current employers. However, as injuries often generate payments that are made several years after the year of accident, estimations of future costs are required. Mechanisms must therefore be established to adjust premiums when actual costs are different from those that where estimated.

Predictability and stability of premium rates is important to employers; however, experience gains or losses are inevitable which, to maintain fairness, must be amortized in a relatively short period, therefore contributing to increase volatility in premiums.

A funding ratio above 100% and corrective actions to maintain the ratio above 100% contributes to the assurance for injured workers and their beneficiaries that the benefits they have been promised will be paid when due.

Funding Policy for the Current Unfunded Liability

Similar principles will be considered in addressing the current unfunded liability, but their application will be different. Obviously, employers will have to pay significant amounts in the future for claims that have occurred in the past; that might not seem fair, but delaying it would actually increase the inequity between generations of employers.

Section 4: Premium Requirements for the "New Claims"

The first element to address in the development of a funding policy for the "new claims" is the premium requirements.

The premiums paid by current employers should cover the estimated costs of current year injuries and all expenses. However, experience gains/losses are inevitable as actual costs will be different from those estimated; these gains/losses should be amortized over a period, short enough to be fair for employers, long enough to maintain premium rate stability.

Based on the funding principles outlined previously, the WSIB, as all other Canadian workers' compensation boards, should determine an Average Premium Rate to be charged to employers on the basis of the following components, making up premium rates at the aggregate level:

- New claim costs (NCC)
- Administration and other expenses
- Premium adjustments with respect to prior years

The following table presents the components of the WSIB's Average Premium Rate since 2009:

Table 4.1 - Average Premium Rate

Year	2011	2010	2009
New Claim Cost	1.010	1.131	1.006
Administration and Other Expenses	0.433	0.400	0.392
Prior Years' Claims	0.909	0.766	0.858
Average Premium Rate	**2.35**	**2.30**	**2.26**

New claim costs (NCC):

The new claim costs component covers all expected benefit payments, current and future, arising from injuries assumed to occur in the coming year. The premium rate is determined such that excess funds are anticipated that can be invested to ensure that long term claims can be paid when due.

The new claim costs should represent the WSIB's best estimate reflecting recent experience, using realistic long term assumptions, without expecting improvements in experience or providing for undue margins.

For 2011 average premium rate, the NCC component was estimated at $1.010, assuming an improvement in experience and using a long term nominal rate assumption of 7% per annum. With a reduction of the nominal rate assumption to 6%, an estimate reflecting most recent experience and no anticipated improvement, the NCC component stands between $1.20 and $1.25.

All assumptions used to determine this rate component will be reviewed thoroughly during the coming year.

This component should be fully charged to employers every year and the average premium rate should react rapidly when anticipated experience varies: employers should immediately benefit from improved cost experience as well as to pay when experience worsens. The rate should be not result is sustained experience gains or losses. This would help in promoting health and safety in workplaces and to prevent and reduce the occurrence of workplace injuries and occupational diseases, or facilitating the return to work of injured workers.

Administration and other expenses:

This component covers the annual costs to run the workers' compensation system and should include in Ontario:

- Administration costs of the WSIB,
- Costs to run the Ministry of Labour and health and safety associations,
- Other legislative obligations, such as health and safety activities,
- Bad debts,
- Net cost of experience rating programs (the excess of premium rebates over additional assessments).

All sources of costs should be accounted for in the calculation of the premium rates. The 2011 average premium rate included all these elements, except the net cost of experience rating programs.

Based on recent estimates, the administration and other expenses represent about a $0.50 rate. It should be reviewed annually and include the best estimates of all expenses.

Premium adjustments with respect to prior years:

Experience inevitably results in gains or losses when compared to expected. An approach has to be defined with respect to the gains/losses that will emerge in the future, covering:

- Current year operations
- Prior years' operations from 2012, separately for:
  - > Investment returns and inflation
  - > Experience results from other sources
- Special circumstances

Amortization of these gains/losses should be done over a period short enough to be fair to employers, long enough to maintain premium rate stability.

The following table summarizes the proposed approach:

Table 4.2 - Treatment of Gains/Losses

Source of Gains/Losses	Amortization Period	Rationale	Comments
Current year	3 years	Gains/losses should be relatively small	Financial report should reconcile results with premium setting
Investment returns and inflation	8 to 10 years	Quite volatile; employers and WSIB have limited control	Amortization of cumulative surplus/deficit
Prior years	5 to 8 years	Could be more significant than for current years	Include assumption changes and experience different than expected
Special circumstances	5 to 8 years (unless Board decides otherwise)	Based on funding principles, a different period could be justified	Impact should be clearly shown in financial statements and premium requirements

Currently, all the gains/losses are combined and shown in the unfunded liability. This new approach will provide for transparency and improve understanding.

Distribution of Costs among Employers

All these cost components can be charged to employers:

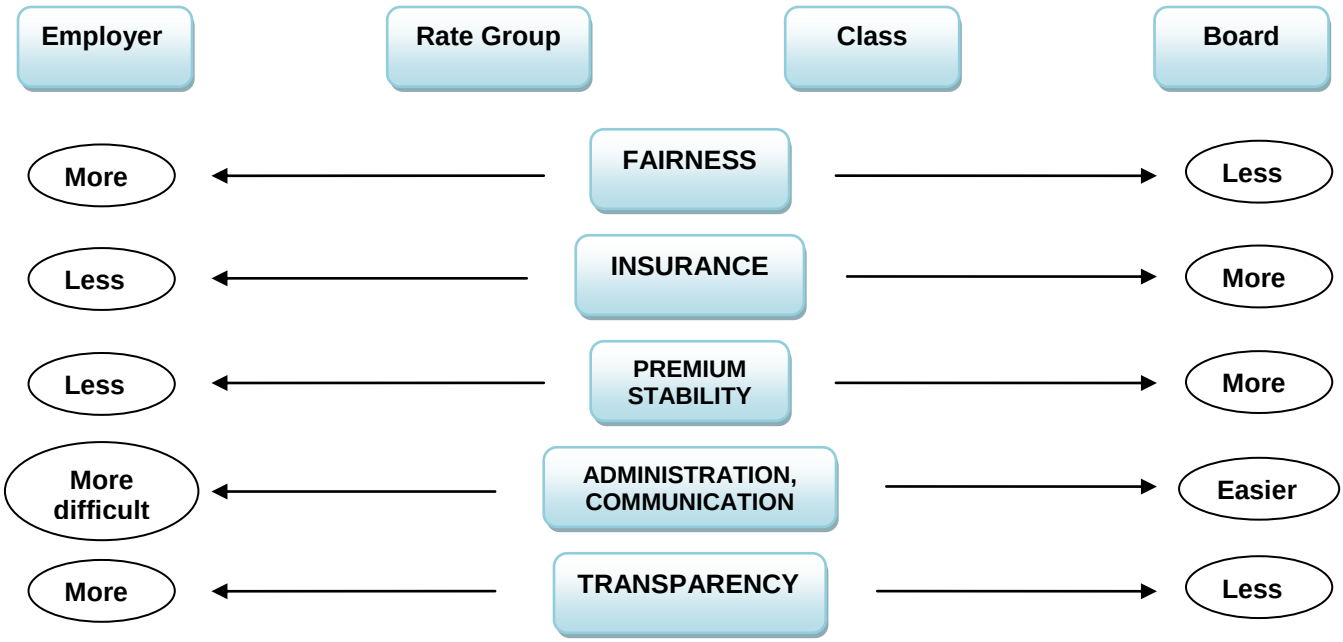
- As a fixed rate (% of payroll) for all employers in all rate groups, or
- Distributed between rate groups based on their NCC (based on their own claim cost experience).

Currently, a portion of administration expenses is charged as a fixed rate and all other costs are distributed between rate groups based on their NCC. The distribution between a fixed rate and the rate groups' NCC depends on the nature of the cost (e.g. overhead administration could be charged as a fixed rate and claim administration based on NCC).

Communications of the premium rate calculations should clearly present the portion based on a fixed rate as well as the portion based on their own claim cost experience to provide transparency and improve understanding.

Level of Cost Sharing

Costs can be shared at the employer, rate group, class or Board level. The level at which different costs will be shared depends on a number of criteria such as the nature of the costs, the possibility to allocate these costs at various levels and the necessary compromise between competing principles. The following chart illustrates some of these elements:



The sharing of the cost of all claims, including the new claim costs (NCC) covering the expected benefit payments, current and future, arising from injuries assumed to occur in the coming year, as well as the costs charged to the Second Injury and Enhancement Fund (SIEF) and experience rating, is discussed in the WSIB concept paper on pricing.

All other elements of costs, such as the costs for the administration and other expenses, all gains and losses and the bad debts, should be shared at the Board level.

If the costs were charged to rate groups reflecting WSIB's best estimates and were equitable among all rate groups, gains/losses resulting from experience fluctuations should be collectively shared at the Board level. Sharing gains/losses at a class, rate-group or employer level adds to the volatility of premium rates.

Section 5: "Ring-Fencing" of Liabilities

In this section, we will address the financing of the significant unfunded liability at the end of 2011, the "past claims". We suggest the "ring-fencing" of the liabilities at the end of 2011, as follows:

- Determine the unfunded liability as at December 31, 2011 and "transfer" all claim benefit liabilities and related investments in an account;
- Add to this account all unfunded liability premiums, starting in 2012;
- Charge all payments related to 2011 and prior years' accidents, with proper allocation of claim administration charges;
- Add investment income;
- Adjust for change in claim benefit liabilities related to 2011 and prior years' accidents.

All operations related to the "new claims" for 2012 and subsequent years' accidents would be treated as indicated in the previous section with respect to surpluses and deficits. We have assumed in our projections of the WSIB total operations that the accumulated surplus/deficit from investment results and inflation would be amortized using 1/8 of cumulative results.

Determination of the 2011 year-end unfunded liability should be done using assumptions reflecting WSIB's best long term estimates, to be reviewed thoroughly in 2011, to ensure they reflect most recent experience and are prudent, with reasonable expectations of future success. On a preliminary basis, the unfunded liability will stand at about $14.4B at the end of 2011.

A fixed premium rate would be charged to pay for the unfunded liability until the 2011 UFL account is fully funded, or the UFL account has reached a pre-determined level, such as 80% or 90%; the UFL premium could then be reduced progressively thereafter. The level of that premium will necessarily be a compromise between the period required for amortization of that significant amount, and the level of the UFL premium. Once the UFL account is fully funded, it will be transferred to the main account; from that point, experience gains/losses for "old claims" would be treated as for those for 2012 and subsequent accident years.

UFL was primarily generated by claim costs larger than expected; most of it should be shared collectively and charged based on claim cost experience (New Claim Costs - NCC). Charging based on NCC provides additional incentives for employers to reduce costs. A small portion of the 2011 UFL premium (e.g. $0.10) could be based on payroll to account for external sources of losses, such as legislative changes, and the recognition that equity in the current situation is impossible.

Projections

Our projections of the funding of the WSIB provide relevant information on the projected financial evolution of the Insurance Fund over the next several years, under multiple economic scenarios. We used as the basis for the projections the assets and liabilities reflected in the financial statements of the WSIB as at December 31, 2010. Some adjustments to actuarial assumptions and methods used to value the benefit liabilities starting as of December 31, 2011 have been made: a nominal rate assumption of 6% and an estimate reflecting most recent experience and no anticipated improvement for termination rates for loss of earnings benefits.

A stochastic model has been used to illustrate the inherent characteristics of the program. Under this model, the WSIB assets and liabilities are projected year by year under multiple economic and financial scenarios, and distributions of a number of parameters have been derived. Under such process, the statistical distribution of the potential outcomes of any given parameter is projected, rather than only the "expected" level of such parameter. The stochastic distribution therefore allows an assessment of the potential risks inherent to the evolution of the

parameter; for example, the distribution will show the potential level of the parameter under analysis in each year of the projection period under very favourable scenarios (5th percentile or one chance out of 20), under favourable scenarios (25th percentile or one chance out of 4), under the median scenario (i.e. everything goes more or less as "expected"), under unfavourable scenarios (75th percentile or one chance out of 4) and under very unfavourable scenarios (95th percentile or one chance out of 20).

The main assumptions used for the projections include:

- Asset mix allocation of the portfolio based on the current investment policy, assumptions on expected return, volatility and correlation between asset classes derived from the September 2010 Asset Liability Study prepared by Russell Investments, except that expected investment returns exclude additional returns from active management; a transition period of 4 years where the current yields of fixed income investments increase to the long term expected yields has been used
- Annual Inflation: 2.50%
- Annual Wage Growth: inflation + 1.00%
- Annual Health Care Escalation: inflation + 4.00%
- 2011 Estimated Payroll: $155.0 B
- Annual increase in insurable payroll: 2.00%, reflecting an annual reduction in covered workforce of about 1.50%
- No improvement in experience
- No change to current benefit legislation

For projection purposes, we have assumed a fixed premium rate for the unfunded liability until the 2011 UFL account is fully funded, as follows:

- 2012: $0.65
- 2013: $0.70
- 2014: $0.75
- 2015: $0.80
- 2016: $0.85
- 2017 and after: $0.90

At the median level, the nominal rate of return over a 20-year horizon is 6.1%, with a significant volatility. The ultimate long term expected return of the total portfolio, when weighted according to the long term target asset mix, produces a nominal rate of return of 6.2% at the median level; however, the returns are assumed to be lower in the next four years.

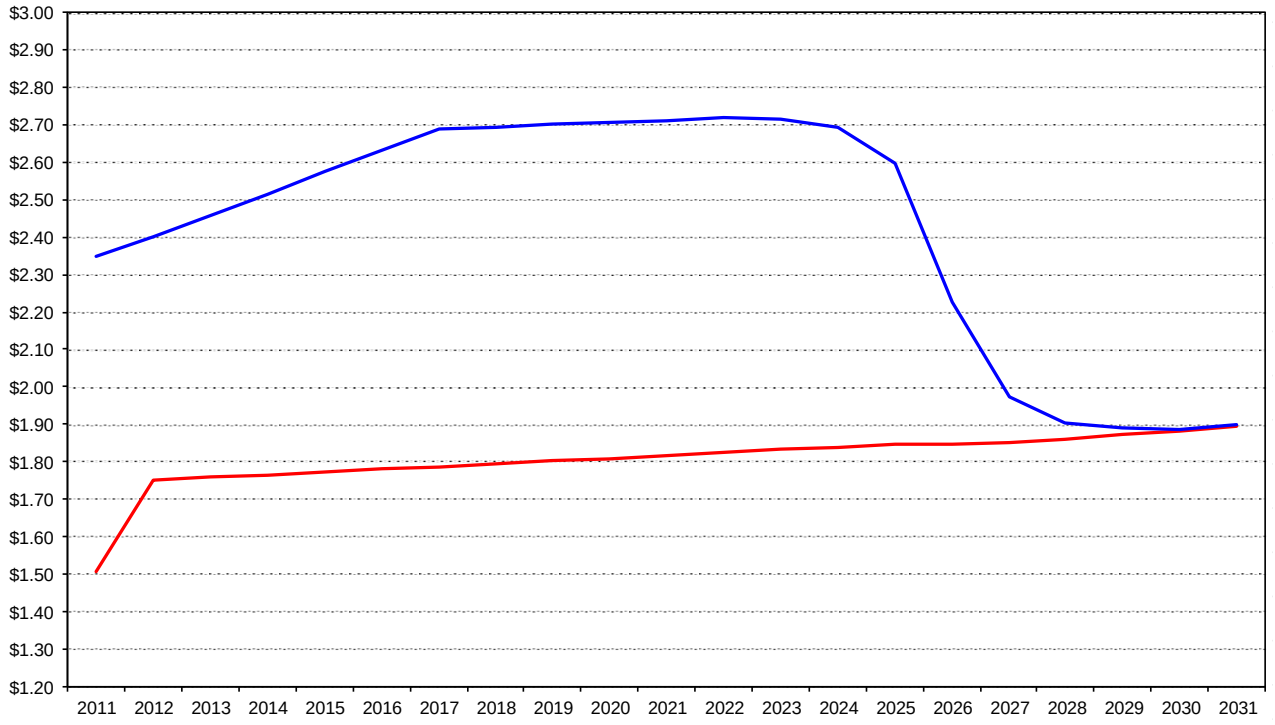
The following table presents some statistics on the cumulative nominal return rates for different periods:

Table 5.1 - Cumulative returns for the period 2011-2030

Statistics	Nominal Rate of Return		
	2011-2014	2015-2030	2011-2030
5th Percentile	13.0%	9.4%	8.9%
25th Percentile	8.4%	7.5%	7.2%
Median	5.5%	6.2%	6.1%
75th Percentile	2.6%	5.0%	4.9%
95th Percentile	-1.1%	3.2%	3.3%

Based on these assumptions, we have estimated the evolution of the average premium rate in the future. The following graph compares the average premium rate at the median level with the required rate for current employers (the sum of the rate for the new claim costs – NCC, the rate for administration and other expenses, and the premium adjustments with respect to prior years for "new claims"):

Projection of the Average Premium Rate at the Median Level and the Required Rate for Current Employers

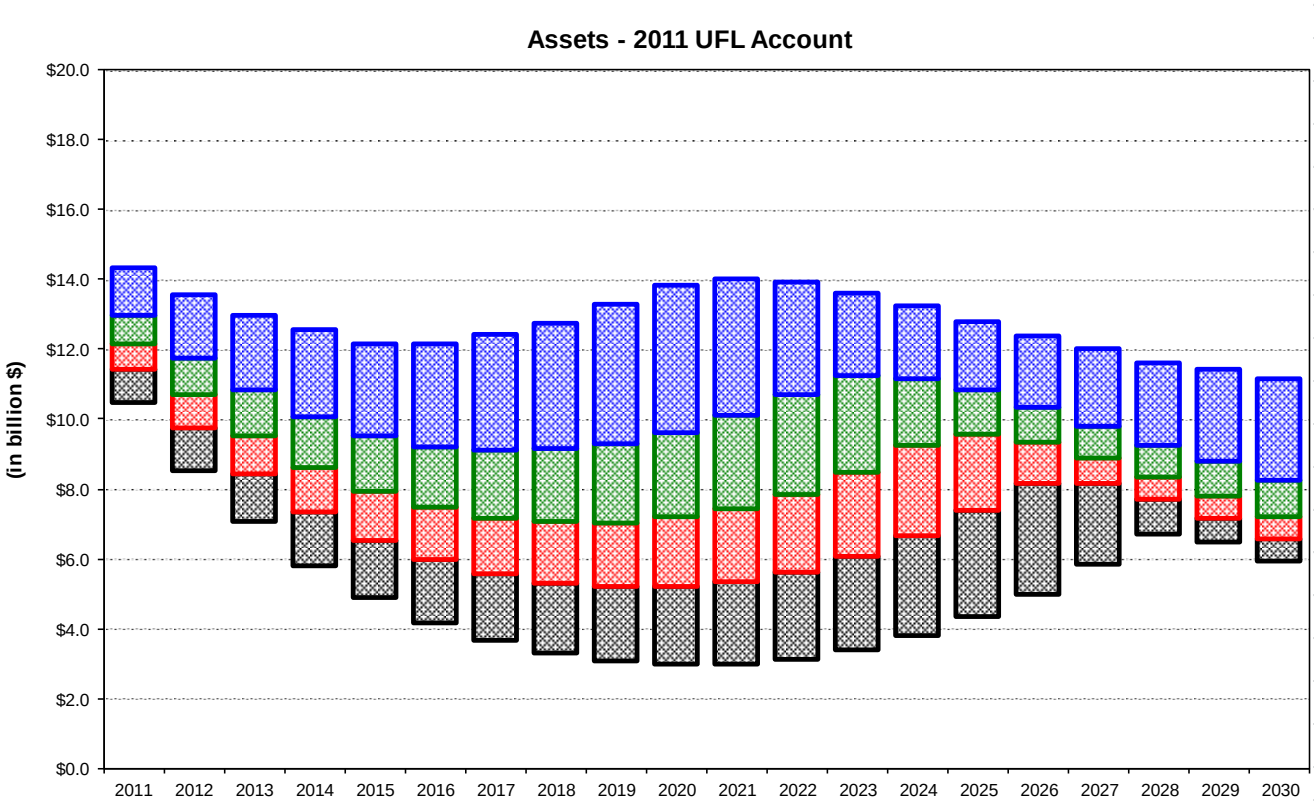


Average Rate	2.35	2.40	2.46	2.52	2.57	2.63	2.69	2.69	2.70	2.71	2.71	2.72	2.72	2.69	2.60	2.23	197	191	189	189	190
Current Rate	151	175	176	177	177	178	179	179	180	181	181	182	183	184	185	185	185	186	187	188	190
New Claim Cost	101	123	123	124	125	126	127	128	129	130	131	132	133	135	136	137	138	140	141	142	144
Administration	0.50	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.53	0.52	0.51	0.51	0.51	0.51	0.51
UFL Rate	0.85	0.65	0.70	0.75	0.80	0.85	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.35	0.06	0.00	0.00	0.00	0.00

The following observations can be made:

- We have assumed no change in the frequency of claims or their durations; the upward trend in the NCC component is the result of health care benefits increasing at a higher pace than the wage growth.
- Any improvement or deterioration in anticipated claim cost experience, as well as any change in administration or other expenses, would be directly reflected in the premium rate.
- The UFL rate increases progressively until it reaches its ultimate level of $0.90, and is maintained until the 2011 UFL account is fully funded, i.e. in 2026 or 2027 at the median level; alternatively, the UFL premium could be reduced progressively when the UFL account has reached a pre-determined level.

The following graph presents the projections of the assets of 2011 UFL Account only:



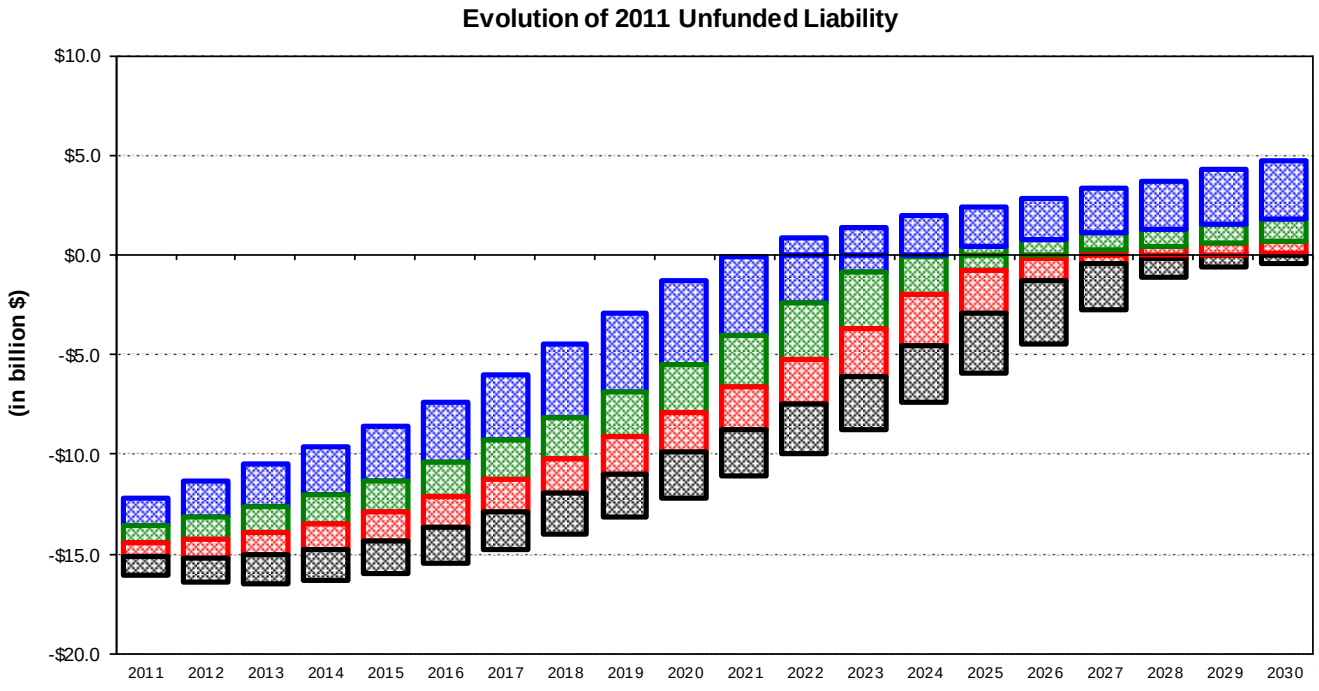
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	14.3	13.6	13.0	12.6	12.2	12.2	12.4	12.8	13.3	13.8	14.0	13.9	13.6	13.3	12.8	12.4	12.0	11.6	11.4	11.2
25th Percentile	13.0	11.8	10.8	10.1	9.5	9.2	9.1	9.2	9.3	9.6	10.1	10.7	11.3	11.2	10.8	10.3	9.8	9.3	8.8	8.3
50th Percentile	12.2	10.7	9.6	8.6	7.9	7.5	7.2	7.1	7.1	7.2	7.5	7.9	8.5	9.2	9.6	9.3	8.9	8.4	7.8	7.2
75th Percentile	11.4	9.8	8.4	7.4	6.5	6.0	5.6	5.3	5.2	5.2	5.4	5.6	6.1	6.7	7.4	8.2	8.2	7.7	7.2	6.6
95th Percentile	10.5	8.5	7.1	5.8	4.9	4.2	3.7	3.3	3.1	3.0	3.0	3.1	3.4	3.8	4.3	5.0	5.9	6.7	6.5	6.0

The following observations can be made:

- Assets reduce in the next few years as claim payments related to 2011 and prior years' accidents, including related claim administration charges, outpace the sum of unfunded liability premiums and investment income under all scenarios, even under the most favourable ones.

- This period of decreasing assets is followed by a period where assets increase; this period ends when the 2011 UFL Account is fully funded.

The following graph presents the projections of the total 2011 Unfunded Liability (« Old » WSIB only):

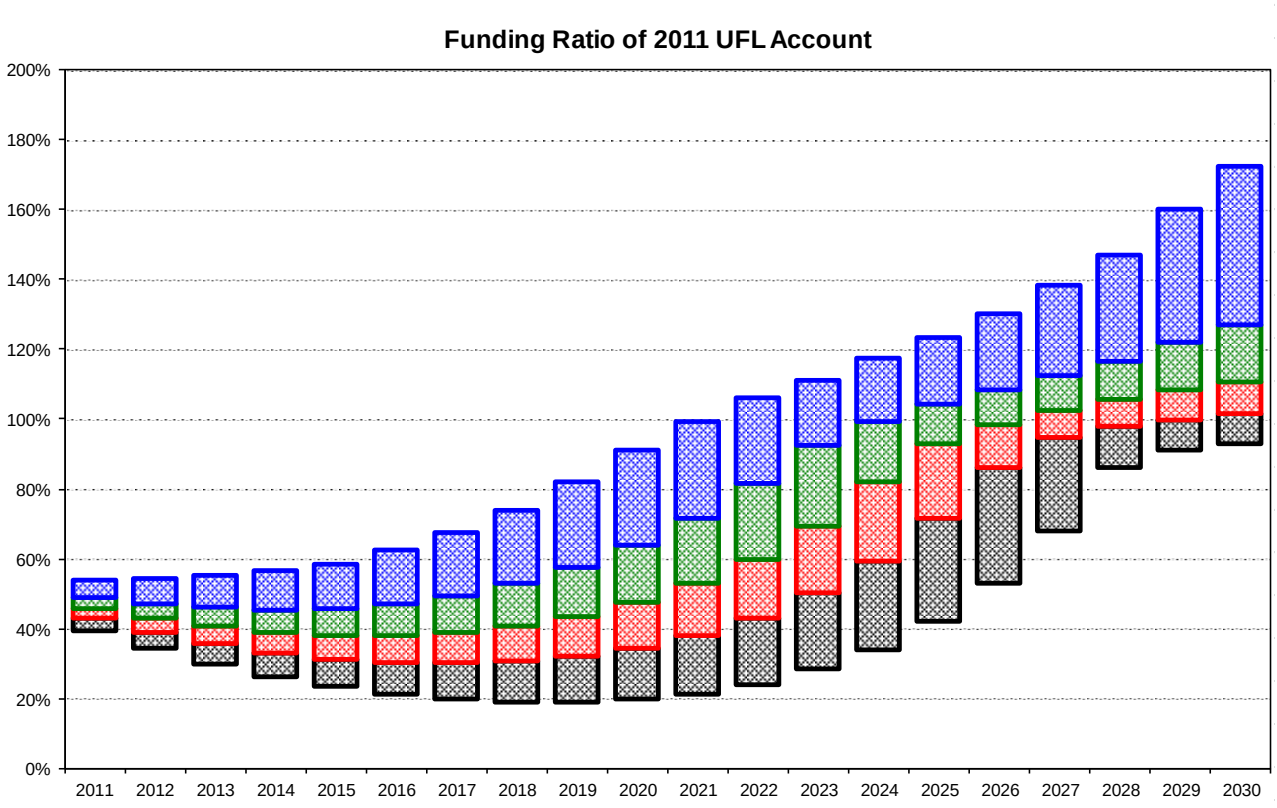


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	-$12.2	-$11.4	-$10.5	-$9.6	-$8.6	-$7.4	-$6.0	-$4.5	-$2.9	-$1.3	-$0.1	$0.8	$1.4	$1.9	$2.4	$2.9	$3.3	$3.7	$4.3	$4.7
25th Percentile	-$13.6	-$13.2	-$12.6	-$12.0	-$11.3	-$10.4	-$9.3	-$8.1	-$6.9	-$5.5	-$4.0	-$2.4	-$0.9	-$0.1	$0.5	$0.8	$1.1	$1.3	$1.6	$1.8
50th Percentile	-$14.4	-$14.2	-$13.9	-$13.5	-$12.9	-$12.1	-$11.2	-$10.2	-$9.1	-$7.9	-$6.7	-$5.3	-$3.7	-$2.0	-$0.7	-$0.1	$0.2	$0.4	$0.6	$0.7
75th Percentile	-$15.1	-$15.2	-$15.1	-$14.8	-$14.3	-$13.7	-$12.9	-$12.0	-$11.0	-$9.9	-$8.8	-$7.5	-$6.1	-$4.6	-$2.9	-$1.3	-$0.5	-$0.2	$0.0	$0.1
95th Percentile	-$16.1	-$16.4	-$16.5	-$16.3	-$16.0	-$15.5	-$14.8	-$14.0	-$13.1	-$12.2	-$11.1	-$10.0	-$8.7	-$7.4	-$6.0	-$4.4	-$2.7	-$1.1	-$0.6	-$0.5

The following observations can be made:

- The amount of the unfunded liability is estimated at $14.4B at the end of 2011, but could be lower under favourable scenarios (e.g. better investment returns than expected in 2011), or higher under unfavourable scenarios.
- Starting in 2012, the 2011 Unfunded Liability reduces slowly at the median level; the reduction accelerates thereafter until the 2011 UFL is eliminated.
- By the end of 2030, even under the unfavourable scenarios, the 2011 Unfunded Liability would be eliminated, and close to be eliminated under very unfavourable scenarios.

The following graph presents the projections of the 2011 UFL Account Funding Ratio only:



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	54%	54%	55%	57%	59%	62%	67%	74%	82%	91%	99%	106%	111%	117%	124%	130%	138%	147%	160%	172%
25th Percentile	49%	47%	46%	46%	46%	47%	50%	53%	57%	64%	72%	82%	93%	99%	104%	108%	113%	117%	122%	127%
50th Percentile	46%	43%	41%	39%	38%	38%	39%	41%	44%	47%	53%	60%	70%	82%	93%	99%	103%	106%	109%	111%
75th Percentile	43%	39%	36%	33%	31%	30%	30%	31%	32%	34%	38%	43%	50%	59%	72%	86%	95%	98%	100%	102%
95th Percentile	40%	34%	30%	26%	24%	21%	20%	19%	19%	20%	21%	24%	28%	34%	42%	53%	68%	86%	91%	93%

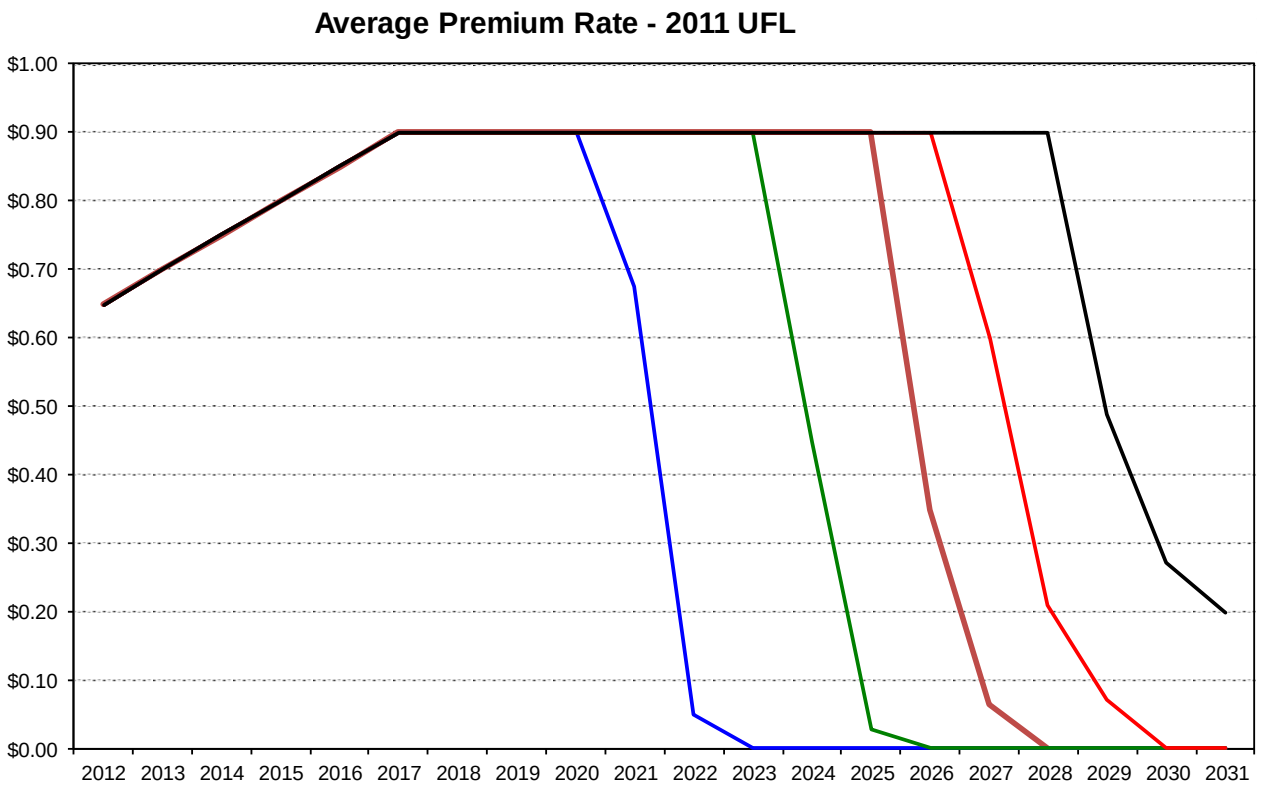
The following observations can be made:

- At the median level, the 2011 UFL account would be funded at 46% (lower than the estimated 51% of the total WSIB, as some assets and liabilities would not be transferred to the 2011 UFL Account, e.g. the LRI Fund).

- Despite significant UFL premiums, the funding ratio of the 2011 UFL account would reduce initially at the median level or under unfavourable scenarios, to possibly reach as low as about 20% under very unfavourable scenarios; the funding ratio will eventually increase under all scenarios, and reaches the fully funded status.

- At the median level, the 2011 UFL account only reaches the 50% funding ratio in 2021, but the progression accelerates thereafter as the assets grow and the liabilities continue to reduce.

The following graph presents the projections of the 2011 UFL Premium only:

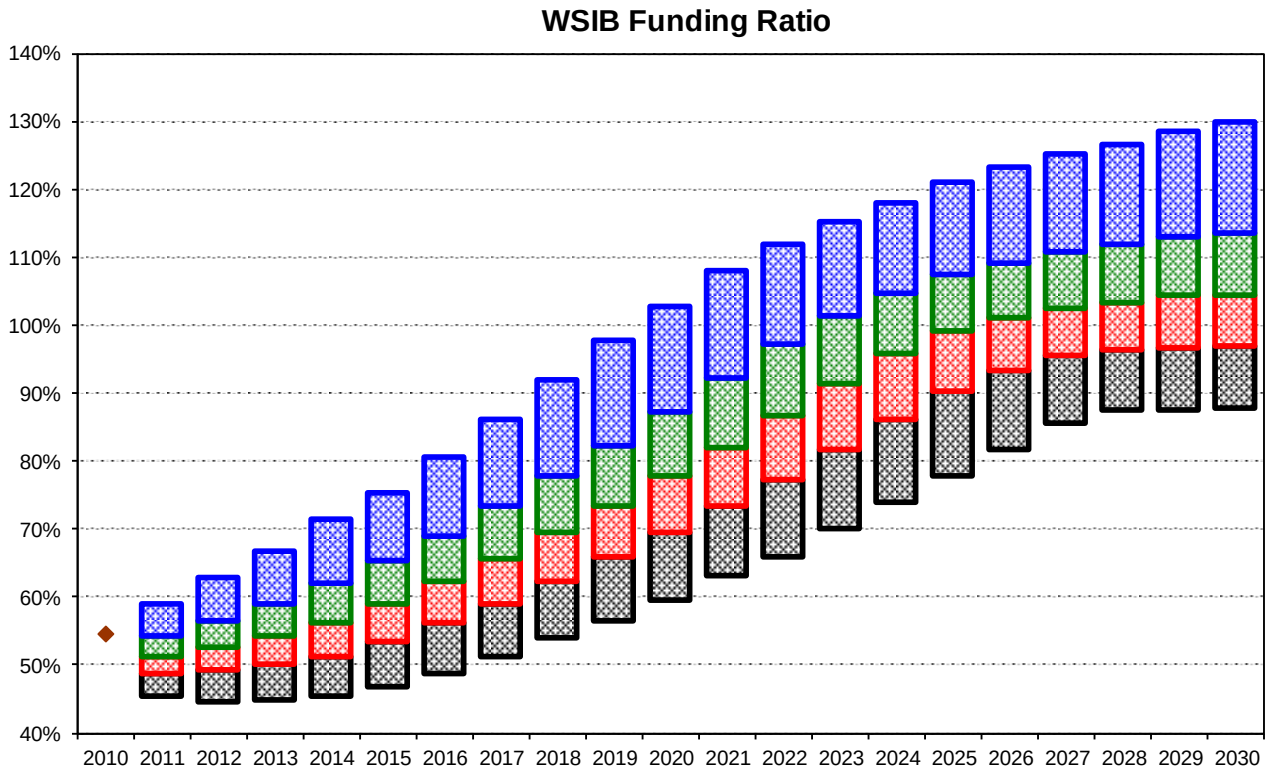


95th Percentile	$0.65	$0.70	$0.75	$0.80	$0.85	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.49	$0.27	$0.20
75th Percentile	$0.65	$0.70	$0.75	$0.80	$0.85	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.60	$0.21	$0.07	$0.00	$0.00
50th Percentile	$0.65	$0.70	$0.75	$0.80	$0.85	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.35	$0.06	$0.00	$0.00	$0.00	$0.00
25th Percentile	$0.65	$0.70	$0.75	$0.80	$0.85	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.90	$0.45	$0.03	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
5th Percentile	$0.65	$0.70	$0.75	$0.80	$0.85	$0.90	$0.90	$0.90	$0.90	$0.68	$0.05	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00

The following observations can be made:

- As indicated before, the UFL premium increases by $0.05 annually until it reaches the ultimate level of $0.90; it reduces when the 2011 UFL Account reaches its fully funded status, in 2026 or 2027 at the median level.
- The level of the 2011 UFL premium represents a compromise between the period required for amortization of the significant unfunded liability at the end of 2011, and the level of the UFL premium. The higher the UFL premium, the shorter the period, and vice versa.

The following graph presents the evolution of the funding ratio of the WSIB (« Old » WSIB and « New » WSIB combined):

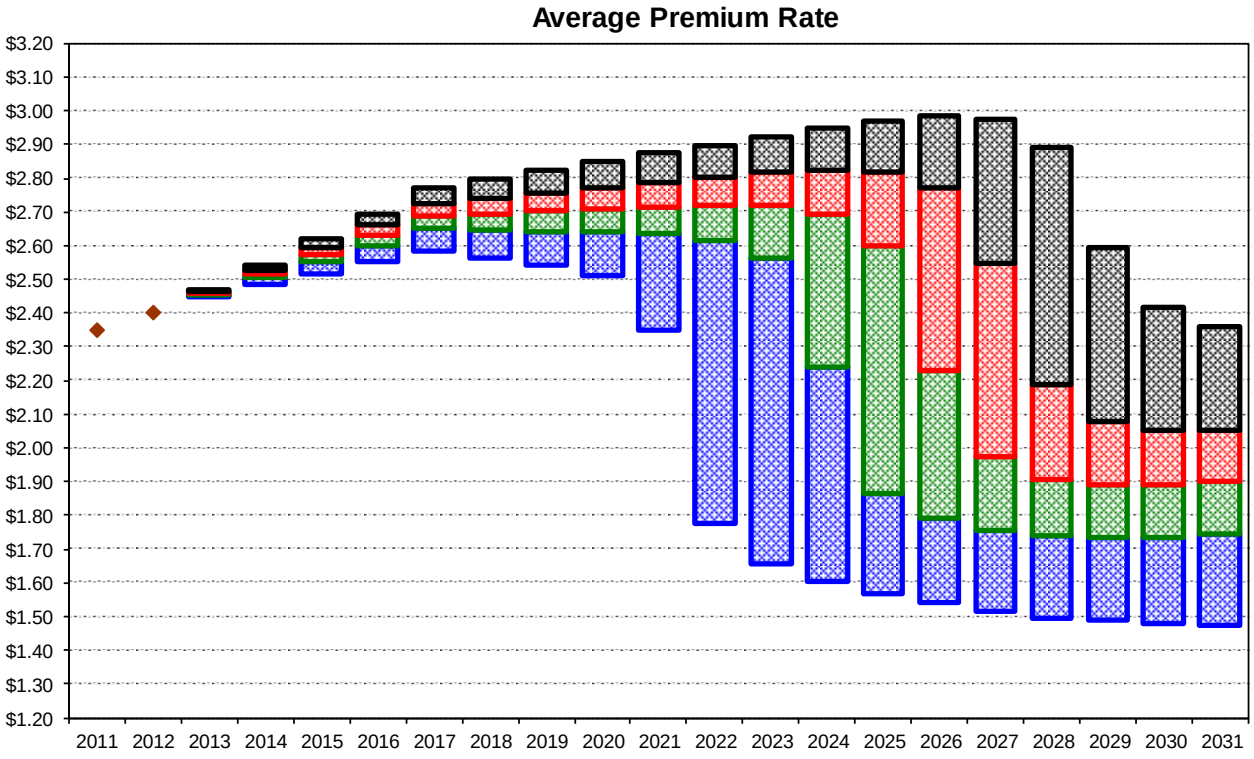


5th Percentile	55%	59%	63%	67%	71%	75%	81%	86%	92%	98%	103%	108%	112%	115%	118%	121%	123%	125%	127%	129%	130%
25th Percentile	55%	54%	56%	59%	62%	65%	69%	73%	78%	82%	87%	92%	97%	101%	105%	107%	109%	111%	112%	113%	114%
50th Percentile	55%	51%	53%	54%	56%	59%	62%	66%	69%	73%	78%	82%	87%	91%	96%	99%	101%	103%	103%	104%	104%
75th Percentile	55%	49%	49%	50%	51%	53%	56%	59%	62%	66%	69%	73%	77%	82%	86%	90%	93%	95%	96%	97%	97%
95th Percentile	55%	45%	45%	45%	45%	47%	49%	51%	54%	57%	60%	63%	66%	70%	74%	78%	82%	86%	87%	88%	88%

The following observations can be made:

- At the end of 2011, the WSIB funding ratio will reduce to 51% at the median level as a result of strengthening the assumptions to value the benefit liabilities.
- Under all scenarios, the WSIB funding ratio will increase, slowly under unfavourable scenarios, more rapidly under favourable scenarios.
- At the median level, the WSIB will be fully funded by 2026.

Finally, this graph shows the projected evolution of the average premium rate over the next 20 years:



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
95th Percentile	$2.35	$2.40	$2.47	$2.54	$2.62	$2.69	$2.77	$2.79	$2.82	$2.85	$2.87	$2.90	$2.92	$2.95	$2.97	$2.98	$2.97	$2.89	$2.59	$2.41	$2.36
75th Percentile	$2.35	$2.40	$2.46	$2.53	$2.59	$2.66	$2.72	$2.74	$2.75	$2.77	$2.78	$2.80	$2.82	$2.82	$2.82	$2.77	$2.55	$2.19	$2.08	$2.05	$2.05
50th Percentile	$2.35	$2.40	$2.46	$2.52	$2.57	$2.63	$2.69	$2.69	$2.70	$2.71	$2.71	$2.72	$2.72	$2.69	$2.60	$2.23	$1.97	$1.91	$1.89	$1.89	$1.90
25th Percentile	$2.35	$2.40	$2.45	$2.50	$2.55	$2.60	$2.65	$2.64	$2.64	$2.64	$2.64	$2.61	$2.56	$2.24	$1.86	$1.79	$1.76	$1.74	$1.73	$1.73	$1.74
5th Percentile	$2.35	$2.40	$2.45	$2.48	$2.52	$2.55	$2.58	$2.56	$2.54	$2.51	$2.35	$1.77	$1.66	$1.60	$1.56	$1.54	$1.51	$1.49	$1.49	$1.48	$1.47

The following observations can be made:

- The variations of the average premium rate is the result of:
  - > A change in the UFL premium;
  - > The amortization of the gains/losses of the « New » WSIB;
  - > A small upward trend as health care benefits increase at a higher pace than the wage growth.
- The $0.05 annual increase of the 2011 UFL premium until 2017 explains most the rate increase in the next few years; thereafter, a sharp decrease follows the full funding of the 2011 UFL Account.
- Under unfavourable scenarios, the average premium rate increases as the accumulated surplus/deficit from investment results and inflation of the « New » WSIB is amortized using 1/8 of cumulative results; the reverse is true under favourable scenarios.

Section 6: Impact of Partial Funding

As a result of the current financial situation of the WSIB, future employers will have to pay for accidents that have occurred in the past. That reduces the equity between generations of employers, which is being addressed with the approach of ring-fencing the past claims with premiums dedicated to fully fund the UFL account within a reasonable timeframe, combined with a « New » fully funded WSIB for 2012 and later claims.

We have prepared some projections to illustrate the impact of adopting instead a partial funding approach for the WSIB. The same assumptions as those used for the financial projections presented in the previous section have been used, except as specifically mentioned.

Two scenarios have been prepared, namely:

- No UFL premium after 2012;
- A steady-state funding approach, similar to the Canada Pension Plan.

No UFL Premium

We have projected the assets of the WSIB should the liabilities as at December 31, 2011 be “ring-fenced” and that no premiums for pre-2012 accidents be paid by employers after 2012. Hence, starting in 2013, the employers would pay the full cost of their accidents and the average premium rate would include the following components:

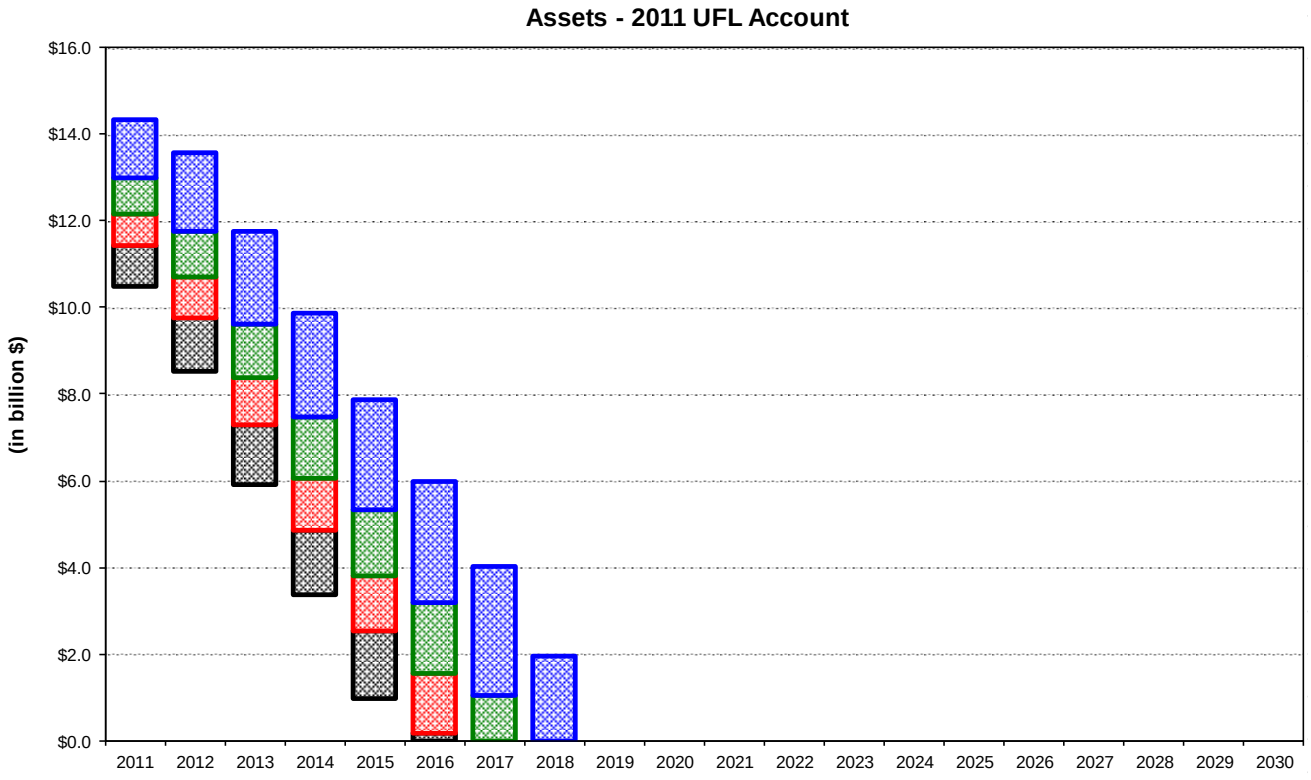
- New Claim Costs,
- Administration and other expenses, and
- Premium adjustments required to maintain the full funding level for 2012 and later claims, but no additional premium towards pre-2012 claims.

The average premium rate at the median level for the years 2012 to 2021 would be as follows:

Table 6.1 - Average Premium Rate at the Median Level with No UFL Premium after 2012

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Rate	2.40	1.76	1.77	1.77	1.78	1.79	1.79	1.80	1.81	1.81

As illustrated on the graph below, the assets related to pre-2012 accidents, despite additional premiums of over $1B in 2012, would be depleted before the end of 2017 at the median level, and before the end of 2019 under the most favourable scenarios:



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	14.3	13.6	11.8	9.9	7.9	6.0	4.0	2.0	-	-	-	-	-	-	-	-	-	-	-	-
25th Percentile	13.0	11.8	9.6	7.5	5.3	3.2	1.0	-	-	-	-	-	-	-	-	-	-	-	-	-
50th Percentile	12.2	10.7	8.4	6.1	3.8	1.6	-	-	-	-	-	-	-	-	-	-	-	-	-	-
75th Percentile	11.4	9.8	7.3	4.9	2.5	0.2	-	-	-	-	-	-	-	-	-	-	-	-	-	-
95th Percentile	10.5	8.5	5.9	3.4	1.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Steady-State Funding

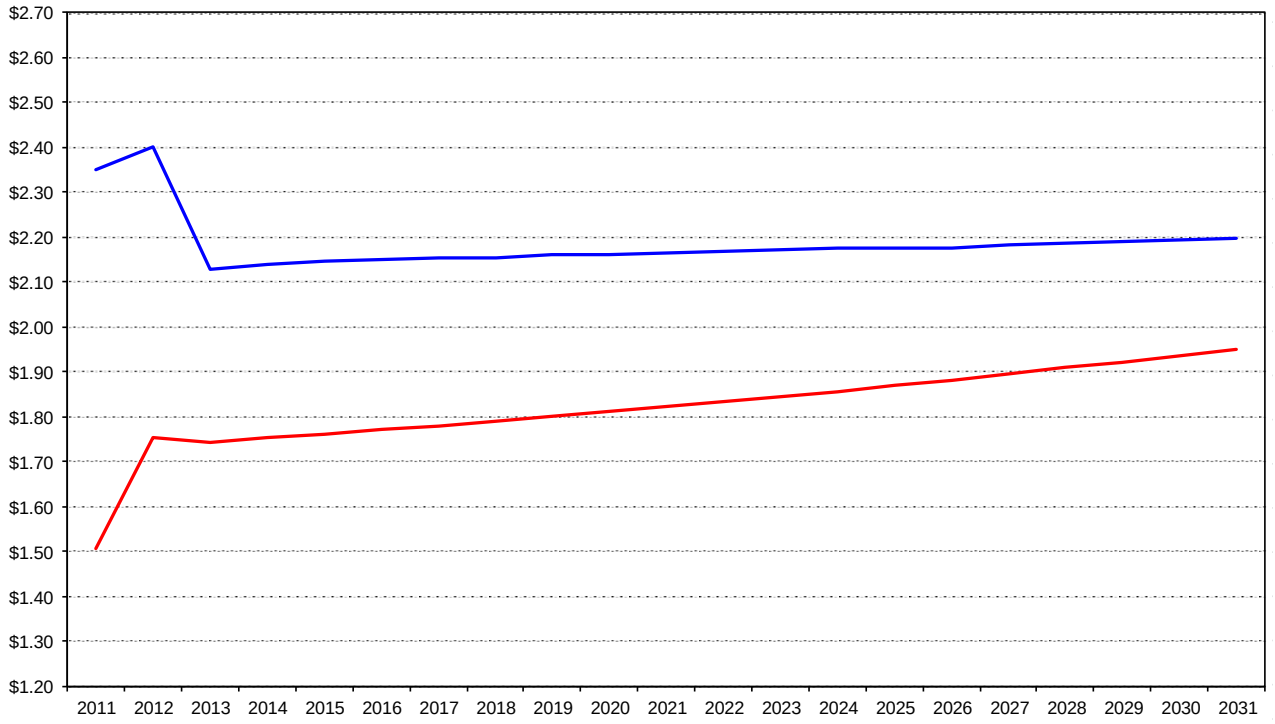
We have estimated the impact for the WSIB to adopt, instead of the full funding approach, a steady-state funding approach. Under this approach, the objective is to build a reserve of assets and stabilize the funding ratio over time. Investment income helps pay benefits but as the assets are insufficient, current employers have to cover benefit payments for prior years.

For projection purposes, we have assumed the target funding ratio to be about 53%. Any experience gains and losses will be amortized. We have assumed that 1/8 of the difference of the amount representing the over or under funding in comparison to the 53% target ratio would be amortized.

It should be noted that, in our projections, the liabilities would be valued using the same 6.0% nominal interest assumption. However, considering the level of liabilities that would not be backed by assets, with no objective to eventually fund those liabilities, there may be little rationale for assuming a discount rate on future unfunded payments higher than a government bond rate. Such a change would impact on the amount of benefit liabilities, deteriorating further WSIB's funding situation. Considering the funding and solvency issues that would be involved, additional analysis and consultations would be required if the approach of steady-state funding was contemplated.

The graph below compares the average premium rate at the median level with the required rate for current employers (the sum of the rate for the new claim costs - NCC and the rate for administration and other expenses):

Projection of the Average Premium Rate at the Median Level and the Required Rate for Current Employers



Average Rate	2.35	2.40	2.13	2.14	2.15	2.15	2.15	2.15	2.16	2.16	2.16	2.17	2.17	2.17	2.18	2.18	2.18	2.19	2.19	2.19	2.20
Current Rate	1.51	1.75	1.74	1.75	1.76	1.77	1.78	1.79	1.80	1.81	1.82	1.83	1.85	1.86	1.87	1.88	1.89	1.91	1.92	1.94	1.95
New Claim Cost	1.01	1.23	1.23	1.24	1.25	1.26	1.27	1.28	1.29	1.30	1.31	1.32	1.33	1.35	1.36	1.37	1.38	1.40	1.41	1.42	1.44
Administration	0.50	0.53	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51	0.51
UFL Rate	0.85	0.65	0.39	0.39	0.39	0.38	0.37	0.36	0.36	0.35	0.34	0.33	0.33	0.32	0.31	0.29	0.29	0.28	0.27	0.26	0.25

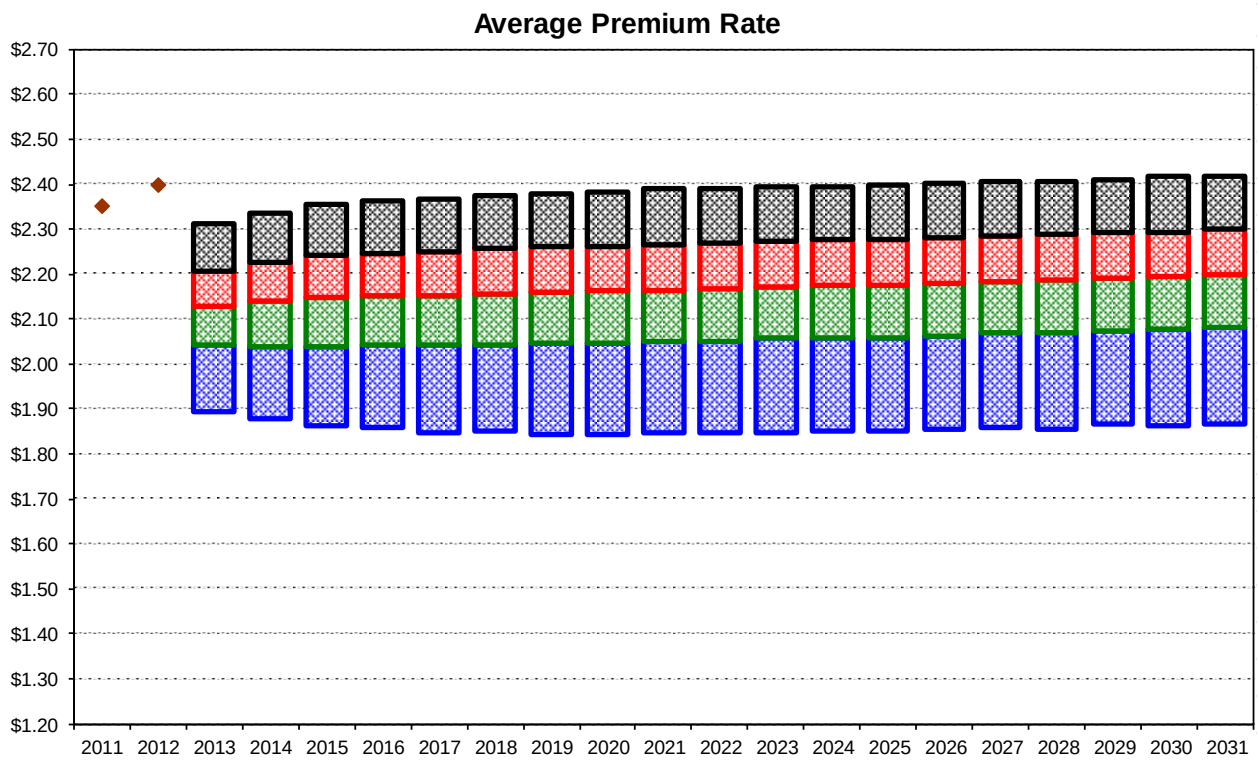
The following observations can be made:

- A slightly increasing premium rate would maintain the funding ratio of the WSIB at about the 53% level. With the assumptions of an insurable payroll increasing at 2% annually and of health care benefits increasing at 4% higher than inflation, the premium rate required for the Unfunded Liability would reduce and eventually stabilize at between $0.20 to $0.25.

- Employers would have to pay for the costs of prior years' accidents and the premiums they pay will always be higher that the real costs generated by the injuries occurring to their workers. The principle of fairness between generations of employers, whereas premiums are well aligned to the costs, will never be attained.

- With an improvement in claim experience, the average premium rate would react only partially to changes in the New Claim Cost component, and the premium required for maintaining the unfunded liability would increase. The fairness of the premiums charged to employers would be reduced further, as would be the incentives for improved safety in the workplaces.

The graph below presents the average premium rate statistical distributions over the next 20 years:

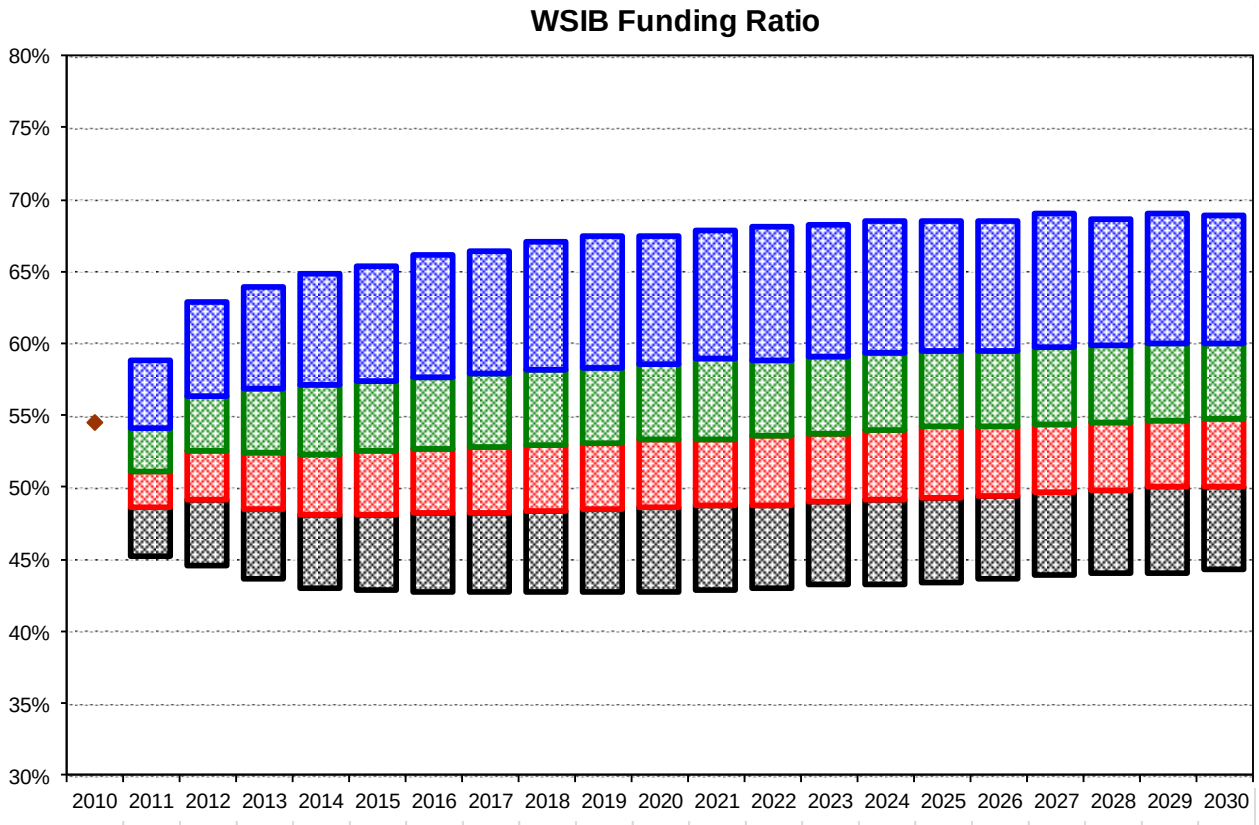


95th Percentile	$2.35	$2.40	$2.31	$2.33	$2.35	$2.36	$2.37	$2.37	$2.38	$2.38	$2.39	$2.39	$2.39	$2.39	$2.40	$2.40	$2.40	$2.40	$2.41	$2.42	$2.42
75th Percentile	$2.35	$2.40	$2.21	$2.23	$2.24	$2.25	$2.25	$2.25	$2.26	$2.26	$2.26	$2.27	$2.27	$2.28	$2.28	$2.28	$2.28	$2.29	$2.29	$2.29	$2.30
50th Percentile	$2.35	$2.40	$2.13	$2.14	$2.15	$2.15	$2.15	$2.15	$2.16	$2.16	$2.16	$2.17	$2.17	$2.17	$2.18	$2.18	$2.18	$2.19	$2.19	$2.19	$2.20
25th Percentile	$2.35	$2.40	$2.04	$2.04	$2.04	$2.04	$2.04	$2.04	$2.04	$2.05	$2.05	$2.05	$2.06	$2.06	$2.06	$2.06	$2.07	$2.07	$2.07	$2.07	$2.08
5th Percentile	$2.35	$2.40	$1.89	$1.88	$1.86	$1.86	$1.85	$1.85	$1.84	$1.84	$1.85	$1.85	$1.84	$1.85	$1.85	$1.85	$1.86	$1.85	$1.87	$1.86	$1.86

The following observation can be made:

- The amortization of the experience gains and losses explains the volatility of the average premium rate.

The graph below compares the statistical distributions of the funding ratio over the 2011-2030 period:



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	55%	59%	63%	64%	65%	65%	66%	66%	67%	67%	68%	68%	68%	68%	69%	69%	69%	69%	69%	69%	69%
25th Percentile	55%	54%	56%	57%	57%	57%	58%	58%	58%	58%	59%	59%	59%	59%	59%	60%	60%	60%	60%	60%	60%
50th Percentile	55%	51%	53%	52%	52%	53%	53%	53%	53%	53%	53%	53%	54%	54%	54%	54%	54%	54%	55%	55%	55%
75th Percentile	55%	49%	49%	49%	48%	48%	48%	48%	48%	49%	49%	49%	49%	49%	49%	49%	50%	50%	50%	50%	50%
95th Percentile	55%	45%	45%	44%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	43%	44%	44%	44%	44%	44%

The following observations can be made:

- The funding ratio at the median level is stable at about 53%; its volatility is the result of variations in investment returns.
- As ultimate investment returns are assumed slightly higher than the nominal rate assumption, gains are more frequent than losses.

Section 7: Comments on the Current Funding Approach

Unfunded Liability

All employers share collectively in the investment earnings of the insurance fund, and in the expenses to administer the *WSIA* and the Occupational Health and Safety Act, as well as in the obligation to pay-down the unfunded liability (UFL).

The unfunded liability component is based on the funding strategy, which called for the UFL to be amortized on a straight-line basis with interest until the target full funding date of 2014, which was the original 30-year funding date established in 1984. If straight-line amortization was not possible due to limitations imposed by the maximum premium-rate increases, as this has been the case in recent years, the UFL premium, which is allocated to the unfunded liability, is modified in that particular year representing the balance of the total premium rate over the other components. As soon as funding deficiencies (excesses) have been recovered, the UFL component would be amortized on a straight-line basis with interest to the target full funding date.

In the 2008 WSIB Annual Report, it has been recognized that the 2014 target date could not be met.

All experience and losses are allocated to the unfunded liability, without distinctions from their origins.

Experience Gains and Losses

Since 2002, experience gains and losses, arising from the differences between premiums and claims for each year's injuries, as well as from changes to assumptions that are applied to value the future payments of claims, are shared collectively by employers within each class from where the experience arose.

While the consideration of gains and losses at the class level might potentially reduce the potential of cross-subsidization by class, in fact, it adds to the variability of premium rates and is contrary to the collective liability concept. Experience fluctuates and this is recognized in the setting of premium rates, where a 5-year experience period is used. The risks of experience fluctuations should be shared by large groups, to follow the collective liability concept.

Consideration should be given to eliminating the experience gain and loss component in the calculation of the premium rates and to consider collectively all experience gains and losses. For accumulated losses as at the end of 2011 (all classes have losses to amortize), they should be combined and considered part of the unfunded liability and amortized collectively by all employers. Alternatively, the current amortization could be phased out over the next few years; in such case, the amounts collected from employers through that process would reduce the amount to be collected for the unfunded liability portion, but would provide less transparency and add administration.

Section 8: Other Elements

Investment Policy and Structure

The investment policy forms with the funding policy the cornerstone of the financial strategies available to the WSIB.

The investment policy should be reviewed following the change in the funding policy, in particular if it translates in significant modifications to the premium revenues, and be the subject of regular monitoring in the future.

Changes to Accounting Requirements

Considering the characteristics of WSIB, the required premiums should continue to be determined using long term best estimate assumptions, independently of accounting requirements.

Reporting, Monitoring and Future Revisions of the Funding Policy

The funding policy should be viewed as a plan towards the achievement of the full funded status. The WSIB would commit to this plan and have a disciplined approach in this regard.

The plan has a long term objective and should not have to be revised annually. However, regular reporting and monitoring are very important in order to inform all the stakeholders of the evolution of this plan.

The WSIB is significantly under-funded and the funding policy to be adopted should focus primarily on achieving a fully funded status. When the funding status of the board will move closer to the fully funded position, the funding policy should be revised and focus on how to maintain that status.

Other Elements of the Funding Policy

Assumptions could include some margin for adverse deviations, resulting in a higher premium, which would have to be returned to future generations of employers if the adverse deviation did not materialize. This would result in intergenerational inequity because a subsidy for future generations of employers would be financed by past generations of employers.

Considering the important under-funding of the WSIB, the primary objective should be to achieve a fully funded status using the best estimate assumptions, without a margin for adverse deviations. When the funding status of the board will move closer to the fully funded position, the funding policy could be revised and focus on how to maintain that status in response to fluctuations in experience.

In addition to a margin for adverse deviations, various tools could be used in the funding policy for that purpose, such as:

- A target funding level that would be higher than the 100% target.
- A “Yellow” or No Action Zone around the target funding level, within which no corrective action is taken, in order to avoid over-reacting to temporary fluctuations in the funding position.
- Reserves that are required in addition to the liabilities, such as:
  - After full funding were achieved, a Capital Adequacy Reserve, to provide adequate capital using the Minimum Continuing Capital and Surplus Requirements (MCCSR) and Minimum Capital Test (MCT) formulas used by the Office of the Superintendent of Financial Institutions in supervising Canadian life and casualty insurance companies;

- A Catastrophe or Disaster Reserve – to provide for the potential impact of a catastrophic event;
- A Contingent Reserve – to provide for potential losses associated with industries that may cease operations in the future;
- An Investment Fluctuation Reserve – to absorb investment gains and losses using an averaging formula;
- An Occupational Disease Reserve – to provide for exposure to long latency occupational diseases that are currently not recognized in legislation or regulations or by the board;
- An Operating Reserve – to mitigate the impact of adverse fluctuations in experience, to provide for greater stability of benefits, for special circumstances or for special initiatives.

While all these tools are interesting, considering the current funding position, we believe that they are not necessarily appropriate at this time.

Appendix A: Impact of Improving the Partially-Indexed Benefits

In the projections prepared in this document, partially-indexed benefits were assumed to increase at a fixed rate of 0.50% per annum, as was the case in the actuarial valuation of the benefit liabilities as of December 31, 2010. We have estimated the impact of fully indexing these benefits starting in 2012 on a number of financial parameters, using the same assumptions as those used for the other projections, and the results are presented in this appendix.

We estimate that the change to the indexation formula would have the following impact:

- The rate for New Claim Costs for 2012 and subsequent years would increase by about $0.025.

- The benefit liabilities at December 31, 2011, assuming inflation of 2.5% in 2011 and no experience gains or losses, would increase by about $1.8B; to replenish the WSIB over the same period as before, an increase in the UFL premium of $0.10 would be required.

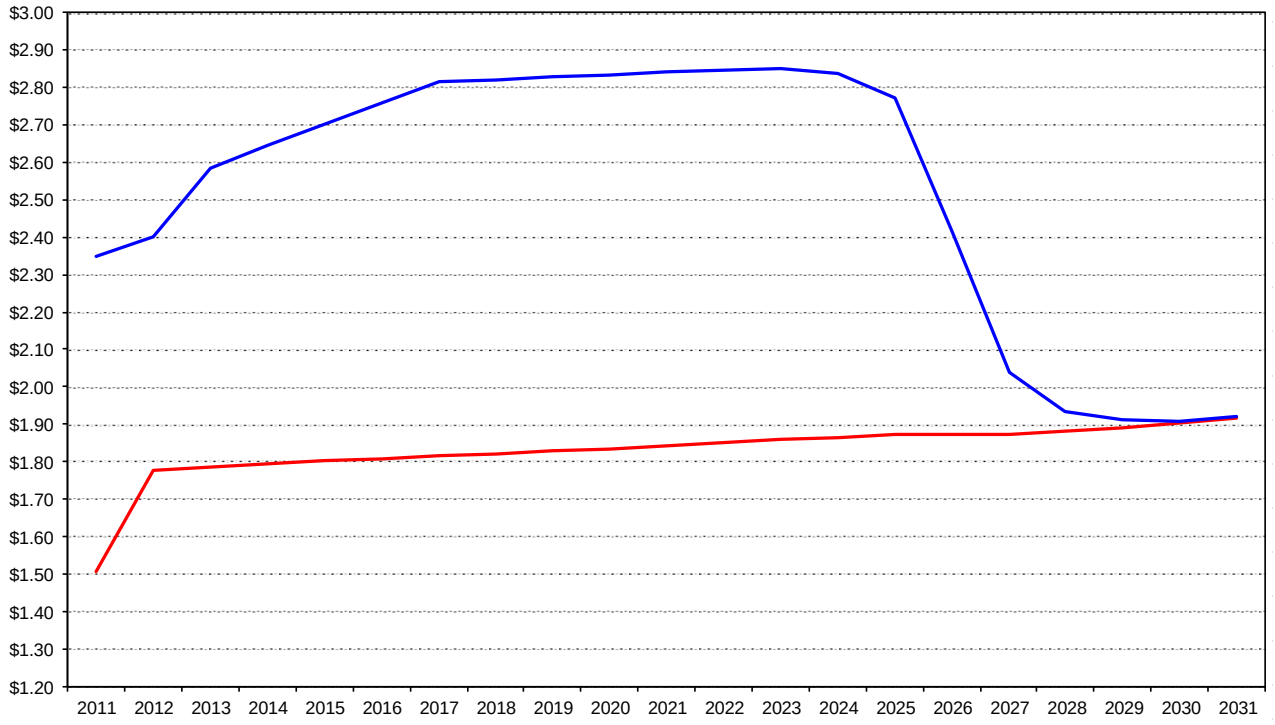
Projections

For projection purposes, we have assumed a fixed premium rate for the unfunded liability until the 2011 UFL account is fully funded of $0.10 higher, as follows:

- 2012: $0.75
- 2013: $0.80
- 2014: $0.85
- 2015: $0.90
- 2016: $0.95
- 2017 and after: $1.00

Based on these assumptions, we have estimated the evolution of the average premium rate in the future. The following graph compares the average premium rate at the median level with the required rate for current employers (the sum of the rate for the new claim costs – NCC, the rate for administration and other expenses, and the premium adjustments with respect to prior years for "new claims"):

Projection of the Average Premium Rate at the Median Level and the Required Rate for Current Employers



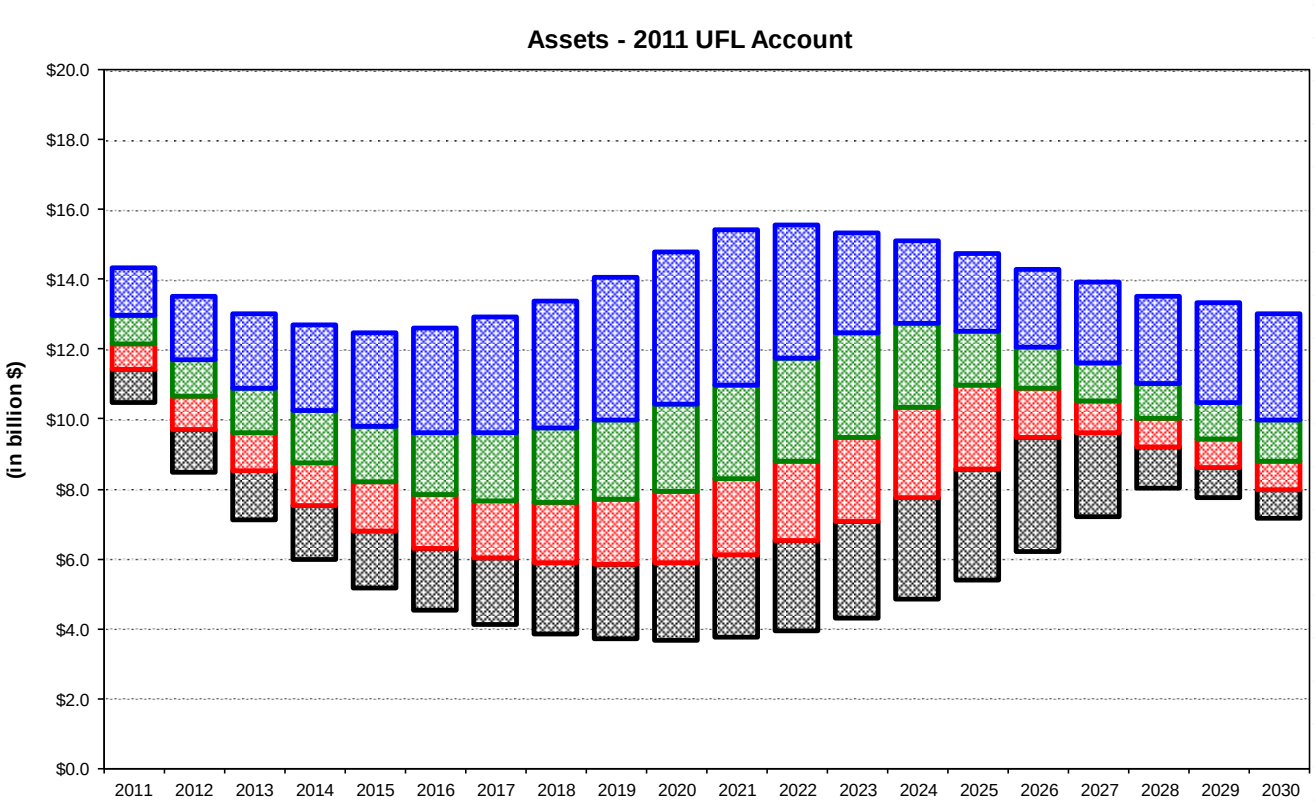
Average Rate	2.35	2.40	2.59	2.64	2.70	2.76	2.82	2.82	2.83	2.83	2.84	2.85	2.85	2.84	2.77	2.42	2.04	1.94	1.91	1.91	1.92
Current Rate	1.51	1.78	1.79	1.79	1.80	1.81	1.82	1.82	1.83	1.83	1.84	1.85	1.86	1.87	1.87	1.87	1.87	1.88	1.89	1.90	1.92
New Claim Cost	1.01	1.25	1.26	1.27	1.28	1.29	1.30	1.31	1.32	1.33	1.34	1.35	1.36	1.37	1.38	1.39	1.41	1.42	1.43	1.45	1.46
Administration	0.50	0.53	0.53	0.53	0.53	0.54	0.54	0.54	0.54	0.54	0.54	0.54	0.54	0.54	0.54	0.53	0.52	0.51	0.51	0.51	0.51
UFL Rate	0.85	0.62	0.80	0.85	0.90	0.95	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.51	0.13	0.00	0.00	0.00	0.00

The following observations can be made:

- Fully indexing the benefits increase the current rate by $0.025 and the UFL rate by $0.10 until the UFL account is fully funded, for a total of $0.12 to $0.13 in the average premium rate when compared to results presented in Section 5.

- We have assumed no change in the frequency of claims or their durations; the upward trend in the NCC component is the result of health care benefits increasing at a higher pace than the wage growth. Any improvement or deterioration in anticipated claim cost experience, as well as any change in administration or other expenses, would be directly reflected in the premium rate.

The following graph presents the projections of the assets of 2011 UFL Account only:

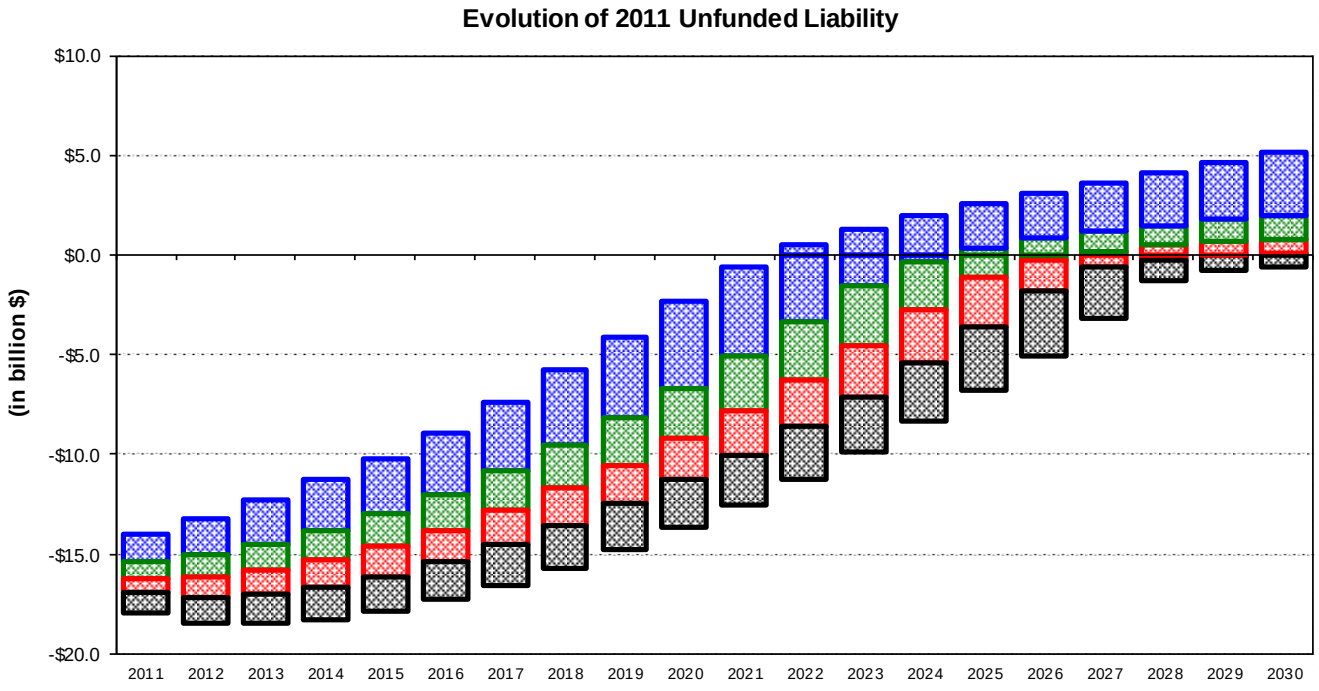


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	14.3	13.5	13.0	12.7	12.5	12.6	13.0	13.4	14.1	14.8	15.4	15.6	15.4	15.1	14.7	14.3	13.9	13.5	13.4	13.1
25th Percentile	13.0	11.7	10.9	10.2	9.8	9.6	9.6	9.7	10.0	10.4	11.0	11.7	12.5	12.7	12.5	12.1	11.6	11.0	10.5	10.0
50th Percentile	12.2	10.7	9.6	8.8	8.2	7.9	7.7	7.6	7.7	8.0	8.3	8.8	9.5	10.4	11.0	10.9	10.5	10.0	9.4	8.8
75th Percentile	11.4	9.7	8.5	7.5	6.8	6.3	6.0	5.9	5.9	5.9	6.1	6.5	7.1	7.7	8.6	9.5	9.6	9.2	8.6	8.0
95th Percentile	10.5	8.5	7.1	6.0	5.2	4.5	4.1	3.8	3.7	3.7	3.8	4.0	4.3	4.8	5.4	6.2	7.2	8.0	7.8	7.2

The following observations can be made:

- Assets have a similar pattern to the results of the projections shown in Section 5: reduction in the next few years, followed by a period where assets increase, which ends when the 2011 UFL Account is fully funded.
- The assets are slightly higher resulting from the $0.10 rate increase of the UFL premium.

The following graph presents the projections of the total 2011 Unfunded Liability (« Old » WSIB only):

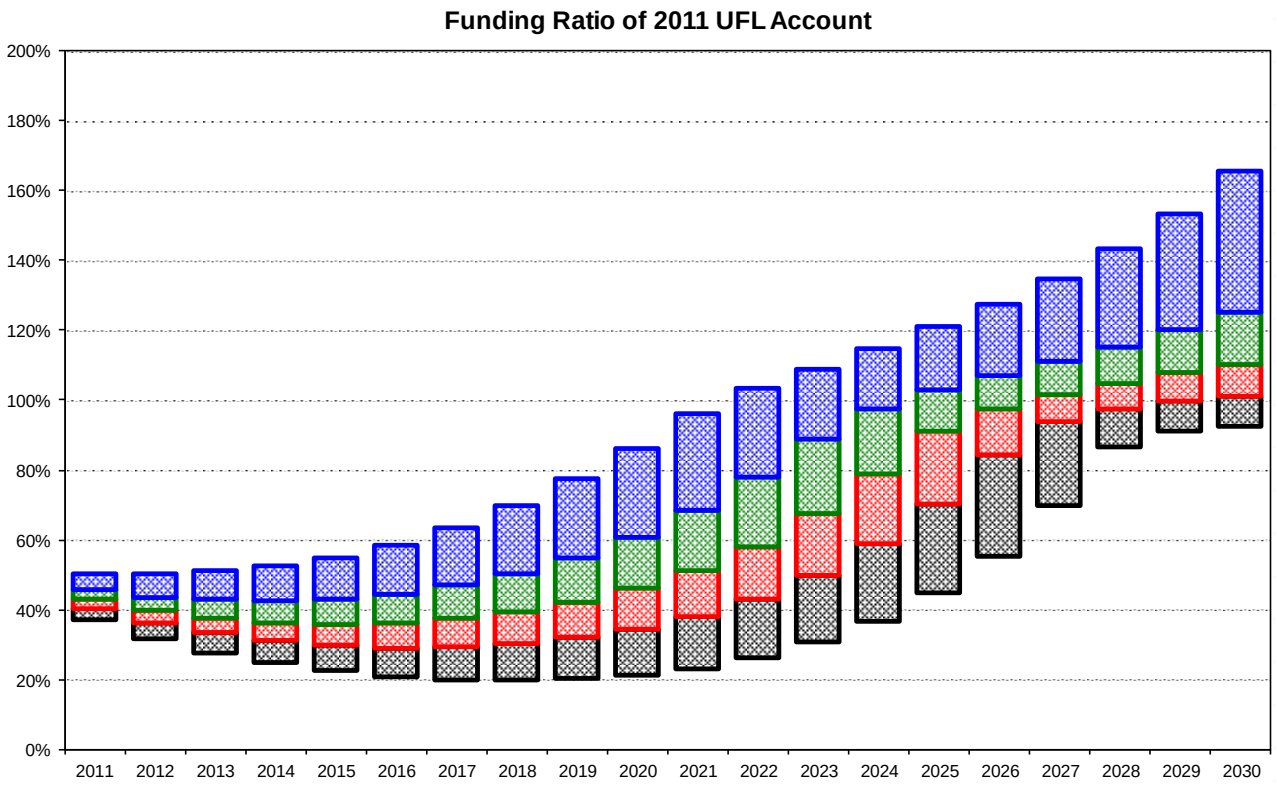


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	-$14.0	-$13.2	-$12.3	-$11.3	-$10.2	-$8.9	-$7.4	-$5.8	-$4.1	-$2.3	-$0.6	$0.5	$1.2	$2.0	$2.5	$3.1	$3.6	$4.1	$4.6	$5.1
25th Percentile	-$15.4	-$15.1	-$14.5	-$13.8	-$13.0	-$12.0	-$10.8	-$9.5	-$8.2	-$6.7	-$5.1	-$3.3	-$1.6	-$0.3	$0.4	$0.8	$1.2	$1.5	$1.8	$2.0
50th Percentile	-$16.2	-$16.2	-$15.8	-$15.3	-$14.6	-$13.8	-$12.8	-$11.7	-$10.5	-$9.2	-$7.8	-$6.3	-$4.6	-$2.7	-$1.1	-$0.3	$0.2	$0.5	$0.7	$0.8
75th Percentile	-$17.0	-$17.2	-$17.0	-$16.7	-$16.1	-$15.4	-$14.5	-$13.5	-$12.4	-$11.3	-$10.0	-$8.6	-$7.1	-$5.4	-$3.6	-$1.8	-$0.6	-$0.2	$0.0	$0.1
95th Percentile	-$17.9	-$18.4	-$18.5	-$18.3	-$17.9	-$17.3	-$16.6	-$15.7	-$14.7	-$13.7	-$12.5	-$11.3	-$9.9	-$8.4	-$6.8	-$5.0	-$3.2	-$1.3	-$0.8	-$0.6

The following observations can be made:

- At the median level, the amount of the unfunded liability is estimated at $16.2B at the end of 2011, an increase of $1.8B compared to the amount of $14.4B shown in Section 5.
- The $1.8B difference in the UFL reduces slowly as the additional $0.10 in the UFL premium rate contributes to increase more rapidly the assets.
- With this additional UFL premium, the 2011 Unfunded Liability would be eliminated at approximately the same date under all scenarios.

The following graph presents the projections of the 2011 UFL Account Funding Ratio only:



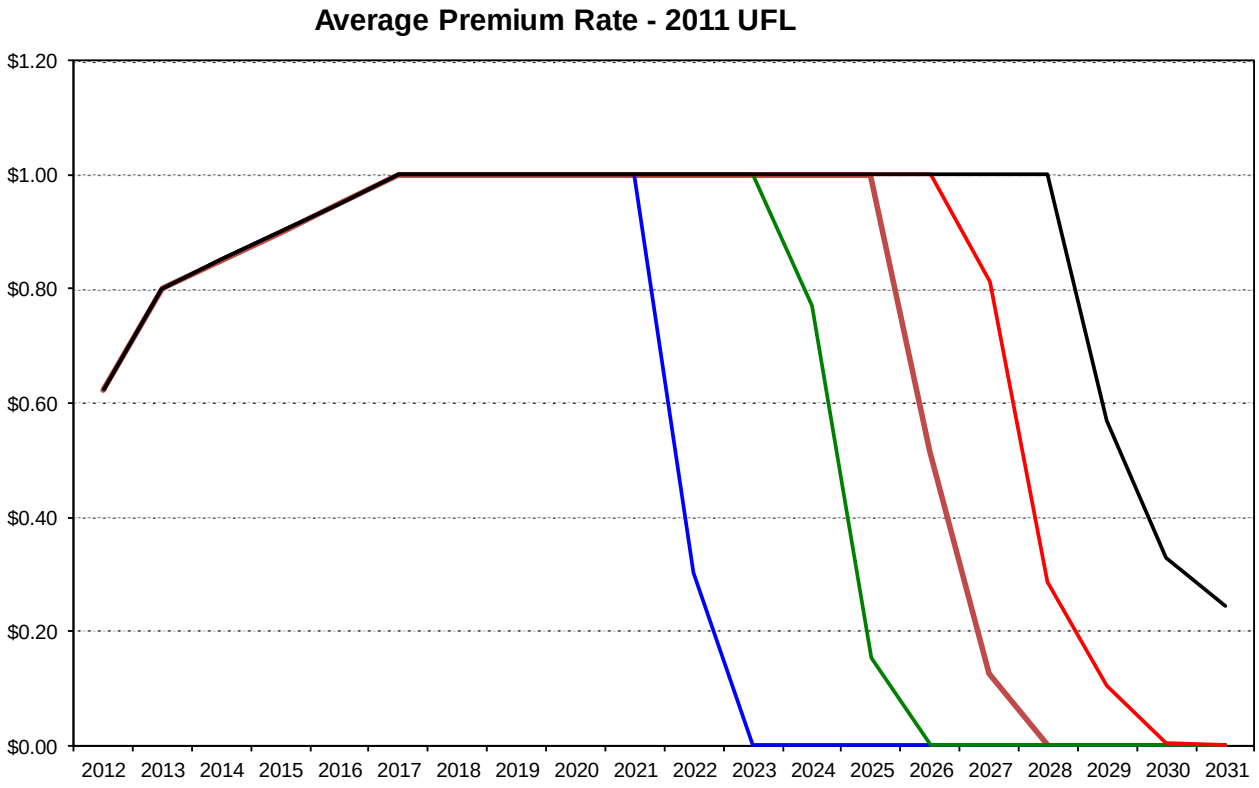
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	51%	50%	51%	53%	55%	58%	63%	70%	77%	86%	96%	103%	109%	115%	121%	128%	135%	143%	154%	166%
25th Percentile	46%	44%	43%	42%	43%	44%	47%	50%	55%	61%	68%	78%	89%	98%	103%	107%	111%	115%	120%	125%
50th Percentile	43%	40%	38%	36%	36%	36%	37%	39%	42%	46%	51%	58%	67%	79%	91%	98%	102%	105%	108%	110%
75th Percentile	40%	36%	33%	31%	30%	29%	29%	30%	32%	35%	38%	43%	50%	59%	70%	84%	94%	98%	100%	101%
95th Percentile	37%	32%	28%	25%	23%	21%	20%	20%	20%	21%	23%	26%	31%	37%	45%	56%	70%	87%	91%	93%

The following observations can be made:

- The funding of the 2011 UFL account would start at a lower level than the scenario presented in Section 5. At the median level, it would stand at 43% at the end of 2011, and would reduce initially despite significant UFL premiums, before increasing towards the fully funded status.

- At the median level, the 2011 UFL account would reach the 40% funding ratio in 2019, a year later than in Section 5.

The following graph presents the projections of the 2011 UFL Premium only:

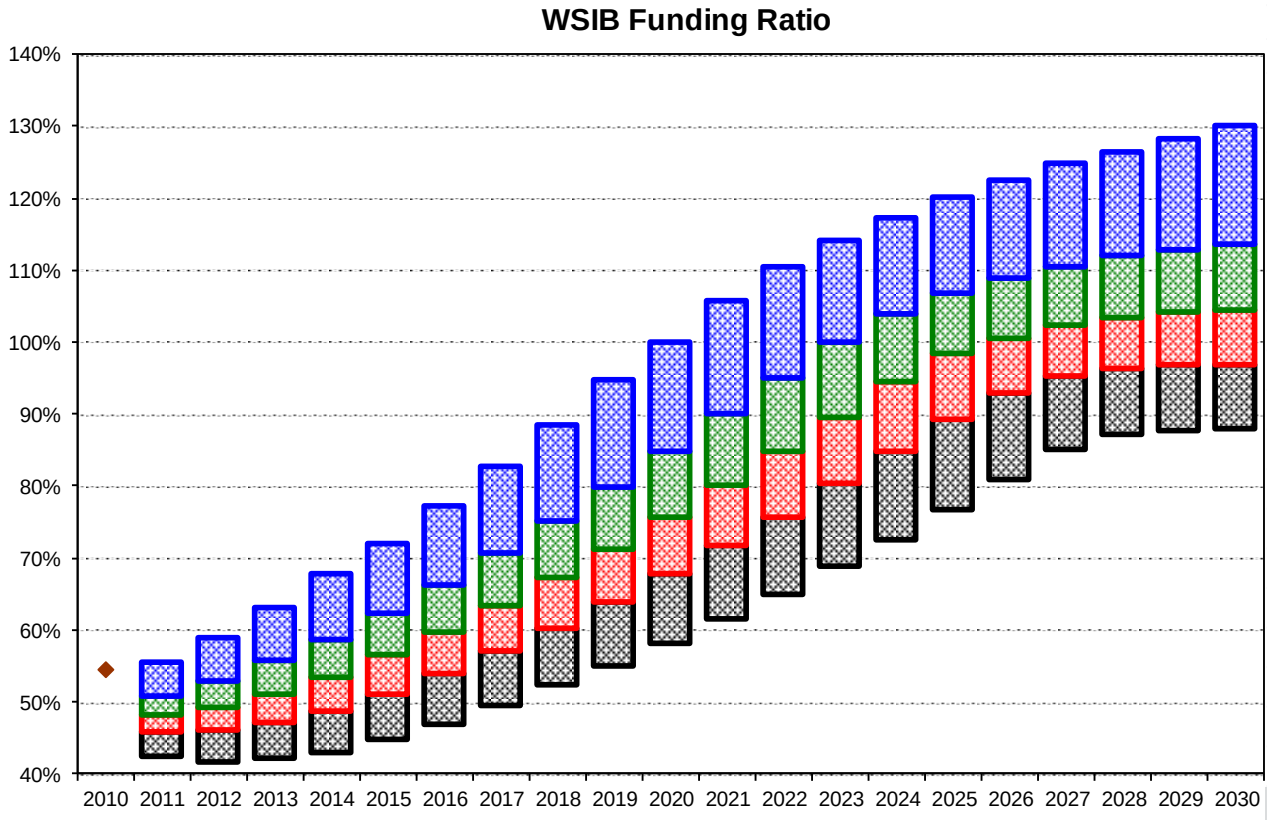


95th Percentile	$0.62	$0.80	$0.85	$0.90	$0.95	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$0.57	$0.33	$0.24
75th Percentile	$0.62	$0.80	$0.85	$0.90	$0.95	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$0.81	$0.29	$0.10	$0.00	$0.00
50th Percentile	$0.62	$0.80	$0.85	$0.90	$0.95	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$0.51	$0.13	$0.00	$0.00	$0.00	$0.00
25th Percentile	$0.62	$0.80	$0.85	$0.90	$0.95	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$0.77	$0.15	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
5th Percentile	$0.62	$0.80	$0.85	$0.90	$0.95	$1.00	$1.00	$1.00	$1.00	$1.00	$0.30	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00

The following observations can be made:

- As indicated before, the UFL premium stands at $0.80 in 2013, increasing by $0.05 annually until it reaches the ultimate level of $1.00; it reduces when the 2011 UFL Account reaches its fully funded status, in 2026 or 2027 at the median level.
- When compared to the scenario of Section 5, the UFL premium in 2012 in lower ($0.62 vs. $0.65) as the NCC component is higher and the average premium rate is fixed at $2.40.

The following graph presents the evolution of the funding ratio of the WSIB (« Old » WSIB and « New » WSIB combined):

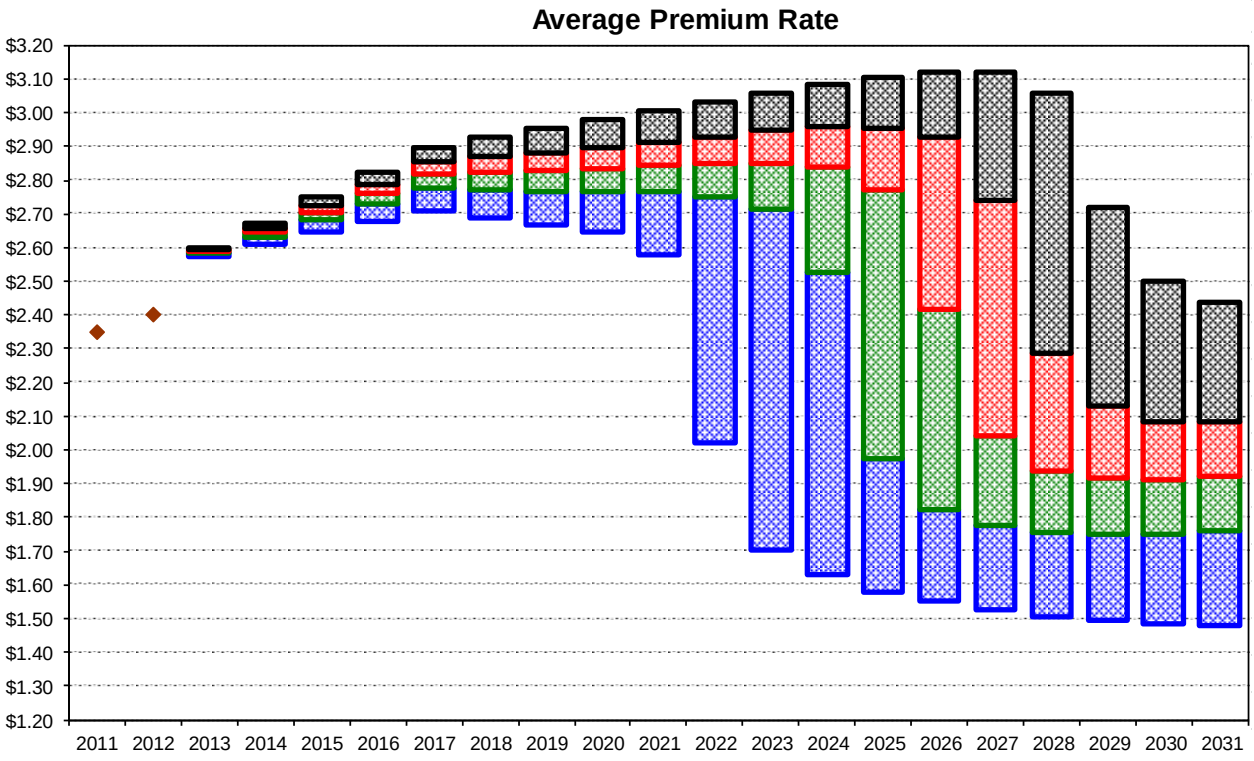


	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
5th Percentile	55%	56%	59%	63%	68%	72%	77%	83%	89%	95%	100%	106%	111%	114%	117%	120%	123%	125%	127%	128%	130%
25th Percentile	55%	51%	53%	56%	59%	62%	66%	71%	75%	80%	85%	90%	95%	100%	104%	107%	109%	111%	112%	113%	114%
50th Percentile	55%	48%	49%	51%	54%	57%	60%	64%	67%	71%	76%	80%	85%	90%	95%	98%	101%	102%	103%	104%	104%
75th Percentile	55%	46%	46%	47%	49%	51%	54%	57%	60%	64%	68%	72%	76%	80%	85%	89%	93%	95%	96%	97%	97%
95th Percentile	55%	43%	42%	42%	43%	45%	47%	50%	52%	55%	58%	62%	65%	69%	73%	77%	81%	85%	87%	88%	88%

The following observations can be made:

- At the end of 2011, the WSIB funding ratio will reduce by about 3% as a result of improving the partially-indexed benefits, and would stand at 48% at the median level.
- Under all scenarios, the WSIB funding ratio will increase, slowly under unfavourable scenarios, more rapidly under favourable scenarios.
- At the median level, the WSIB will be fully funded by 2026.

Finally, this graph shows the projected evolution of the average premium rate over the next 20 years:



95th Percentile	$2.35	$2.40	$2.60	$2.67	$2.75	$2.82	$2.90	$2.92	$2.95	$2.98	$3.00	$3.03	$3.06	$3.08	$3.10	$3.12	$3.12	$3.06	$2.72	$2.50	$2.44
75th Percentile	$2.35	$2.40	$2.59	$2.66	$2.72	$2.79	$2.85	$2.87	$2.88	$2.90	$2.91	$2.93	$2.95	$2.96	$2.95	$2.93	$2.74	$2.28	$2.13	$2.08	$2.08
50th Percentile	$2.35	$2.40	$2.59	$2.64	$2.70	$2.76	$2.82	$2.82	$2.83	$2.83	$2.84	$2.85	$2.85	$2.84	$2.77	$2.42	$2.04	$1.94	$1.91	$1.91	$1.92
25th Percentile	$2.35	$2.40	$2.58	$2.63	$2.68	$2.73	$2.77	$2.77	$2.77	$2.76	$2.76	$2.75	$2.71	$2.53	$1.97	$1.82	$1.78	$1.75	$1.75	$1.75	$1.76
5th Percentile	$2.35	$2.40	$2.57	$2.61	$2.64	$2.68	$2.71	$2.69	$2.67	$2.64	$2.58	$2.02	$1.70	$1.63	$1.58	$1.55	$1.52	$1.50	$1.49	$1.48	$1.47

The following observations can be made:

- The improvement of partially-indexed benefits increases the average premium rate by $0.025, plus an additional $0.10 until the UFL account is fully funded.
- When compared with the results shown in Section 5, the volatility of the average premium rate increases as more benefits are fully adjusted with inflation.

2011

Workplace Safety and Insurance Board of Ontario

A Pricing System Conceptual Design for Moving Forward

The WSIB is about to move forward with a new funding strategy, following the review by Professor Arthurs. Before moving forward, the WSIB needs to take stock of its pricing model, to ensure that it will support the funding strategy and meet the needs of workers, employers and the WSIB.

The four components of a WSIB pricing system are Classification, Rate Groups, Premium Setting and Experience Rating. These components must be coordinated in order for the pricing system to work effectively.

The current WSIB pricing system is reviewed in an Appendix to this report and the strengths and weaknesses have been outlined. The review looks at the current system from the perspectives of:

- Fairness
- Collective Liability
- Predictability
- Transparency and ease of understanding
- Ease of administration

The report includes an outline of our opinion of the best practices in the various components of WSIB pricing, based upon our 35 years of experience in workers compensation pricing, updated by a recent review of pricing in a few comparable Canadian jurisdictions.

The report considers what principles should be included in the ideal WSIB pricing system and then measures the current WSIB pricing system against them.

The conceptual design for moving forward describes how an alternate system for pricing, would be more advantageous in meeting the objectives of fairness, collective liability, predictability, transparency and ease of understanding, and ease of administration.

Nexus Actuarial Consultants Ltd.
HP
5/31/2011

I. Executive Summary

The WSIB is funded solely by employers. Consequently, one of the fundamental aspects of the system is the process by which the contribution - the premium - to be paid by each individual employer is set each year. As with each of the core processes of the workplace insurance system, it is critical that the approach by which this premium is set is fair, credible and transparent. Employers must be able to see how their premium rate was established, how it relates to what they have cost the system through their claims, and why they are paying the premium they are asked to contribute.

Particularly at a time when the WSIB is asking employers to support a new funding approach to bring the WSIB into financial sustainability, the WSIB must set employer premium rates in a manner that is equitable and fair to both employers and workers. Premium rates must be set using the best approach available – one that fairly promotes financial sustainability while incenting employers to prevent injuries and return injured workers to safe and sustainable employment. The best approach reduces unintended effects: it will not encourage employers to circumvent their fair contribution, nor will it incent employers to suppress claims or provide inappropriate return to work programs whose primary goal is to eliminate loss of earnings payments to injured workers rather than achieve safe and sustainable outcomes.

The current WSIB pricing system – in place for 20 years – no longer fulfills those objectives. It does not provide fairness in pricing to either employers or workers.

Employers have lost their line of sight between their current WSIB claims experience and their current premiums paid to the WSIB. Consequently, employers believe that their current premium rates do not match their current risk and they are therefore challenging every aspect of the current complex pricing system.

In attempts to have premiums more closely match their risk, employers in increasing numbers are asking:

- To be reclassified to a lower risk classification unit or at least have additional separate classifications for the low risk parts of their business (“rate shopping”);
- To have their industries separated from the other higher risk industries in their rate group; and
- To have WSIB rates frozen or reduced.

The desire of most employers is to get close to “their average risk as they perceive it”. Most employers view themselves as “one entity”, but they will ask for multiple classifications to try to get to their real risk as they see it.

In attempts to have premiums more closely match their risk, employers are also increasingly challenging the current experience rating programs. As the impact of one claim under the current retrospective programs can be significant, resulting in the removal of a refund or the increase of a surcharge, some employers are resorting to negative or bad behaviours such as:

I - Executive Summary

- Allocating claims to their lower risk classifications;
- Pressuring their workers not to file a claim ("claims suppression"); and
- Providing overly aggressive return to work programs whose primary purpose is to eliminate WSIB loss of earnings payments to the worker ("non productive return to work"),

rather than positive outcomes.

As the WSIB responds to these increased challenges, a downward spiral forms – the system becomes ever more complex, increasingly fragmented as more multiple classifications are granted, and the relationship between an employer's costs and the premium they pay ever more obscured and the administration of the system becomes ever more costly for the employer.

The current pricing system is not meeting the needs of either employers or workers. It is not sustainable.

It is also not necessary – there is a better approach.

This paper will review the current pricing system and its problems and outline a proposed alternative better suited to today's business world and better able to fulfill the needs of employers and the workplace insurance system.

Guiding Principles

Any proposed pricing system – the current approach or an alternative - must be judged by how it meets the following guiding principles that all parties can accept as fundamental to an effective and fair system.

1. **Collective liability:** That Schedule 1 employers must collectively pay the premiums required each year to maintain the WSIB insurance fund and be provided with insurance protection from random fluctuations in costs.
2. **Fairness:** That premiums paid by the current employers are well aligned to the costs currently generated by these employers.
3. **Predictability of premiums:** That the annual premiums for each employer must be predictable and stable. An employer's premiums should only significantly move as a result of a sustained change in their claims experience, rather than a short term change.
4. **Transparent and understandable:** That the employer can see and understand how their premium has been set and can see how and why their premium moves with their own experience.
5. **Financial security:** That injured workers and their beneficiaries are reasonably assured that their benefits will be paid as promised.

6. **Promote positive behaviour:** That the pricing system encourages employers to prevent injuries, improve health and safety in their workplace, return injured workers to sustained employment and discourages negative behaviours such as "rate shopping", misallocation of claims, "claims suppression" and "non productive return to work".

7. **Ease of administration:** That it is as easy and as simple as possible for the employer to meet their obligations to report and pay their premium. And equally, that the WSIB can administer the pricing system efficiently and effectively (since ultimately employers pay the cost of administration).

The current pricing approach and the proposed alternative will be reviewed for their alignment to these principles.

The Current System: Historical context

The concepts for the current WSIB pricing system were first established a century ago. While it has been modified at various points throughout the years, the fundamental basis for the classification of employers for the purpose of establishing their premiums has been constant. Generally, employers are grouped and their rates are set according to the business activity they are involved in. This grouping of employers engaged in like activities has been the proxy to estimate the risk and the likely cost of each employer to the system.

There was reason to start with this approach. In prior periods, industrial and business processes were simpler and more uniform, and improvements and changes occurred gradually over time. Even up to 20 years ago, when the current WSIB classification system was revised, business activities were relatively static and similar businesses were seen as reasonably homogeneous. In that context, developing a pricing system based upon similarity of business activities was reasonable, particularly given the technical limitations of gathering information or managing an approach based on other factors.

The Current System Described

In Ontario, business activity classification systems were developed and employers were classified into a business activity. Rate groups were established based upon similarity of business activities and all employers in the rate group paid the same premium rate.

Even in the beginning, when the system was relatively simple, the inequity of charging all employers in a rate group the same rate was understood by the founder of Ontario's system, Sir William Meredith. That is why he recommended 47 different classes of employers and suggested that premium rates could vary within each class, sub class or plant. Over the years, the inequality of all employers in a rate group paying the same rate has grown and has resulted in a growth of complexity in the pricing system. Currently, there are over 800 classification units, grouped into 154 rate groups and 9 classes. Individual employers are often classified into multiple rate groups, each with different premium rates.

On top of the sheer number of rate groups, added complexity is introduced as premium rates are set at the Schedule 1, Class and Rate group levels, each using a different methodology. The WSIB currently

does some pooling of claims costs and expenses at various levels including Schedule 1, Class and Rate Group. The WSIB currently sets rates at each of these levels, using rules which are frequently changing, which further decreases employers' ability to relate what their claims are costing to the premiums that they are paying.

Finally, the premium rate paid at the rate group level can be adjusted at the individual employer level by one of 3 experience rating plans designed in part to correct for some of the inequities of the other parts of the pricing system. Assuming that is, that the employer is a member of an experience rating plan – which up to 100,000 are not.

The current pricing system has so many levels and is so complex that it is at risk of collapsing under its own weight.

Problems of the current pricing approach

Not surprisingly, such a complex system is beset with challenges.

Today the WSIB is mired in an increasingly complex pricing system with too many layers. It is not transparent. It does not provide predictable rates to employers and does not make employers responsible for their predictable costs while providing collective liability protection from random fluctuations in their claims experience. Employers have lost their line of sight between what their claims experience is costing the system and what they are paying in premiums.

The root cause of this result is the concept of classifying employers by business activity. In a time when business was simpler and business organizations more uniform, the connection between the predominant activity of a firm and its risk was clearer. Most workers in the firm would be involved in that activity and its risk would bear a close relationship to the overall risk of the employer. Today, with diverse and complex business organizations this is no longer the case. For many employers, more than one activity may be undertaken, parts of each activity may be outsourced, some workers in the firm may be involved in more than one activity, or in ancillary and less risky supporting operations, and fewer workers may be engaged full time in the activities that are used by the system to classify the employer's level of risk.

As a result employers no longer see how their premium relates to their overall risk, and no longer feel their competitors – who may be organized very differently - represent fair approximations of their risk.

Consequently, employers consider the current WSIB pricing system to be unfair and are challenging every aspect of the pricing system – classification, grouping classification units into rate groups, rate setting and experience rating. They believe their injury risk is lower than the premiums they are being charged. In a system where employers question the fairness of the rate they are paying and do not understand why they are paying it, their response is only natural – they look for ways to bring their premium in line with what they believe they should be paying.

As a result, we have seen many behaviours in the system that while rational for the individual employer in the short term, are bad for the system, employers and workers in the longer term.

The response to this perceived unfairness has been met by two main modifications to the system: the increasing move to seek multiple classifications by individual employers, often based on occupations within the firm, and the inappropriate manipulation of experience rating programs.

Multiple Classifications

Employers strive to influence and change their classification since it is so central to their premium. Employers are "rate shopping" and attempting to get all or at least the part of their business with lower risks classified into a classification unit that has a lower rate.

Similarly, employers are increasingly asking for occupation classification, such as a separate classification for their clerical staff, in an effort to get a lower total premium.

Neither approach solves the problem in the long run.

Permitting more employers to have multiple classifications, particularly for their lower risks, is not a solution to moving employer premiums closer to their risk. The assignment of multiple classifications does nothing to change the overall cost of the system. It only shifts costs between different workers within the firm and increases the effort required to understand how the overall premium paid relates to the firm's overall risk and claims costs. For example, if all employers were permitted to have a separate classification for their clerical staff, they would have a lower premium rate for their clerical staff but the rate for their non clerical staff would increase. If an employer's clerical staff, as a proportion of their total work force, is the same as the average for their classification unit, then the employer's total WSIB premiums would remain the same. As each part of an employer's operation is separated into a different classification unit, it actually is pooled with similar parts of another employer's operation. In the end result, the employer becomes less able to understand its total premium and less confident it is paying total WSIB premiums related to its own risk.

As a firm's classifications and rate groups proliferate, any view of the business as a whole is lost. Increased pooling across multiple classifications means an employer's total premium is less predictable, as the experience of the various classification pools determines the rate rather than the employer's own experience.

Finally, while each employer is trying to reduce their total WSIB premiums they may not see that their actions increase administrative costs. Occupational classification would actually increase the cost of the WSIB Schedule 1 rate, as it would increase the need to administer multiple classifications for every firm (versus the 8.5% of firms that now have multiple classifications). The WSIB already has increased administration to prevent the "rate shopping" as evidenced by the WSIB's identification of "high risk" classification units which need management review and approval of all new and revised classifications. Further additional administration cost would be required to audit the separation of insurable earnings and claims between those for clerical staff and the other classification unit(s) for all employers.

I - Executive Summary

Experience rating

To help correct for some of the inequities of classification and rate setting, the WSIB added three experience rating plans. While nominally designed to improve workplace safety, these programs in many cases have become ways to adjust premium rates to "fit" the individual employer.

The design of each of the three experience rating plans permits volatile changes in individual employer total premiums from one year to the next. Employers can move from their lowest to highest premiums based upon one bad year of claims experience and this incents some employers to bad behaviours as they scramble to reduce the unpredictable rise in their premiums. Because of the immediate and significant increase in premiums as the result of each claim under the experience rating programs, employers are incented to mitigate the consequence, which leads some employers to short term measures such as "claims suppression" and "non productive return to work" programs. The current experience rating programs do not incent long term improvement when employers are focussed on the short term.

Employers are beginning to recognize the unfairness of volatile experience rating surcharges and negative impact that it is having in some industries. For example, the volatility of the experience rating surcharges is seen for a group of motor vehicle manufacturers which has recently been declining in size in the following table:

Experience Rating Issue Year	WSIB Premiums Paid	Net Surcharge
2010	$50.1 million	$31.0 million
2009	$46.9 million	$51.5 million
2008	$64.5 million	$25.8 million
2007	$74.2 million	$13.7 million
2006	$75.2 million	$11.5 million

In 2009 the net surcharges exceeded the premiums.

The complexities of the experience rating plans have caused increased administration, while the relationship between what an employer's claims were costing and what premiums they were paying remained unclear. Although multiple classifications and experience rating help, the pooled experience of their rate groups, rather than their own claims experience continue to dominate their premium rates.

To counter such impacts, employers are increasingly asking to have their group of firms separated out into their own rate group. They believe that they are currently being asked to unfairly and inappropriately subsidize other employers in their current rate group who have not taken the necessary actions to both eliminate injuries and provide sustained return to work for their injured workers. For example, more recent arrivals to Ontario's automobile manufacturing sector have WSIB claims experience which they believe is significantly better than the original big 3 North American automobile manufacturers, and have repeatedly asked for their own WSIB rate group. They believe that continuing

to subsidize automakers that have not adopted their prevention and return to work practices is creating a moral hazard for the other automakers. They believe a single rate group provides a direct disincentive for the other automakers to take the necessary actions to reduce their injuries further and provide sustained employment for those already injured.

In short, each effort to counter balance and correct the inadequacies of the current approach only causes new problems. Every attempt to restore and clarify the link between the employer's risk and premium based on the current approach just causes the system to grow ever more complex as it sets up a never ending cycle to break down the classification scheme into ever finer units to better match the employer's claims cost to its overall premium.

The answer seems obvious: Establish the employer as the first level of collective liability. Then establish a premium rate directly related to that employer's cost to the system.

Intuitively, the employer knows that their risks are based upon their attitudes, their processes and the skills and training of their workers. An employer that safety trains all their workers and takes every step to eliminate risk of injury in its operations will have lower risk clerical workers, lower risk production workers and lower risk sales persons. It makes more sense to pool this employer's lower risk workers within the employer itself, than to pool each of its activities and occupations with other employers on some presumed risk basis.

Current pricing system is unsustainable

As demonstrated above, as the WSIB responds to each employer challenge to its current pricing system, whether to classification, rate grouping, rate setting or experience rating, the solution invariably adds more complexity. More complexity is introduced to address the latest identified inequity by adding further patches to the current system. As more complexity is introduced, more administration is required. There are further reductions to transparency, understanding and predictability. Unfortunately, employers who started each of the challenges in order to achieve more fairness in pricing are less and less able to see the relationship between their current claims experience and their total WSIB premiums. Thus their perception of fairness actually decreases. This leads to more challenges and in some cases to inappropriate employer behaviours that adversely affect workers.

So what we currently have is a WSIB pricing system that does **not** meet many of the basic principles of an effective and credible pricing system:

1. **Collective liability:** Although Schedule 1 employers collectively pay the premiums required each year to maintain the WSIB insurance fund, they have **not** been paying sufficient premiums to keep the funding level from declining. Also more than 130,000 employers in experience rating are **not** being provided with insurance protection from random fluctuations in costs.

2. **Fairness:** The premiums paid by the current employers are **not** well aligned to the costs currently generated by these employers. Employers have lost their line of sight between what

they are costing the system and what they are paying in premiums, due to multiple classifications and too many layers in rate setting.

3. **Predictability of premiums:** The annual premiums for each employer are **not** predictable and stable, due to volatile experience rating which can significantly change the premiums paid based upon random fluctuations. Although an employer's premiums should only significantly move as a result of a sustained change in their claims experience, a short term change in experience can increase an employer's premium by more than 50%.

4. **Transparent and understandable:** An employer **cannot** see and understand how their premium has been set and **cannot** see how and why their premium moves with their own experience, due to too many layers in the rate setting.

5. **Financial security:** Injured workers and their beneficiaries are **not** reasonably assured that their benefits will be paid as promised, because the funding of the system has deteriorated.

6. **Promote positive behaviour:** The pricing system **does not** encourage employers to prevent injuries, improve health and safety in their workplace, return injured workers to sustained employment and **does not** discourage negative behaviours such as "rate shopping", misallocation of claims, "claims suppression" and "non productive return to work". The volatile impact of one claim under the current experience rating programs may actually be incenting some employers to inappropriate behaviours that adversely impact workers and may even be delaying the recovery of injured workers

7. **Ease of administration:** It is **not** easy and **not** simple for the employer to meet their obligations to report and pay their premium, due to multiple classifications. The WSIB cann**ot** administer the pricing system efficiently and effectively due to the complexity of multiple classifications, multiple layers in rate setting and 3 significantly different experience rating plans.

Some of these problems might be capable of improvement, but a system this complex and flawed **cannot be patched** to meet the most critical test of all - to be seen as fair and accepted as credible by those we are asking to pay the premiums its sets each year.

It really doesn't have to be this way. Both tools and pricing methods exist today to address the changing business environment. The Ontario WSIB just hasn't moved there, yet.

A new WSIB pricing system to meet the needs of today

A new WSIB pricing system can be designed to fit the circumstances of today. The world has changed dramatically in the last 20 years. Technology has advanced at a rapid pace, changing everything we do and the processes by which we do them. The ongoing development of computers and the internet permits huge volumes of information to be created, gathered, stored and analysed. The results of analyses maybe shared around the world in an instant. New products or business processes that are developed in other countries quickly become available to Ontario businesses. Some businesses move to new processes quickly while other competitors are slower to adapt. The technology and information is

continuously changing the very nature of industries and their workforces. Technology is also impacting the WSIB itself.

Today, unlike any time in history, we can have 2 employers engaged in the same business activity, producing the same product but using widely different processes, equipment and workers with entirely different training and skills. For example, today we have automobiles manufactured in many different ways. Some automobile plants are fully automated, with computer directed robots performing almost the entire assembly. Others use a production line with a combination of workers and robots assembling the vehicle. The training and skills of workers in each of these automobile assembly environments are vastly different. So also is their risk of injury.

We have also learned that there is a wide variation in the attitudes of senior management of an employer towards injury prevention and sustainable return-to-work, even between competitors. Today we believe that all injuries are preventable and that changing employer attitudes leads to changing employer behaviours and the prevention of injuries. Today there are many companies that believe that all injuries can and should be prevented, and there are some companies that do not.

In the world of today, since we know that risk of injury depends on employer's attitudes, business processes and training and skills of their workers, it is not appropriate to presume that two employers engaged in the same business activities producing the same product have similar risks of injury and therefore should pay similar WSIB premiums. In the world of today we could have an employer centric pricing system that measures an employer's risk relative to all employers, and prices their WSIB premiums accordingly. An employer centric pricing system does not have to be complex.

We need to ensure that the employer can see directly how their current WSIB claims experience measures up to what they are paying in WSIB premiums. We need to show the employer that what they are paying is their fair share of the total payments into the insurance fund.

Proposed new WSIB pricing system

We have the technology and the capability of establishing a new WSIB pricing system that sets each employer's premium rate based upon each employer's own experience. And this can be done in a way that achieves all of the guiding principles. It is of interest to note that the technological advances that made the old pricing system obsolete, have also given us the capability to set and communicate individual employer rates.

The proposed new employer centric rate setting system would comprise the following features:

- A business has **one rate** only for all its operations – it is the first line of collective liability. Multiple classifications and rates are ended. Whatever the mix of risk within an employer's operations, all that risk is pooled within the employer in the calculation of the employer's one new rate. This significantly increases fairness to both the individual employer and to all the other employers.

I - Executive Summary

- Each employer has a required rate that reflects its experience relative to that of Schedule 1 as a whole (i.e. a rate that may be more or less than the average Schedule 1 rate). For example if the Schedule 1 premium rate is $2.35 per $100 of insurable earnings, and the employer's claims experience is double Schedule 1 claims experience, then the employer's required premium rate will be $4.70 per $100 of insurable earnings. A **direct line of sight** is made between what the employer is currently costing the system and the Schedule 1 rate and the employer's required rate is set proportionately to the Schedule 1 rate. Since all employers (except new employers with no experience) are measured exactly the same way the system is not only fair, but seen to be fair by all employers.
- To increase **transparency** and **understanding** and to incent employers to positive long term injury prevention and sustained return to work programs, the measure of claims experience is 12 months of claim payments on claims that are less than 8 years old. Claim payments on claims that are more than 8 years old are pooled. The claim payments that are included in the measure are those that the WSIB and employers agree employers should be held accountable for (i.e. for preventable injuries). The powerful advantage of using a 12 month slice of claim payments is that one atypical bad (or good) year of claim payments only impacts one year of setting the employer's required rate.
- To preserve **predictability**, protect the employer from random fluctuations in claim costs and not incent "claims suppression" and "non productive return to work", an employer moves from its starting or current rate to its required rate in steps. These steps, up and down, are designed to smooth violent fluctuations in the premium rates, provide predictability and to incent real, long term changes in cost behaviour by employers.
- To provide an **incentive for appropriate behaviour** and **increase fairness** to individual employers and to employers collectively, steps are progressive – i.e. the longer the employer continues to have better or worse experience than what the employer is paying – the bigger the steps it takes each year to its required premium rate.
- To preserve **collective liability**, the maximum or minimum rate an employer must pay is established within a broad risk group of employers with similar risks. All classification units are assigned to a risk category based upon their payment experience over several years compared directly to Schedule 1 payment experience over the same years. The employer's risk category is determined by their dominant classification unit. An employer's rate can move anywhere within the risk category boundary limits, based upon the employer's claims experience relative to Schedule 1. The risk category boundary limits ensure that each employer will still retain some collective liability for their industry.
- To preserve **collective liability**, all employers share in the annual change in the Schedule 1 rate.
- To **ensure the financial security** of injured worker benefits and that the Schedule required premium is achieved and the WSIB funding plan is met, employers participate in a balancing factor. This ensures that the sum of individual employer rates does not exceed or fall short of the overall required Schedule I rate. Since everything (experience gains and losses, bad debts, refunds under SGP and SCIP, etc.) is build into the Schedule 1 average rate, it is important to achieve the required Schedule 1 rate.

- To **simplify** and **ease the administration**, all employers with at least one calendar year of claims participate in the employer centric rating plan.
- To **remove the negative incentives** for some employer's to "claims suppression" and "non productive return to work", supplementary retrospective experience rating is not permitted. There is no need for experience rating as the new system "self-adjusts" to an employer's changing experience without the volatility of retrospective experience rating and the bad behaviours that it can incent.

These features are outlined in more detail as follows. First, the WSIB would set a new Schedule 1 required premium and premium rate each year based upon the new WSIB funding policy.

The Schedule 1 premium rate will be set according to the funding policy and will include:

- The full cost of new injuries;
- The full costs of all overheads (including WSIB administration costs and legislative obligations, expected bad debts, expected payouts for incentive plans like SCIP of SCP or expected income from the Workwell program, amortization of actual experience gains and losses from prior years etc.); and
- The cost of amortizing the unfunded liability for past claims, according to the new funding policy.

Once the Schedule 1 premium is set for the year, the new pricing system would allocate it to employers.

The first step in allocating the premium to employers is to restate each employer's current year's premium rate to account for any change in the Schedule 1 average rate for next year. For example, if the Schedule 1 rate for next year is an increase of 2%, then the starting point for next year for each employer is 102% of their current rate. The concept here is that each employer shares in the change in the Schedule 1 average rate. It is fair and understandable that before recognizing individual current experience everyone shares in the system wide rate increase or decrease.

The second step would be to total current claims experience of each employer, all of their WSIB firm numbers over all of their classification units, and compare it to the current average Schedule 1 claims experience. This determines the employer's relative to Schedule 1 WSIB claims payment experience. An employer whose current claims payment experience per dollar of insurable earnings was twice that of Schedule 1 would have a required rate that was 2 times the Schedule 1 premium rate for the next year.

The third step would be to compare the employer's required premium rate for next year to the employer's restated premium rate for this year. Every employer then takes a progressive step towards their new required rate. The size of the step is determined by how many years the employer has been moving in the same direction. An employer whose premium rate has been increasing each year moves

up in larger steps each year toward their required rate. Similarly for an employer whose premium rate has been decreasing, the steps are larger. Steps up should always be twice as large as steps down, to reduce the imbalance caused by the rate change limits.

The following table is an example of how the steps would increase for the number of years in a row that an employer's rate is moving in the same direction.

Year	Decrease	Increase
First*	-5%	10%
Second	-10%	20%
Third	-15%	30%
Fourth	-20%	40%
Fifth +	-25%	50%

**First means the first year that a firm changes from a rate increase to a rate decrease or vice versa*

The purpose of increasing steps by the number of years of moving in the same direction is twofold. First it prevents a random fluctuation in experience from unduly impacting the employer. For example, one bad year of claims experience on its own only causes a small increase in premium rate for next year. Second, if the employer's claim experience has changed and that change is being sustained, the employer will begin to move faster and faster toward that sustained experience level. By having a small step the first time the employer's experience changes for the worse, the employer is incented to take positive action to reverse the worsening experience, before the increased steps occur. If the employer does not take positive action, the employer will face predictable consequences of ever increasing rates. This prevents the moral hazard of the employer continuing to have its sustained worse than average experience paid for by other Schedule 1 employers under the guise of collective liability.

The fourth step would be to limit an employer's premium rate based upon their broad risk category. All employers would be assigned to a risk category. Broad risk categories would be set up to permit all sizes of employers to move anywhere within their risk category based upon their own claims experience, but to restrict them (particularly the smaller employers) so that they pay their fair share towards collective liability.

The fifth and final step would be to apply a balancing adjustment (1% to 3%) to each employer's rate so the sum of the individually set employer premiums for all employers in Schedule 1 adds up to the Schedule 1 required premium.

More detail on the new pricing system is given in Appendix E.

Advantages of the new pricing system

The new pricing system meets all of the key principles for a WSIB pricing system.

1. **Collective liability:** Schedule 1 employers **will** collectively pay the premiums required each year to maintain the WSIB insurance fund and be provided with insurance protection from random fluctuations in costs. Collective liability is achieved in four ways:

- All employers share in the Schedule 1 average rate change each year by means of restating the employer's prior year premium rate before applying this year's employer centric rate setting;

- Since the employer centric rates will be balanced to the Schedule 1 level, the Schedule 1 required premium is achieved each year;

- The small initial step and subsequent progressive steps for sustained changed claims experience protects the employer from random fluctuations; and

- The risk category boundary limits (the employer's risk category is determined by their dominant classification unit, when the classification units are assigned to a risk category) ensure that each employer will still be partially collectively liable for their industry.

2. **Fairness:** The premiums paid by the current employers **will** be well aligned to the costs currently generated by these employers. Since the 12 month slice of current claims payment experience for each employer will be measured directly against the same 12 month slice of Schedule 1 claim payment experience, employers will have a direct line of sight to what they are costing the system and how it relates to their current and next year's premium rate.

3. **Predictability of premiums:** The annual premiums for each employer **will** be predictable and stable. An employer's premiums **will** only significantly move as a result of a sustained change in that employer's claims experience, rather than a short term change. The small initial step and subsequent progressive steps, up or down, for sustained claims experience are designed to smooth violent fluctuations in the premium rate, provide predictability and to incent real, long term changes in cost behaviour by employers.

4. **Transparent and understandable:** The employer **will** see and **will** understand how their premium has been set and **will** see how and why their premium moves with their own experience, since their current claims experience will be measured directly compared to Schedule 1.

5. **Financial security:** Injured workers and their beneficiaries **will** be reasonably assured that their benefits will be paid as promised, because both new and old claims are 100% funded in the Schedule 1 premium rate, which will be achieved each year because of the balancing factor.

6. **Promote positive behaviour:** The pricing system **will** encourage employers to prevent injuries, improve health and safety in their workplace, return injured workers to sustained employment and **will** discourage negative behaviours such as "rate shopping", misallocation of claims, "claims suppression" and "non productive return to work". The small initial step and the subsequent progressive steps, up or down for sustained claims experience are designed to smooth violent fluctuations in the premium rate, provide predictability and to incent real, long term changes in cost behaviour by employers.

7. **Ease of administration:** The new pricing system **will** be easy and **will** be simple for the employer to meet their obligations to report and pay their premium, because the employer will have one classification and one rate. The WSIB **will** be able to administer the pricing system efficiently and effectively (since ultimately employers pay the cost of administration), since there is only one classification and one rate for each of the 240,000 employers.

The new pricing system also has flexibility. The WSIB can consult with employers on what payments should be included in the comparison with Schedule 1 and adjust the plan according to what is agreed upon with no major transition issues. For example, the WSIB can consult with employers on what occupational diseases are included in both the employer's records and the Schedule 1 records for determining each employer's required rate. Occupational diseases such as noise induced hearing loss would be included if the WSIB and employers agreed that a portion (or all) of them are preventable. To continue to exclude preventable diseases from the claims costs for the comparison to Schedule 1 runs the moral hazard of incenting employers not to take steps to prevent them.

Need for a simplified classification system.

The importance of a classification system is deemphasized under the new system, but a classification system is still necessary. Classification units still need to be assigned to risk categories and the WSIB still needs premium rates for the 20,000+ new employers each year, until they have sufficient claims experience to fully enter the new employer pricing system. Comparisons with peers are still needed. They enable employers to know if they have a competitive advantage. They enable targeting of prevention and return to work initiatives by enabling an initial identification of much better and much worse than normal performance.

The classification and pricing system can be greatly simplified from what it is today with the use of current technology. Computer tools can be developed to simplify classification of employers and set rates for new employers.

Transition to the new system

The transition from the current WSIB pricing system to the new system can be accomplished with relative ease (compared to the 1993 upheaval). Our investigation shows that the WSIB has the capability to bring together all of an employer's WSIB firm numbers and classification units and the capability of calculating a current weighted average rate for each employer. The WSIB also has all of the data to set employer centric rates.

Once the detailed conceptual design of the new system has been completed and prototyped for proof of concept and tuning, (see section VI – Next Steps) the WSIB has several options for moving to the new system. It could move one class or sector in a pilot program or move all sectors and classes at once. An appropriate first step would be to calculate 2012 required rates for each employer using a 12 month slice of recent payment data. Each employer could then compare their 2012 required rate with their

current weighted average rate. In other words each employer could compare what they are currently costing the system with what they are currently paying. It may even be appropriate to produce required rates for 3 years.

There are some choices as to how to transition from the existing level of experience rating to the new level, but these can be worked out during consultations.

New pricing system is well suited to a rapidly changing world

The new employer centric pricing system is well suited to a rapidly changing world in which business processes and skills and training of workers change quickly and not at the same pace for all employers. The WSIB no longer needs to attempt to determine the employer risk in initially classifying the employer. Employers receive one classification and one rate when they initially register with the WSIB. Once they have at least one calendar year of claims experience, the employer centric rating system will calculate their required rate based upon that experience.

It will not matter what the mix of workers is in the makeup of that employer. The employer centric rate will be set based upon the combined risk of all of the employer's workers. As the mix of workers changes the changing risk will reveal itself in the employer's required rate.

Similarly, within an employer, senior management changes, and with those changes can come a change in attitudes towards injury prevention and safe and sustained return to work for injured workers. When attitudes change they will be reflected in the claims experience of the employer and in the calculation of the employer's required rate. The progressive steps in the movement towards the new required rate means that the employer will move slowly at first, and then in increasingly larger steps as the new level of claims experience is sustained. The employer should be incented to positive behaviour by the progressive steps, particularly if the WSIB rate letter points out the eventual impact (several years down the road) of a sustained new level of WSIB claims experience. The eventual impact of course is that the employer's premium rate will continue to move in increasing steps towards the new required rate.

It would be unfair to that employer's workers as well as unfair to all the other employers in Schedule 1 to not have an employer with sustained changed experience move towards the new level of experience.

The new pricing system achieves all of the basic principles

The new pricing system provides each employer with a direct line of sight between what their claims experience is costing and what they are paying.

The new pricing system is fair to both workers and employers. It deemphasizes classification. It maintains collective liability. The new pricing system provides predictable rates for employers and protects them from random fluctuations in their claims experience without incenting employers to bad behaviours, especially towards workers. The new pricing system is also easier to administer.

It is time to move forward.

Table of Contents

Table of Contents

Table of Contents

II. Needs of a WSIB Pricing System

A WSIB pricing system must meet the needs of workers, employers and those of the WSIB. A serious look at a WSIB pricing system should start at the basic needs of the participants. Before doing so, it is helpful to review the concepts of workers compensation in Ontario.

A. Basic Concepts of Workers Compensation

The basic concepts of workers compensation are:

- Workers are provided with coverage for loss of earnings and health care costs resulting from occupational injuries through a government run insurance program;
- Employers pay for the cost of the insurance in return for workers giving up their right of legal action in the event of occupational injury;
- The cost of the insurance is allocated to employers based upon a measure of relative risk; and
- The WSIB adjudicates the claims and administers the system in a fair and impartial manner.

Under the WSIB system, the workers, employers and the WSIB itself have basic needs that must be met in the principles of the WSIB pricing system.

B. Basic Needs

The following are the basic needs of a WSIB pricing system.

1. Both workers and employers need employers to pay the incurred costs[1] of injuries in the year in which they occur:
    a. Employers need to pay the total incurred costs of all injuries in the year of injury to ensure that:
        i. Employers focus on prevention of current injuries and the current health and safety of workers;
        ii. Employers focus on early sustained safe return to work; and
        iii. Future employers are not unfairly burdened with current year costs of current employers.
    b. Workers need to have employers pay the incurred costs in the year of injury to ensure that:

[1] The incurred costs includes costs paid out in the year of injury with sufficient funds set aside to provide for all future costs arising out of the year's new workplace injuries, illnesses and diseases.

i. Employers focus on current health and safety of workers and early sustained safe return to work;

ii. There are sufficient funds to cover the costs of the past injuries. **Without sufficient funds, future premium rates must increase when the covered workforce contracts.**

2. Employers need to pay a premium related to relative risk to the system to:
    a. Accept WSIB pricing as fair;
    b. Incent positive long term health and safety behaviour and early sustained safe return to work for injured workers;
    c. To prevent the moral hazard of employers shifting sustained poor cost behaviour to others, especially to injured workers, without consequences.
3. Employers need WSIB premiums that:
    a. Are predictable;
    b. Related to their recent claims experience;
    c. Prevent random fluctuations in recent claims costs from unduly impacting their premiums.
4. Workers need a WSIB pricing system to:
    a. Avoid incenting employers to damaging behaviour such as hiding injuries or not supporting appropriate care and return to work efforts.
5. The WSIB needs a pricing system which:
    a. Collects sufficient funds to meet their funding strategy and their total revenue requirements for each year;
    b. Is transparent and shows all costs being charged;
    c. Is simple enough to be understandable;
    d. Is simple enough to be efficiently administered;
    e. Charges premiums based upon relative risk to incent employers to health and safety and early sustained safe return to work;
    f. Prevents employers from shifting sustained poor costs to others;

g. Is responsive to changes in relative risk as a result of new work processes, etc.

h. Corrects for the inequities of the employer classification and rate group components of the pricing system;

i. Incents employers to positive long term health and safety and return to work behaviours; and

j. Does not incent employers to damaging short term behaviour.

III. Best Practices

The best practices for a WSIB pricing system outlined below are based in part on our recent review of practices in several provinces, and on our in-depth experience with workplace insurance pricing systems over the last 35 years.

The best practices are:

1. A classification system that is centralized and kept current, with a simple "rules based process" for permitting multiple classifications (e.g. include B.C.'s "best practice" of separate classification unit only if 25% of employer's total earnings and income comes from a separate classification), and a process to ensure correct classification of claims for employers with multiple classifications.

2. Groups classification units that do not meet the "Partially credible" criteria into industry groups by using similarity of "business activities".

3. A rate group system that is dynamic, uses claim payment statistics for partially credible classification units/industry groups to initially group and regroup classification units when experience changes (e.g. use B.C.'s "best practice" of moving a classification unit after 3 years of sustained claim payment statistics 20% different than its rate group).

4. A rate setting system that first determines a Schedule 1 required premium based upon sound 100% funding of new claims as well as past deficits, transparently tracks the projected costs (e.g. B.C and Quebec), and then uses prudent methods to allocate that premium to employers in order to ensure that the Schedule 1 required premium income is attained.

5. An employer premium rate setting system that holds an employer accountable for their combined claims experience across all their business activities. An employer's claims experience is pooled within the employer when determining the employer's total premium. This is consistent with Canadian health and dental coverages where a single percentage change in premium rate is applied to all groups within the employer.

6. An employer premium rate setting system that is based upon the employer's own claims experience, provides predictable premium rates, protects the employer from random fluctuations in claims experience and recognizes sustained changes in claims experience (e.g. Manitoba's best practice[2]).

7. An employer premium rate notification system that is specific to the employer and provides the employer with both the employer's rate for next year and an indication of where the employer's premium rate will move in the future if the employer's current claims experience continues (e.g.

[2] Manitoba sets next year's employer premium rate using this year's employer premium rate, current claims experience and change limits based upon a measure of sustainability.

III – Best Practices

Manitoba's best practice of individual employer rate letters that indicate where the employer's rate will move towards in the future if current claims experience continues).

Combining all of these "best practices" could produce a fair, transparent, and easy to administer system that would give employer's responsive, predictable rates that would be seen to be fair by employers and that they could understand. Labour and injured workers would see the system as fairer, while continuing to need the WSIB to proactively discourage employers who engage in inappropriate behaviours.

There would also be an opportunity to communicate to each employer where there premium rate will go if they maintain their current experience.

IV. Basic Concepts of Effective WSIB Pricing Systems

Appendix B contains a detailed review of the strengths and weaknesses of the current system from the point of view of Fairness, Collective Liability, Predictability, Transparency and Ease of Understanding, and Ease of Administration. In this section we discuss the basic concepts of an effective pricing system and outline where the current pricing system needs improvement.

A. Employers must collectively pay the total WSIB costs, as close as possible to when these costs are incurred

A concept of the WSIB pricing system is that employers must pay the collective costs of the system. In order to do this the WSIB must determine:

- The total Schedule 1 incurred cost of new claims each year;
- The cost of all WSIB administration and overheads plus the net cost of items such as experience rating, safety group program rebates and bad debts; and
- The cost of amortizing any past surpluses or deficits, according to its funding policy.

This total cost must then be allocated to employers.

It is imperative for the WSIB to estimate the incurred cost of Schedule 1 new claims as accurately as possible, so current employers pay for the current costs of injuries. If current employers do not pay for the costs of current injuries, benefits promised to injured workers are at risk. If current employers must pay some portion of prior injuries, the promised benefits will be challenged when they become too much of a burden on current employers.

All systems which shift current costs to the future are a form of pay-as-you-go financing and all pay-as-you-go financing systems come under extreme pressure when the covered group paying the premiums stops expanding. This is particularly true of the Ontario WSIB Schedule 1 system which lists industries that are included in Schedule 1, rather than list industries which are not included. Ontario Schedule 1 does not automatically include new industries and has seen slower growth in covered workforces than the growth in Ontario's overall workforce. For example, the significant move to contract employment and outsourcing has changed the very nature of most industries in Ontario and added to the difficulty in the WSIB's ability to appropriately charge premiums for past claims.

Ideally, the WSIB would have no past deficits or surpluses and Schedule 1 employers would only be charged the incurred costs of new injuries plus administrative costs and overheads. To the extent that there is a past unfunded liability or deficit, these need to be recovered over a reasonable period of time so as to not unfairly burden either current or future employers.

In a system that charges the entire cost to employers, the goal of the funding program must be to be fully funded at all times and to charge the incurred costs of new claims plus overheads to current employers.

B. WSIB pricing must vary by insurance risk

From the beginning of workers compensation in Ontario, it was recognized that it was necessary for fairness to employers to vary premiums by risk. Risk varies by factors such as processes, training and attitudes.

Risk can be measured by outcomes such as claim costs per dollar of insurable earnings. This in turn requires claims costs and insurable earnings to be summarized by appropriate groupings such as workplace, employer, industry (CU), rate group, sub class and class. Claim costs could be limited so as to exclude newer occupational diseases. They could exclude payments on older claims. They could replace actual payments for fatalities with average payments. These would be important choices that would enable pooling while retaining the key concept of premium rates responding to each employer's current experience.

Armed with accurate coding for insurable earnings and claims, measurement of risk can be established by any combination of employer, industry, rate group, sub class and class. Each measurement is normally for a block of claims (usually new claims per calendar year). The measurement can use payments between two dates, lifetime to date payments or fully reserved costs (lifetime to date payments plus an estimate of future costs).

In Ontario CUs are grouped into rate groups and rate groups into classes. Class risk measurements, using fully reserved costs, are used to set per class average new claim costs. Rate group risk measurements, using lifetime to date payments on the last 6 years of claims are used to set relative to class average new claim costs.

However as risk depends upon processes, training and attitudes, the linkage between an employer's risk and its rate group's risk is based upon presumed commonality of training and presumed commonality of attitudes. With ever accelerating changes and choices for processes the linkage is also increasingly dependent upon presumed commonality of processes rather than actual commonality of processes.

Thus more than ever before, varying WSIB premiums for insurance risk requires recognition of each employer's recent measurements of their own insurance risk.

C. WSIB must classify employers, insurable earnings and claims

Even though commonality of insurance risk by business activity is lower than it used to be, there is still a need for business activity classification for reasons such as:

- Setting premium rates for new employers;
- Measuring performance of industries and groups of industries;

- Collecting data and statistics to measure, target and manage health, safety and return to work initiatives; and
- Supporting insurance pooling of random high cost events at various levels such as rate group, class or risk category.

It is essential to collect occupational injury data by business activity of the employer in order to measure, target, and manage health, safety and return to work initiatives to the employers who engage in the business activities where the injuries are occurring. Targeted initiatives are the best use limited resources.

The classification system needs to be simple, easy to understand, accurate and cost effective. The business activity descriptions would be structured to permit computer tools to aid in the classification process and to enable quick and easy updates as the business activity evolves over time. There would need to be a process for periodic review and update of all classification unit descriptions, so that they evolved along with the changing nature of industries. The periodic process would also remove business activities that no longer existed (e.g. uranium mining) and add new business activities that developed (e.g. cell phone companies). The classification system would also need a process to periodically review each employer's classification.

Ideally, employers would be assigned to only one classification unit, and that should be their dominant classification. All other business activities of the employer should be considered ancillary.

And finally, if classification units (CU) are grouped into rate groups and/or risk categories based upon their risk performance measurements, the WSIB must maintain an annual regrouping process to move those CU or rate groups whose performance measurements show a significant and sustained change in risk.

D. Hold Employers Accountable for Their Combined Business Activities

An employer can be held accountable for their total WSIB claims experience. The employer, not the Classification Unit can represent the first level of collective responsibility. Employers with multiple classifications of their business activities can be held accountable for their combined business activities. An employer's attitude toward prevention and return to work and the training of their workers can and should be a dominant factor in each employer's WSIB insurance risk and in many cases more dominant than the impact of their business activities. The underlying belief is that most WSIB injuries are preventable; an employer can take positive action to prevent them and take positive steps to reduce their consequences.

Differing employer attitudes and worker training is why WSIB claims experience must first be pooled at the employer level.

Some employers have asked for occupational classification, in an attempt to lower their premiums. However occupational classification greatly increases administration due to the increased need to audit the separation of an employer's insured earnings and coding of its new claims.

Occupational classification is also unnecessary if claims pooling is per employer, as long as there is appropriate insurance protection against unpredictable, infrequent large costs. In addition to fairness and simplicity, per employer pooling, with appropriate protection against unpredictable, infrequent large costs, can be understandable and efficiently administered.

E. Set WSIB Premiums by Employer

The current WSIB pricing system sets rates at the Schedule 1 level, then at the Class level, and then at the Rate Group Level. On top of that the WSIB applies experience rating to the majority of firms using 1 of 3 experience rating plans.

It is safe to say that most employers do not see the relationship between what they are costing the WSIB system and what they are paying. For example the factors that go into Schedule 1, Class, Rate Group, and experience rating rate setting each cover different periods of time making determination and comparison of "what you cost" and "what you paid" far more complex than it needs to be. There is a simpler way.

Employers are frustrated because their premiums don't reflect the changing nature of their business and their own changing WSIB claims experience. Employers have been told by the WSIB that if they improve their prevention of WSIB injuries and their consequences, their premiums will move down. However setting premiums by Class and then by Rate Group can move their premiums up while their own claims experience moves down.

In fact there are cases where the maximum 20% increase in 2011 premium rates applied to employers with significant improvements in prevention and return to work due to significant efforts to further improve the effectiveness of their prevention and return to work programs. Others continued to have zero costs but still faced a 20% increase in their 2011 premium rate before and after experience rating.

When this occurs, employers will challenge all aspects of the pricing system because they do not trust that their WSIB premiums are being set fairly.

The solution to remove the employer frustration and begin to build trust in the WSIB pricing system is to set premium rates for each employer, based upon their recent experience.

F. Address the Causes of Employer's Bad Behaviour

The current WSIB experience rating plans are causing bad behaviour in some employers, and some of this is adversely affecting injured workers.

Under all 3 of the current WSIB experience rating programs, an employer can go from the lowest to highest premium based upon one bad year of claims, which is incenting some employers to bad behaviour. Bad behaviour can include underreporting of insurable earnings, hiding WSIB claims in different classification units (with lower rates), pressuring injured workers to not file a claim, and paying injured workers directly for non productive "modified work" just to reduce WSIB claim costs.

Even under the small experience rating plan, moving from the lowest to highest premium can mean a 67% jump in premiums in one year. Under the large experience rating plans, large employers have the potential to move from the lowest to highest premium rate in one year, which would result in a 200% to 300% increase in WSIB premiums. When you consider that the construction industry experience rating program can treat an employer with 25 employees as a large employer, the volatility in employer premium rates is responsible for incenting some employers to bad behaviour.

The current volatility in employer premium rates should not be allowed to occur. Employers require premium rates that they can reasonably predict and a WSIB pricing system that protects them from random fluctuations in their claims experience.

WSIB premium rates for employers should only be permitted to move from the lowest rate to the highest rate based upon much worse than average claims experience which is sustained over a period of at least 5 years. WSIB premium rates for employers should also only be permitted to drop from the highest to the lowest rate over a period of more than 5 years.

There will always be some employers who engage in bad behaviours, but all experience rating should not be discredited because of the outliers. In general, the positive impacts of insurance risk based premiums to reduce workplace risk due to appropriate behaviours outweighs the impact of bad behaviours, especially if bad behaviours are subjected to significant consequences.

G. Employer Premium Rates Must Recognize Sustained Experience

WSIB pricing can and should recognize that employers with sustained lower or higher WSIB claims experience as these employers have an increasingly predictable insurance risk.

Had the WSIB not adopted new experience rating plans in the 1980s and 1990s, it is unlikely that the WSIB new lost time injuries would have dropped by over two thirds in the last 23 years. Experience Rating is responsible for a portion of this improvement. Nevertheless the volatility in experience rating premium adjustments has incented some bad employer behaviour. Recognizing this, the WSIB pricing system needs to move to eliminate volatility in premiums and replace it with pricing that recognizes sustained performance.

The current WSIB retrospective experience rating plans do not recognize sustained performance. Employers with sustained excellent experience paying close to the lowest experience rated premium in their rate group still must pay the higher rate group rate during the year, and then receive their experience rating refund next year. Similarly, employers with sustained poor experience paying close to the highest experience rated premium in their rate group must only pay the lower rate group rate during the year, and then receive their experience rating surcharge next year.

When the rate group's average premium rate moves up because the poor performers in the rate group are getting worse, the employer with sustained excellent experience gets the same rate increase as the employer with sustained poor experience. This causes employers to lose trust in the WSIB pricing system. The ideal pricing system will recognize employers with sustained high or low WSIB claims experience up front in the pricing.

V. Overview of a New WSIB Pricing System

The volatility in employer premiums that incents employer bad behaviours must be removed to ensure that proper premiums are collected and injured workers are not treated adversely. Employer fairness and perceived fairness will be enhanced by a simplified employer centric rating system that starts and ends with each employer's own experience. This replaces a system than starts with the experience of the employer's rate group and then modifies it with their own experience.

A new WSIB pricing system must meet the concepts outlined in the previous section.

A new way of pricing WSIB premiums in Ontario has the following features:

1. Once the Schedule 1 required premium revenue and premium rate is established for next year, the Schedule 1 premium revenue is allocated to employers based upon their recent claims experience.

   Setting an employer's premium rate relative to Schedule 1 will tremendously increase transparency, understanding and fairness in premium rates. Employers are collectively liable for the total Schedule 1 required premium revenue and will understand how their portion of that Schedule 1 premium was determined.

2. Each employer's claims experience is pooled across all of its business units which may span distinct classifications, so that they are held accountable for their combined activities.

   This will minimize the impact of misclassification of insurable earnings and claims and therefore increase fairness. It will not matter if an employer has multiple classifications or not because their premium rate, except for new employers, will be the same.

3. Next year's premium rate is based upon their current premium rate, their current claims experience and the number of years their premium rate has been moving in the same direction.

   Moving an employer's premium rate from where they are (what they are paying) to where they need to be (what they are costing) is understandable, eminently fair and promotes predictability. Moving an employer's premium rate in bigger steps towards what they are costing for sustained better or worse than average experience is fair to both the employer and all other employers in Schedule 1. Random fluctuations in an employer's claims experience do not incent the employer to bad behaviour because the rate changes are predictable and not volatile. This is fair to both employers and employees.

4. Each employer is told what their current claims experience has cost and each employer takes a limited step toward their current cost experience, every year.

   It is imperative that employers be told their required premium rate as well as their actual limited premium rate for next year. There must be a personalized rate letter sent each year to

the employer stating what their current claims experience means in terms of a required rate. The required rate is what they are currently costing the system and their rate will continue to move towards that rate in subsequent years if their WSIB claims experience remains at the current level. By giving employers this information in advance each year, the WSIB will provide each employer with a predictable rate and forewarn them of ever increasing steps toward their required rate in future years.

Pre-established rate change limits will increase predictability and remove the volatility that is causing bad behaviour in some employers.

5. The WSIB must still have a classification system and a rate grouping system under the new pricing system, in order to set premium rates for new employers. Existing partially credible classification units and credible rate groups must be assigned to Risk Categories established relative to the Schedule 1 rate. Each Risk Category will have minimum and maximum boundary limits for premium rates, to ensure that all employers in that Risk Category share collectively in the Schedule 1 average rate and are protected from high costs of random events.

There are also features to accommodate changes in the Schedule 1 average premium rate and to ensure the required Schedule 1 average premium rate is maintained.

More detail on the new pricing system is given in Appendix E.

VI. Next Steps

This report includes a high level conceptual design of a new pricing system for the WSIB. The concepts need to be discussed and explored by the WSIB, its actuaries, and its actuarial advisors. When the WSIB is ready to proceed, the next steps for the WSIB to move towards a new pricing model are as follows:

1. Prepare a proof of concept detailed design of the new pricing system which includes:
    - Outline
        - The future classification, CU grouping and experience rating programs in sufficient detail to enable initial planning;
        - The current classification, CU grouping, rate setting and experience rating programs in sufficient detail to enable initial planning;
        - The transition from the current classification, CU grouping, rate setting and experience rating programs;
        - The feasibility of starting with the:
            - Overhaul of the current grouping of CUs;
            - Implementation of employer centric rating; and
            - Development of the new classification scopes without implementation
        - The testing required to support refinements and consultations;
        - Scheduled key milestones.
    - Define data inputs and timing;
    - Define methodologies, for example, level of collective liability/insurance/pooling of various claims (occupational diseases, fatalities, etc.) versus employer accountability for claim costs;
    - Detailed formulae for the new model with a focus on parameters to enable refinements and “what if” testing;
    - Initial design of reports necessary for annual administration of the CU grouping and employer centric rating;
    - Initial design of the annual employer rate letters together with employer level support materials to support detailed employer enquiries;

VI – Next Steps

- Initial design of a detailed calculation tool to enable manual spot testing of the annual production run and manual recalculations of individual employer's premium rate
- Defining the information necessary to be included in the annual Employer letters with their premium rates
- Initial plans for transitioning each component of the pricing system.

2. The WSIB Actuarial Services develops a PC based prototype of the model that enables back testing, what-if scenarios and a detailed calculation tool.

3. The WSIB starts to design, build and test the production components of the new pricing system recognizing that most refinements can be accommodated by building a system that is driven by tables of parameters set by the users.

4. The WSIB consults on the new pricing model and transition plans and makes refinements where required.

5. The WSIB Implements the new model with each firm stepping from their current rate(s) with or without some recognition of recent experience rating adjustments.

VII. Appendix A – The Current WSIB Pricing System Components

The components of the current pricing system are classification of employers' business activities, grouping classifications into rate groups, setting rates for Schedule 1 and each of the rate groups, and experience rating individual employers. This section summarizes the existing components of the current pricing system.

A. Classification

The WSIB classifies employers into one or more of 800+ business activity classification units (CU) for the primary purpose of charging WSIB premiums which are based upon insurable earnings and premium rates which vary by rate group. As the premium rates are based, in part, upon the past experience of each rate group this not only requires reporting of insurable earnings by CU but also the classification of new claims by CU. A secondary purpose of gathering insurable earnings by CU and classifying new claims by CU is to compile injury statistics by business activity, which is useful in targeting health and safety initiatives.

The current classification system was established in 1993 based upon the 1980 Standard Industrial Classification (SIC) system. Existing employers were reclassified into one or more new classification units. Since 1993 these initial classification units have been updated on an ad hoc basis, when concerns have been raised by industry. For example in the early 2000's the auto parts industry requested a review of their classification, which resulted in the rewriting of the scopes. It is important to note that the driver for the auto parts classification review request was that the industry thought they were paying too much and wanted a lower premium rate. There is, however, no established process to periodically review and update the classification unit descriptions or "scopes".

In 2011, new employers are classified into one or more classification units at the time of registration by one of the approximately 175 Account Specialists responsible for registering, classifying and managing the employer accounts. The WSIB has about 240,000 active employer accounts with 25,000 to 30,000 new employers registering each year and a similar number going out of business each year.

The classification system of the Ontario WSIB is established by a regulation – currently Ontario Regulation 175/98 - of the Workplace Safety and Insurance (WSI) Act, 1997 (the ACT) which lists the business activities that are covered under the ACT via "products" and "services". The regulation is inclusive in that there are business activities listed under Schedule 1, business activities listed under Schedule 2 and excluded business activities listed under Section 3. As a result there are business activities that are not listed which gives rise to optional coverage for some employers and administrative overheads regarding who has and who does not have compulsory coverage. Another area of voluntary coverage arises for an employer's executives, the self employed, owner operators etc. There is also an option where employers engaged in Schedule 2 business activities may apply to be in WSIB Schedule 1 for all or part of their business activities. Employers engaged in Schedule 1 business activities are liable to contribute to the insurance fund whereas employers engaged in Schedule 2 business activities are individually liable to pay benefits under the insurance plan.

VII – Appendix A – The Current WSIB Pricing System Components

Within Regulation 175/98 Schedule 1, business activities are listed under 9 Classes and the regulation includes complex provisions for restricting the allocation of an employer's business activities to more than one CU and a provision outlining the requirement for permitting a segregated business activity with its own separate premium.

The WSIB attempts to classify an employer into one business activity, but permits multiple business activities if the employer's wage records are "**properly segregated**" into multiple business activities which are not considered "**ancillary**" to one of the employer's business activities.

The processes for determining whether an employer's business activities are "**properly segregated**" and/or "**ancillary**" are many, complex, and make up a significant portion of the training for a new Account Specialist. The WSIB currently permits **8.5%** of employers in Schedule 1 (about 20,000 of the approximately 240,000 employers) to classify their payroll into 2 or more classification units, which in most cases, means they pay WSIB premium rates in 2 or more Rate Groups with different premium rates. The 8.5% of employers in multiple classification units account for a full one third (33.7%) or $1.131 billion of the $3.360 billion 2010 Schedule 1 premiums.

Employers with multiple classifications result in increased administration for the WSIB. Since premium rates are almost always different for each classification, the WSIB has a need and a responsibility to ensure (i.e. audit) the classification of both payrolls and claims into the correct classification unit.

Currently the WSIB reviews the segregation of employer payrolls into business activities at registration. We understand, from the May 11th, 2010 Employer Classification Process Internal Audit Report, that there was no formal process to review and approve new account registrations and classifications. The WSIB audits the ongoing segregation of payrolls on an ad hoc basis, when potential problems are identified or an employer requests a new or additional business activity classification, or anytime they do a payroll audit. There are about 3,500 reclassification decisions per year. We understand that following the 2010 audit, management implemented a process of manager approval of all reclassifications and registrations that were considered high risk.

Currently, the claims classification receives little attention. The claims eligibility and registration area is responsible for seeing that each new claim has a classification unit and rate group assigned to it. If the form 7 - Employer's Report of Injury - has a rate group and classification unit entered on the form, we understand they are not checked or verified. If the classification unit and rate group is missing the claims eligibility and registration area checks for an "**active**" classification unit and rate group and assigns the classification unit and rate group. If there is more than one classification unit for the employer (as there would be for an estimated one third of the new claims), we understand that the claims eligibility and registration area assigns the classification unit and rate group based upon the information available on the form 7 (occupation, etc.). The claims eligibility and registration persons that are assigning the classification unit for firms with multiple classifications have had no formal training on the WSIB classification system.

B. Rate Groups

When the WSIB established a new classification system in 1993, employer's payrolls and claims for past years were assigned to the new "business activity" classification units based upon their allocation in the prior rate groups. The classification units were grouped together by "similarity of business activity" to form rate groups that were large enough to be considered by the WSIB to be "statistically credible" using the WSIB's then current measure of statistical credibility. A WSIB statistically credible rate group in 1993 was one which had 550 lost time injuries over the last 5 years, and at least 110 lost time injuries in each of the last 2 years.

Most of the classification units had some statistical credibility, which permitted the use of calculated statistics measuring relative risk at the classification unit level to group the classifications units into rate groups based upon similarity of statistics. It is our understanding that "similarity of business activity", and "calculated statistics" measuring risk, were both used to group the classification units into statistically credible rate groups.

As lost time injury rates continued to decline from their 1988 peak, employers challenged the WSIB's measure of full credibility. The WSIB was asking employers to take actions to reduce their injury rates and thereby lower their WSIB premium rates, but as employers lowered their premium rates they were being told that their rate group was becoming non credible. As a result the WSIB introduced a new measure of full credibility based upon size of insurable earnings as well as number of lost time injuries. In 2011 the WSIB's measure of a fully credible rate group is one with:

- $900 million of insurable earnings over the last 5 years ($180 million per year);

  OR

- 400 lost time injuries over the last 5 years (80 per year).

$900 million of insurable earnings over 5 years is approximately equal to about 5,000 full time employees or equivalents. Thus in theory with $150 billion of Schedule 1 insurable earnings and 50,000 Schedule 1 lost time injuries there could be a little under 1,000 separate rate groups and one might expect more than the current 154 rate groups.

In 1993 the WSIB established 219 rate groups. Employer's current and past claims and payroll were assigned to these 219 rate groups and used to determine the new rates for these 219 rate groups. As many employers were moving from prior rate groups with much higher or lower rates, the WSIB established methods to transition employers from the old to the new rates over several years. The transition, initiated in 1993 took 5 years. The 1998 rate year was the first year since 1992, that all employers in each rate group were paying the same rate, in all rate groups.

After a few years of operating the new rate groups the WSIB observed that some of the rate groups were falling below their then current level of "statistical credibility" and they began to set the rates manually for these below full credibility rate groups, to avoid anomalies in the rates. A few rate groups

were closed and by 2000 there were 213 rate groups, 45 of which were deemed to be less than fully credible.

There were 65 of the 213 rate groups in 2000 that had their rates set manually. About half of the 65 had their rates set by combining their data with other rates groups by "similarity of business activity" and the other half had their rates set by blending their estimated 2000 rate calculated on a non credible rate group with their 1999 rate group rate.

In 2001, 42 rate groups were closed, reducing the number of rate groups from 213 to 171. Most of the rate groups were collapsed into other rate groups by considering "similarly of business activity", but a few rate groups were split up with their classification units going to different rate groups. It is our understanding that the decision to move the classification units of one rate group to 2 or more different rate groups was primarily based upon "similarity of business activity" rather than the partially credible "calculated statistics" of the classification units.

Since 2001, as further rate groups became less than "fully credible", the WSIB has further reduced the number of rate groups to where in 2011 there are 154 rate groups.

C. Premium Setting

When the WSIB established a new classification system in 1993 it also established a new system of calculating premium rates.

The first step in setting WSIB premium rates is to calculate a Schedule 1 average premium rate which is based upon the WSIB's required Schedule 1 revenue for the rate year. This is followed by the calculation of average costs per claim and premium rates for each Class. The premium rates for each rate group are then calculated and in part use a rate group cost index which compares the past claims cost experience of the rate group with that of its Class.

Schedule 1 Premium Rate

The Schedule 1 premium rate has 3 components:

- New Claims Costs;
- Overheads (WSIB admin costs and legislative obligations); and
- Past Claims Costs (unfunded liability, recent gains and losses, and bad debts).

The methodology used for the Schedule 1 average rate begins with the calculation of the new claim costs for the prior year. The new claims costs for the prior year claims is made up of the payments on new claims in the prior year plus their yearend liability as determined as part of the overall year end liability calculations. . This is then divided by the number of new claims for the prior year to determine the average costs per claim for the prior year. This Schedule 1 average cost per claim for the prior year

is then projected 2 years to the next year to produce an average cost per claim for next year. In 2011 the average cost per claim was changed from an average cost per allowed lost time claim to an average cost per allowed claim (lost time plus no lost time).

The Schedule 1 injury frequency is calculated for the prior year and then projected for the next 2 years using the corporate goal assumptions for reduction in injury frequency over the current and next year.

The Schedule 1 actual insurable earnings for the prior year are projected 2 years to the next year using per class growth in earnings and growth in employment assumptions based upon information obtained from Infometrica[3] and modified with input from other sources.

The projected number of new claims for next year is calculated by multiplying the projected Schedule 1 employment (derived from projected Schedule 1 insurable earnings) for next year by the projected Schedule 1 injury frequency for next year. The projected Schedule 1 new claim costs for next year is calculated by multiplying next year's projected number of new Schedule 1 claims for next year by the projected average cost of new Schedule 1 claims. The Schedule 1 new claims cost (NCC) component of the Schedule 1 premium rate is then calculated by dividing the projected Schedule 1 new claim costs by the projected Schedule 1 insurable earnings.

The next step is to calculate the components to cover the Overheads. The WSIB Overhead expenses for next year include the projected costs of

- Administering Schedule 1 of the WSIB;
- Administering the Occupational Health and Safety Act (OH&SA) by the Ministry of Labour (MoL);
- Administering the Health and Safety Associations (HSA) ; and
- Other legislative obligations including the offices of the worker and employer advisors, the Workplace Safety and Insurance Appeals Tribunal (WSIAT) and research primarily through the Institute of Work and Health.

Each of the components for Overheads is set using their projected Schedule 1 expense and dividing by the projected Schedule 1 insurable earnings.

The next step is to determine the WSIB Schedule 1 Past Claims Costs rate. Past Claims Costs include:

- Unfunded liability, including the interest on the unfunded liability;
- Gains and losses, based upon the previous six years of rate setting experience by rate group; and

[3] Infometrica is a privately owned Canadian company specialized in quantitative economic research.

- Bad debt expense component based upon the expected bad debts provision allocated by industry class.

In recent years the WSIB Schedule 1 Past Claims Costs rate has been the balancing item. In recent years, political considerations have influenced the setting of the Schedule 1 average premium rate.

Premium Rates by Class

Premium rates are calculated for each class using similar methodology as for the Schedule 1 average premium rate. The prior year's new claim costs are determined for each class using the year end liabilities. For loss of earnings, survivor benefits and non economic loss periodic payment claims, the year end methodology is a seriatim method and the sum of the liability for these claims by class will equal the sum of the liability of these claims at the Schedule 1 level. For future award liabilities on existing claims, the liabilities are determined using a cost per claim analysis over the last six years and projection for the future. The sum of the future award liabilities at the class level is usually close to the Schedule 1 level, so no balancing adjustment is usually made. Projected insurable earnings, employment, injury frequencies and average costs per claim for each Class are set using the Schedule 1 methodologies.

Premium Rates by Rate Group

The first step in setting premium rates per rate group is to set the new claims component using a relative to the Class cost index. The cost index starts with the sum of per injury year ratios of a rate group's claim payments divided by insurable earnings. Prior to 2011 five(5) injury years were used (e.g. for 2010 premium rates 2004 to 2008 injury years were used where for example the sum of 2004 to 2008 payments on 2004 injuries were divided by 2004 insurable earnings). Starting with 2011 six (6) injury years (2004 to 2009) are used with up to six years of payments. The claim payments can be considered as a triangle as, for example, 2004 injuries have six years of payments, 2004 through 2009, whereas 2009 injuries only have 2009 payments.

The second step is to calculate the cost index by dividing the sum of rate group's claim payment / insurable earnings ratios with the sum of the ratios for its Class.

Schedule 1 Overheads are allocated to the rate groups based upon both insurable earnings and new claims costs with refinements to reflect the rate group's Safe Workplace Association coverage.

The Schedule 1 unfunded liability is allocated based upon the rate group's new claims costs.

Six year gains and losses and bad debts are determined by class and then allocated to the rate group based upon the new claims costs.

The components of the rate are then totalled. The rate is then compared to the prior year and some rate change limits are applied. For the 2011 rates the rate change limits were no decrease in rate and rate increases up to 20%.

VII – Appendix A – The Current WSIB Pricing System Components

The impact of the rate change limit on the components of a rate group's premium rate:

a. New Claim Cost
b. WSIB Administration
c. Legislative obligations
d. Prevention
e. Unfunded Liability
f. (Gain)/Loss
g. Bad Debts

is not clear. For example the components for Rate Group 110 – Gold Mines, the first rate group with a 0% increase for 2011, add up to 7.79 but there is no indication which if any of the components were increased in order to maintain the 7.79 premium rate.

Changes for the 2011 Rates Methodology

The WSIB changed some of its rate setting methodology for the 2011 rates. Specifically the changes were:

- Move from allowed lost time injury rate to allowed (lost time + no lost time) injury rate;
- Move from 5 years of claims experience to 6 years;
- Introduce explicit charge for bad debts to be recouped at the class level;
- Reflect the Health and Safety Association (HSA) realignment; and
- Change the maximum decreases and increases in premium rates from 2010's maximum rate decrease of 10% and maximum rate increase of 10% to 2011's maximum rate decrease of 0% and maximum rate increase of 20%.

In addition to the changes in methodology there was also the impact of legislated benefit enhancements regarding indexing for partial disablement and extension of presumptive legislation to volunteer firefighters.

D. Experience Rating

The WSIB currently has six incentive programs applying to employers in Schedule 1. Three are mandatory experience rating (NEER, CAD-7 and MAP)[4], 2 are voluntary (SCIP and SGP) and one is a non-voluntary audit program (Workwell). There is also a new Accreditation program that is currently being developed by the WSIB.

SCIP and SGP Voluntary Incentive Programs

The 2 voluntary incentive programs are financial incentive premium rebate programs (up to 5% or 6% of WSIB premiums) designed to help employers develop and enhance their health and safety programs. The Safe Communities Incentive Program (SCIP) started in 1997 and is for smaller employers with under $90,000 in annual premium. SCIP can include employers from many industries (rate groups) in one program. Rebates are based upon attendance at safety education sessions and development of safety policies. The Safety Group Program (SGP) started in 2000 and each safety group usually includes employers from only one industry who work together to improve their health and safety. Rebates are based upon attendance at safety education sessions, improvements in safety policies and success in the group reducing costs below pre-established targets.

In 2010 these rebates were about $2 million for SCIP and $43 million for the SGP. The expected amount of the rebates was not built into the 2011 premium rates.

Workwell Non-Voluntary Audit program

The Workwell program identifies high risk employers based upon health and safety performance, audits them, gives those who fall below 75% on the audit 6 months to improve, re-audits them after 6 months, and adds a surcharge of up to 75% to firms that fall below 75% on the second audit. The total surcharges of the Workwell program generate about $2 million in additional revenue per annum. The expected amount of additional surcharges has not been built into the 2011 premium rates.

MAP Mandatory Experience Rating for Smaller Employers

The Merit Adjusted Premium (MAP) program came into effect in 1998 for smaller employers with annual premiums of greater than $1,000 and less than $25,000. MAP prospectively increases (up to 50%) or decreases (up to 10%) an individual firm's premium rate for the next year based upon its recent claims experience. Claims are only counted if they have WSIB claim payments of $500 or more. A rebate is provided for no claims (or 1 claim if average premium is greater than $20,000) in a three year period, with no adjustment for the next claim and surcharges added for each subsequent claim until a max 50%

[4] NEER is the New Experimental Experience Rating program introduced in the early 1980's for some employers and since made mandatory for all larger (greater than $25,000 annual premium) non construction employers in WSIB Schedule 1. CAD-7 is the construction industry experience rating program for larger (greater than $25,000 annual premium) employers. MAP is the Merit Adjustment Premium program for smaller (less than $25,000 annual premium) employers in WSIB Schedule 1.
SCIP is the Safe Communities Incentive Program and SGP is the Safety Group Program.

surcharge is reached. Map covers about 100,000 of the WSIB's 240,000 employers, with about 80% getting rebates, 12% with no adjustment, and 8% getting surcharges. The net impact in 2010 was a reduction in WSIB premiums of about $16 million. The expected reduction in WSIB premiums from MAP has not been built into the 2011 premium rates.

NEER Mandatory Experience Rating for Larger Employers (Non construction)

The New Experimental Experience Rating (NEER) program started in 1984. NEER was originally designed to provide both prospective and retrospective experience rating for employers.

- Prospective experience rating sets an employer's premium rate for the next year based upon the employer's:
    - Recent claims experience;
    - Current year's premium rate; and / or
    - Rate Group's premium rate.
- Retrospective experience rating provides refunds and surcharges to past employer premiums based upon recent claims experience.

The prospective experience rating part of NEER was dropped in the mid 1980's due, at least in part, to the start-up impact of combining prospective and retrospective rating on employers with significantly higher than average experience.

In the initial design of the NEER program, the refunds and surcharges were balanced so that the plan did not result in net refunds or surcharges. It is helpful to note that a balancing feature was also incorporated into NEER's predecessor and was a significant cause for employers complaints regarding lower refunds especially as the unfunded liability component of rates and the percentage of cost relief increased during the 1970's.

Changes to NEER over the years included the:

- removal of the balancing feature;
- removal of the unfunded liability component;
- changing the NEER reserve factors to capitalize the Future Economic Loss pensions to age 65;
- addition of an expected insurance feature (to cover the costs of occupational disease claims, SIEF claims relief and the cost of claims exceeding the limits);
- changes in the NEER rating factor, which measured the employer accountability for their own experience;
- increases to the per claim and per firm limits; and
- increases to the maximum rebate and surcharge range.

The NEER refunds greatly exceed the NEER surcharges in the mid nineties due to several factors such rate group new claim cost component being set more prudently than NEER reserve factors, an under allowance for cost relief and no balancing feature.

In 2010, about 16,500 employers (21,000 firm accounts) paying about $2 billion in annual premium, participated in NEER. Two thirds of the NEER employers received rebates totalling $161 million and one third received surcharges totalling $242 million, resulting in a net surcharge of $81 million. The expected net surcharge was not built into the 2011 premium rates.

CAD-7 Mandatory Experience Rating for Larger Employers in the Construction Industry

The CAD-7 construction Industry experience rating program was also started in 1984. The WSIB had consulted widely on experience rating in the late 1970's and produced a series of experience rating papers known as Experience Rating –Draft 1 through Experience Rating – Draft 7, prior to Professor Paul Weiler being appointed to review all aspects of the Ontario compensation system, including experience rating. Since experience rating was to be piloted in the mid 1980's, the construction industry wished to have their own CAD-7 pilot plan which was based upon the Draft-7 cost based experience rating formula modified to include a frequency component. CAD-7 stands for the "**C**ouncil [of the construction industry] **A**djusted **D**raft-7". The construction industry felt that construction employers had more control over preventing workplace injuries than they did over the seriousness and consequences of the injury, which is why they wished experience rating to be based 50% on injury frequency.

The CAD-7 experience rating was initially based on costs of claims that were up to 5 years old and counts of claims for up to 3 years. It also combined the employer's experience for each their construction industry rate groups.

Since 1984 CAD-7 has gone through many changes including:

- Changing the formulas for calculating the expected costs;
- Changing the definition of a claim used to calculate the injury frequency component;
- Changing the weighting of costs and frequency (reducing the frequency component from 50% to 33 1/3%);
- Increasing the rating factor to 200% to make the plan more aggressive, and
- Changing the frequency component from last 3 years to 2 years.

The last of these changes, occurred in 2004, and were made to hold employers more accountable by increasing the maximum rebate and surcharge amounts.

In 2010, about 6,000 employers (6,400 firm accounts) paying about $560 million in annual premium, participated in CAD-7. 70% of the CAD-7 accounts received rebates totalling $63 million and 30% received surcharges totalling $40 million, resulting in a net rebate of $23 million. The expected net rebate was not built into the 2011 premium rates.

VIII. Appendix B – Detailed Review of Current WSIB Pricing System

The objective of the current review is to determine the strengths and weaknesses of the current system from the point of view of Fairness, Collective Liability, Predictability, Transparency and Ease of Understanding, and Ease of Administration. In this section we assess the components of the WSIB's current pricing system from each of these points of view.

A. Fairness

Fairness in WSIB pricing means each employer makes a fair contribution to the Insurance Fund. Given the current pricing system fairness in WSIB classification means that the classification of employers into CUs should be correct at time of registration and be correct in each subsequent year. Fairness also requires correct classification of their insurable earnings and their claims. Fairness requires pre-established rules continuously apply to all.

Fairness to an employer also means that the premiums paid by a given employer should be well aligned to the claim costs allocated to the employer and the costs shared between employers should be allocated on a reasonable basis that appears fair to employers. Fairness in WSIB pricing from a worker's perspective means that employers should not be incented to under report injuries and engage in inappropriate claims management practices. Fairness for workers is in part implemented by significant consequences for under reporting and inappropriate claims management practices. Fairness to both employers and workers in the administration of a WSIB pricing system occurs when employers with special knowledge of the workings of the system cannot use their special knowledge to shift part of the burden of their incurred WSIB claim costs to other employers.

Fairness in the current WSIB pricing system

The current WSIB classification system was established in 1993 based upon 1980 SIC coded and has only been updated on an ad hoc basis since then. There is no mechanism to periodically review each classification unit and update it. There is also no process to update the classification of all employers in an industry on a periodic basis, although we understand that an employer's classification of payroll is audited when their payrolls are audited.

In the past 30 years, the processes and equipment involved in most business activities have changed significantly.

A weakness of the current classification system is that many of its aspects are out-of-date.

There are over 800 classification units and there are rules (outlined in policy and the regulations of the Act) for determining when an employer is permitted have multiple classifications for their business activities. Although the rules are complex, 8.5% of employers representing 34% of annual premiums currently have multiple classifications. Multiple classification units for insurable earnings for an employer require the WSIB to ensure that claims are also classified to the correct classification unit, to ensure integrity in the WSIB pricing system.

There is no process to ensure that claims for employers with multiple classifications are correctly classified. This does mean that up to one third of the WSIB injuries have the potential to be misclassified. Although it is anticipated that most employers with multiple classifications will correctly classify their own claims, an employer could misclassify (inadvertently or deliberately) their claims. This should be a concern in a system that experience rates with limits by rate group rather than experience rating the employer as a whole with limits applied for the employer.

A weakness of the current classification system is that it does not ensure correct classification of claims.

Although the WSIB used claim cost statistics, claim volumes and business activities at the classification unit level to group classification units into rate groups in 1993, no method was established for regrouping business activities into rate groups when their claim cost statistics, claim volumes, insurable earnings or business activities changed.

A weakness of the current grouping of classification units into rate groups is that there is no automatic mechanism to move or regroup the classification units when their claims cost experience, claim volumes, insurable earnings or business activities change.

Because no method was established for the regrouping of business activities into rate groups, regrouping has only been performed on an ad hoc basis or when the WSIB determined that the rate groups had decreased in size to be insufficiently credible for setting premium rates. The WSIB calculates both "claim costs ratios" and size credibility for each classification unit each year but these are only used for regrouping when a rate group becomes too small or an ad hoc classification issue has been raised and a classification review conducted. Currently there are many classification units that are large enough to be 100% credible as a rate group, that remain within the rate group that was established in 1993. Because of the changing claims cost experience of classification units relative to their rate groups, there are many classification units that are grouped in rate groups even though their annual claims cost statistics are significantly different than their rate group.

It is unfair to keep a classification unit with significantly credibility and claims cost experience that is significantly different from their rate groups in their current rate group.

The current rate setting methodology establishes a Schedule 1 rate based upon the cost of new claims plus overheads plus a balancing component for past claim costs to bring the rate to a politically agreed upon level. Currently the method for funding the past claims costs is sufficient to cover the interest on past claims, but is insufficient to pay down the unfunded liability over a reasonable period of time. This situation appears to have arisen due to:

a. Repeated increases in average claim costs mainly due to higher percentages of claims remaining on benefit for longer periods of time plus increasing costs of health care and retroactive legislative amendments. Results in repeated increases in the unfunded liability.

b. A practice of building in improvements in injury rates without building a sufficient allowance for increases in average claim costs. Results in the cost of new claims at the end of the injury year costing more than the revenue collected for new claims.

c. The major economic upheaval over the last few years that has resulted in lower investment income, smaller employment and increased pressure from employers to keep their cost downs so as help them deal with their economic challenges. Resulted in a major increase in the unfunded liability, a smaller base to charge fixed costs and significant pressure to limit rate increases.

Resolving this challenge requires containment of repeated increases in average claim costs (in constant dollars).

A weakness of the current rate setting system is that the past claims component has not kept pace with a rising unfunded liability due in part to the strong external influences to reduce the average Schedule 1 premium rate in recognition of the 50% reduction in injury rates since 1998 and more recently to limit increases in the average Schedule 1 premium rate for other reasons.

The WSIB is a provincial government insurance company and should be governed and operated like an insurance company. The WSIB has been operating since 1915 and when the government of the 1990's changed the name from the Workers' Compensation Board to the Workplace Safety and Insurance Board it was done specifically to recognize that workers compensation was insurance. At the same time the WSIB terminology for many items changed to emphasize that the WSIB was an insurance company. The term "assessable earnings" was changed to "insurable earnings", the term "assessment" was changed to "premium" and the term "injury" was changed to "claim" all to further the idea that the WSIB was an insurance company. The intention was to have employers think about the WSIB as an insurance company to which they paid "premiums", rather than a government agency for a social program which assessed "tax".

The thinking behind the change to an insurance company was also based upon the fact that everyone knows how to reduce insurance premiums (by reducing claims) and the government wanted to promote a reduction in WSIB claims. It is noteworthy that the since the name change the annual number of WSIB lost time claims have fallen from 88,906 (1997) to 51,492 (2009) even though Schedule 1 employment has increased by more than 20%.

A strength of the current WSIB pricing system is that the insurance terminology (insurable earnings, premiums, claims) has influenced the reduction in WSIB claims and reduced premiums below where they were.

It is fair to both workers and employers that WSIB claims have reduced, influenced in part by the recognition of the WSIB as an insurance company.

Governance of the WSIB as an insurance company requires the Board of Directors to have a plan to recover the unfunded liability for past claims over a reasonable period of time, as well as fully covering

the cost of new claims plus overheads in the year in which they are incurred, so that current and future employers are not overly burdened with the cost of past claims over too short of a period or unfairly burdened with an ever growing cost of old claims over too long a period. The ideal situation for a government insurance company is that there is no unfunded liability for past claims and current employers pay for the costs of current claims plus overheads, plus or minus the amortization of any recent experience gains or losses.

The first step in rate setting by the WSIB is to calculate a required Schedule 1 average premium which is sufficient to cover:

- The estimated cost of new claims;
- Overheads;
- The amortization of the past claim unfunded liability over a reasonable period of time.
- The amortization of recent gains and losses over the last 5 or 6 years; and
- Other items such as bad debts.

This is the required premium and can be arrived at in many ways using the past WSIB Schedule 1 data with projections at the Schedule 1 level. Important issues relate to the degree of optimism in the projections, allowance for items such as off balances, bad debts and penalties and the speed of retiring the unfunded liability.

Fairness has been challenged by what appear to have been optimistic projections and a lack of allowance for items such as off balances.

Having set the required premium revenue for the rate year, the rest of rate setting becomes a process of allocating the required Schedule 1 premium revenue to the rate groups. Currently the WSIB sets new claims costs for each class. Although the basis for the class level average claim costs is consistent with the basis for Schedule 1 there are issues such as loss of earnings termination rates differing between classes.

Fairness has been enhanced by setting average claim costs by class.

Having set per class average claim costs the claims costs for rate groups are set using a cost index based upon a six year triangle of claim costs normalized by insurable earnings. The triangle puts a lot of weight on first year costs. The triangle of costs has six years of duration 0 costs, five years of duration 1 costs, etc. and one year of duration 5 costs.

W**eaknesses of the triangle are that it puts too much weight on first year costs (payments made in the year of injury) and too little weight on longer term costs (payments made several years after the year of injury).**

This is unfair for rate groups that have a significantly different payment pattern than their class. For example a rate group that has first year costs similar to their class but significantly lower costs in later years will have their average claim cost overstated. Conversely a rate group that has first year costs similar to their class but significantly higher costs in later years will have their average claim cost understated. There are ways to address the inequity cause by the payment triangle such as supplementing the payment triangle with reserves for the future (as is done in Quebec since the late 1990's) or using a slice or series of slices (a rhombus) of costs for the rate group cost index.

The use of six years in the relative costs comparison covers most of the pre lock in period for loss of earnings period but none of the period of lock in (after 6 six years) for long term earnings loss. A rate group that has a significantly lower lock in rate than their class is not benefitting from that fact in the rate setting and is paying a higher rate group premium rate than necessary. This weakness could be lessened by extending the period of costs for the relative comparison from 6 to, say 8 years, to include at least 1 year of lock in payments.

A weakness in the rate setting is not including at least 1 year of lock in loss of earnings payments in the relative comparison.

In 5 of the last 10 years, the WSIB has not increased the average rate. In those years when the average rate did not increase the WSIB permitted individual rate group rates to move with their claims experience and to increase or decrease.

It is a strength in rate setting to permit individual rates to move even when the average rate does not.

The WSIB places limits on the change in rate group rates, and prior to 2011 the limit was usually plus or minus 10%. For 2011 the WSIB determined that they needed a 2% increase in the average rate. For 2011 no rates were permitted to decrease and some rates were permitted to increase up to 20%. This caused significant negative employer feedback, as significant rate increases usually do, and probably lead to a significant drop in employer trust in the fairness of the WSIB pricing system. In the absence of prospective rating for individual firms, all firms in a rate group with a 20% rate increase for 2011 received the 20% increase in their premiums up front. Every firm in that rate group, including those with little or no WSIB claim costs that annually received the maximum retrospective experience rating refund, received a 20% rate increase up front. Knowing that they would get a partial refund next year of the 20% increase in premium this year did little to ease that employer's sense of the unfairness of the WSIB pricing system.

Not permitting any rates to decrease for 2011 is a weakness in the pricing model. Frozen rates, in the absence of prospective experience rating, will always be viewed as unfair by rate groups with improving performance especially when they were encouraged by the opportunity to reduce their future premium rates.

There are fairer methods to ensure a specific average Schedule 1 premium rate without unduly modifying the incentives to continuously reduce workplace injuries and their consequences. An alternative to the "no rate increases" is as follows:

- Introduce a restatement feature to accommodate changes in the average Schedule 1 premium rate;
- Maintain the traditional plus and minus 10% premium rate change limits ; and
- Introduce a balancing factor that loads every premium rate by a calculated percentage so that the balanced limited premium rates produce the required premium revenue.

For example if the average Schedule 1 premium rate is to increase by 2% in 2011, limits kept at +/- 10%, the calculated balancing factor were 0.5% so as to maintain the 2% increase after application of limits, and a rate group with a $2.00 premium rate for 2010 has a required premium rate of $1.75 for 2011. This firm would get a 2011 premium rate of $1.85 rather than a frozen rate of $2.00. The specific calculations are:

- $2.04 Restated 2010 rate (102% of $2.00)
- $1.75 Required 2011 rate
- $1.84 Limited 2011 rate {lower limit $.1.84 (90% of $2.04); upper limit $2.24 (110% of $2.04)}
- $1.85 Balanced 2011 rate {100.5% of $1.84}

The WSIB's three incentive plans (2 voluntary incentive plans and 1 non-voluntary targeted audit plan) overlap with the WSIB 3 mandatory experience rating plans, measuring claims experience for similar periods. Since the incentive plans are refund only plans and they use the same periods of claims used in experience rating it is important to price for these refunds in the Schedule 1 average rate. The impact of the safety education and training of the 2 voluntary incentive plans, SGP and SCIP, in helping to bring down the number of WSIB injuries in Ontario should not be underestimated.

The SGP and SCIP incentive plans are a strength of the current pricing system.

The Workwell audit program also increases safety awareness amongst employers targeted with higher than average claims frequency and claims costs. The threat of a penalty seems to be more effective in getting the employer to take corrective action on deficiencies in their prevention programs than the actual penalties themselves.

The Workwell incentive plan is a strength of the current pricing system.

The 3 mandatory experience rating plans covering slightly more than half of the 240,000 schedule 1 employers are effective to varying degrees.

MAP, which applies prospective experience rating adjustments to almost 100,000 small employers with annual premiums between $1,000 and $25,000, permits refunds up to 10% and surcharges up to 50% based upon reasonable simple formulae. Most employers understand and accept MAP as reasonably

fair, as evidenced by the fact that there has been no significant change, or employer lobby for significant change, since its inception in 1998. Nonetheless there are concerns regarding fairness that arise from MAP's simplicity. For example a no lost time claim with $600 of claim cost has the same impact upon an employer's premium rates for the next three years as a far more serious lost time claim.

MAP prospective experience rating has unfair features arising out of its simplicity.

If we define "**leverage" of an experience rating plan** as the ratio of the highest premium paid under the plan versus the lowest premium paid under the plan we would say that **MAP has a leverage of 1.67** (=1.50/0.90) for the largest firms in MAP. For example, if the rate for the rate group was $1.00, an employer with $20,000 to $25,000 in annual premium under MAP could pay as little as $0.90 (i.e. get a 10% discount) or as high as $1.50 (i.e. get a 50% surcharge).

Leverage is a useful measure for an experience rating plan because it measures the competitive advantage of WSIB premiums for two employers in the same business. An experience rating plan with a leverage of 1.67 means that an employer with bad WSIB claims experience could be paying 67% more than an employer with excellent (no claims) WSIB claims experience. If the leverage in an experience rating plan is too small, the plan does not provide much of an incentive to improve (to prevent injuries and to return injured workers to employment), and WSIB premiums are more likely to be considered "just a cost of doing business".

Consider non fleet car insurance for a moment. The average premium is about $1,000 per driver per year. The best drivers (with driver training or education, no traffic violations and no accidents) can get about a 15% discount. The worst drivers can get a 1,000% or more surcharge and pay more than $10,000 per year. Thus car insurance has a leverage factor of at least 12.0.

NEER is a retrospective experience rating plan, providing refunds and surcharges for up to 3 years following the injury year.

NEER has a maximum refund of about 40% of premiums and maximum surcharge of about 120% of premiums for very large firms. **NEER has a leverage for a very large firm of 3.67** (=2.20/0.60). For example, if the rate for the rate group was $1.00, a very large employer under NEER could pay as little as $0.60 (i.e. get a 40% discount) or as high as $2.20 (i.e. get a 120% surcharge). For the smallest employer in NEER the maximum refund is about 5% of premium and the maximum surcharge is about 15% of premium. **The leverage for a small firm under NEER is 1.21** (=1.15/0.95). Note that a firm that crosses the $25,000 annual premium threshold and moves from MAP to NEER moves from a plan with a leverage of 1.67 to one with a leverage of 1.21.

A strength of NEER is that it has a leverage of 3.67 for the very large firm. A weakness of NEER is that it has a leverage of 1.21 for the smallest firms in NEER, which is much lower than the leverage for the firms in MAP.

CAD-7 is a retrospective experience rating plan, providing refunds and surcharges for up to 5 years following the injury year.

CAD-7 has a maximum refund of about 40% of premiums and maximum surcharge of about 80% of premiums for the very large firm. **CAD-7 has a leverage for a very large firm of 3.00** (=1.80/0.60). For the smallest employer in CAD-7 the maximum refund is about 10% of premium and the maximum surcharge is about 20% of premium. **The leverage for a small firm under CAD-7 is 1.33** (=1.20/0.90). Note that a growing firm that crosses the $25,000 annual premium threshold and moves from MAP to NEER moves from a plan with a leverage of 1.67 to one with an initial leverage of 1.33. CAD-7 however becomes more aggressive quite quickly reaching a leverage of 3.00 for an employer with 25 full time employees or the equivalent.

A weakness of CAD-7 is that it reached maximum leverage for an employer with only about 25 full time employees.

This is a concern because CAD-7 is a retrospective plan and an employer with 25 employees can quickly flip from a maximum refund of 40% of premiums to a maximum surcharge of 80% of premiums.

The aggressiveness of CAD-7 to employers with about 25 employees is unfair to both employers and employees.

When the impact of one or two claims for employer with 25 employees can cause the employer to flip from maximum refund to maximum surcharge, the employer may be tempted to under report claims.

There are significant boundary issues to having three WSIB experience rating plans, especially 3 plans that are not coordinated in terms of their leverage. When employers cross the thresholds from the small employer plan to the large employer plan (into either NEER or CAD-7) they initially move to a less aggressive plan. Employers declining in size crossing the threshold form CAD-7 or NEER to MAP initially move to a more aggressive plan. This is not considered fair by employers.

Three WSIB experience rating plans with uncoordinated boundaries are a weakness in experience rating.

NEER, CAD-7 and MAP all have one serious weakness. Employers in these plans can move from maximum refund to maximum surcharge based upon one bad year of claims experience. It is our opinion that employers should only be permitted to move from maximum refund to maximum surcharge or vice versa based upon a "sustained" change in experience. It is noteworthy that only NEER permits employers to move from a maximum surcharge to a maximum refund in the following (one) year, whereas CAD-7 and MAP do not.

It is a weakness in NEER, CAD-7 and MAP to permit employers to move from maximum refund to maximum surcharge on one bad year of claims experience.

B. Collective Liability

When workers compensation was first established in Ontario, it was established under the principle of no-fault insurance for workers in return for workers giving up their right to sue employers for workplace

injuries. The no-fault insurance scheme was to be funded by employers collectively under Schedule 1 and by employers individually under Schedule 2.

Schedule 1 employers are liable to contribute to the Insurance Fund. They are required to pay premiums {88(1)} and are not individually liable to pay benefits directly to workers or their survivors under the insurance plan {88(2)}.

From the very beginning it was recognized that some industries and some employers in an industry had higher injury rates and costs than other employers in the industry, so the Act permitted the Board to vary the Schedule 1 premiums by industry, sub industry and even by employer. The original legislation had 46 classes of employers and stated that premiums did not have to be uniform in a class.

The Act always gave the Board the power to combine classes when they became "unduly small" and to separate out groups of employers for "insurance purposes or for the prevention of accidents", but the overriding consideration was to require Schedule 1 employers to pay premiums to fund the program and not be liable to pay benefits directly to workers and their survivors under the plan.

It is noteworthy that the original act required a minimum of 2 months advance notice prior to changing the groups. The WSIB current grouping of classification units into rate groups does not recognize that it is important to separate out or reclassify classification units whose claims experience have moved significantly away from that of their rate group.

In our opinion the concept of insurance is built upon pooling unpredictable, infrequent large costs while experience rating predictable costs so as to achieve fairness, retention of business, encourage the insured to prevent claims and avoid predictable cross subsidies. This concept of collective liability, as opposed to collective funding or collective financing, such as employer's payroll deductions for EI, CPP and EHT, should be focused on unpredictable, infrequent large costs and not focus on predictable costs.

Failure to move classification units whose experience has moved significantly away from their rate group average experience is inconsistent with the concept of collective liability only applying to unpredictable, infrequent large costs.

The concept of collective liability extends down to experience rating. Employers are permitted to vary from their premium rate at the rate group level, but should be limited to recent experience that represents their predictable experience and not include unpredictable, infrequent large costs.

The leverage of experience rating outlined above shows the extent of variation permitted from the rate group average. The various levels of leverage of WSIB experience rating have not hindered the system from achieving a tremendous reduction in new claim volumes. Perhaps even more can be achieved if the leverage in experience rating is standardized (brought to similar level for all employers) and there is a focus on sustained performance as well as an immediate response to a change in performance.

At the Class level the WSIB determines per injury year, per Class liabilities primarily based upon the claims experience of each Class so as to determine per injury year, per Class gains and losses. It also determines per Class average claims costs again primarily based upon the claims experience of each

Class. It does not, however, maintain per Class sets of accounts. Thus Class level premium rates are consistent with restricting pooling to unpredictable, infrequent large costs.

Where collective liability starts to breakdown is at the rate group level. This breakdown is assessed using the concept that within insurance collective liability is used to pool unpredictable, infrequent large costs. The breakdown is not due to the concept of rate groups itself but to:

- The inclusion of CUs with predictable costs that are significantly different from those of its rate group, and
- Predicting costs with too much weight on first year costs and too little weight on longer term costs.

Another breakdown arises from CAD-7 applying to larger construction employers, NEER applying to larger non-construction employers and our understanding that each plan's off balances are added to the Schedule 1 unfunded liability rather than to the Class gains and losses.

It is a weakness of the current pricing system that the rate groups can be made up of CUs with predictable different experience.

C. Predictability

Predictability of insurance premiums for "must have" insurance is an important need for the managers of any business. "Must have" Insurance premiums are an expense and are built into the pricing of the company's products or services and like other expenses need to be managed. The premiums need to reflect the insured risks and respond to effective prevention and effective post claim interventions (e.g. early safe sustained return to work).

It is a weakness whenever changes in premium rates, inclusive of experience rating, are inconsistent with recent experience. There are several areas where improvements can be made including movement of CUs, more gradual recognition of an initial change in experience that can nevertheless eventually lead to a larger recognition as the change is sustained.

The WSIB Schedule 1 average premium of $2.35 may represents about 2% of gross payroll on average. For employers in rate groups with a rate above the Schedule 1 average, changes in premium rates can be significant in impacting their net income if they have not been allowed for in the pricing of their products or services. The WSIB recognizes this and for the past 35 years or more has tried to announce the following year's premium rates by rate group four to six months in advance.

The WSIB's current pricing system methodology was designed to generate reasonably stable rates at the rate group level. The intention of the WSIB in establishing large "statistically credible" rate groups was to have rate groups where the rates would not be unduly impacted by unpredictable, infrequent large costs and thereby subject to unreasonable volatility. For the most part the WSIB has achieved their objective. The premium rates for most rate groups over the last 15 years have not been volatile and

rates have annually moved to their new calculated level each year, most being within the usual plus or minus 10% rate change limit.

It is a strength of the current pricing system that the annual rate group premium rates have been fairly predictable and not volatile.

But has this predictability of annual rates been achieved in a way that is perceived to be fair by employers?

When rate groups were first established they were determined by grouping classification units together by similarity of business activity and claims costs statistics, until the rate groups were large enough for full statistical credibility and were therefore expected to produce fairly stable assessment rates. Since 1993, however, there has been and still is no process to move a classification unit that has significantly changed their claim cost statistics relative to their rate group average, even if the classification unit meets the criteria for a 100% statistically credible rate group on its own.

Predictability, at the expense of equity, is unfair to employers.

This is understood to be a significant source of employer distrust in the WSIB pricing system.

It is worth noting that predictability of premium rates can be achieved without having rate groups with full statistical credibility. Even when a classification unit or rate group is not fully credible, annual rates for that group can be determined in the same manner as for the existing rate groups, using the comparison of relative triangles (or slices, etc.) and applying rate change limits if the calculated rate moved more than the limits. This would allow the group to move in the direction of what they are costing the fund from what they are paying into the fund. Employers will view this as fairer (more equitable) to them than moving their non fully credible business activity to a different rate group.

Although the WSIB understands that predictability of rate is important to employers, and makes every effort to get next year's rates available 6 months in advance, the communication of the rates to employers currently misses an excellent opportunity to provide employers with a longer term view than next year's rates.

The 2011 rate information at the Schedule 1 level announced a 2% increase in the average rate for 2011 and another 2% increase for 2012. This was helpful to employers, to know what will happen at the Schedule 1 level, but there was not similar information at the rate group level, which would have been much more helpful to individual employers.

A review of the rate group packages that were handed out at several employer association meetings showed employers how their rates changed for their rate group from 2010 to 2011. The packages also showed the major item that impacts the new claims costs component of their rate, which was how their average costs for their rate group were changing relative to their sector and to Schedule 1. The total averages costs information was provided for the current (2004 to 2009 costs) and prior (2004 to 2008 costs) rate setting. While the rate packages talked about costs being on an upward trend, what they missed was a projected rate based upon:

- Costs levelling off at the 2009 level.

Having an understanding of the future rate group premium rate beyond next year would enable employers to plan and encourage them to take actions to reduce their WSIB premiums where the effective actions have predictable outcomes.

A weakness in the communication of the WSIB premium rates is that it misses the opportunity to provide a projection of the rates beyond next year, if claim trends level off at the last year's level. This would increase employer predictability of WSIB premiums.

A strength is that the limited direct communication with employers does not create additional expense for the WSIB.

D. Transparency and Ease of Understanding

The current WSIB pricing model is neither transparent nor easily understood. The system is not simple enough in design that most employers and injured workers can see that the principles of fairness, collective liability, and predictability are operating effectively.

The classification system is out-of-date. The 800+ classification units have descriptions (scopes), most of which have not been changed since 1993. New employers are not easily classified when business activities have changed from those included in the scopes.

In 1993, classification units were grouped into rate groups based upon the classification unit's claims costs statistics and their business activities. The groupings were rationalized and may have made sense at that time. Many of those original rate groups have not changed since, except to add in other industries from rate groups that became too small. Many classification units have claim cost statistics today that are significantly different from their rate group. If the classification units were regrouped today based upon the claim cost statistics, many WSIB rate groups would look very different. There also would be a lot more rate groups if classification units that meet the criteria of full credibility for a rate group are permitted to be their own rate group.

Many employers do understand the components of their rates at the macro level. They understand that they pay for their new claims costs plus overheads and a portion of the unfunded liability. The WSIB has provided a fairly consistent message on the macro components for 20 years.

Many employers, however, do not understand why their premium rates move the way they do. Under the current pricing system, a rate group with improving experience will see their rate increase if their improvement is not as much as the improvement for the class as a whole. This is a consequence of setting rate group rates relative to class rates.

Changes in rates are more acceptable to employers when their premium rates are moving in the same direction as the employer's own claims experience. When premium rates are moving in a direction opposite of their claims experience, most employers believe something is wrong and their trust in the

pricing system decreases. By way of illustration most Ontario motorists with maximum no claim bonuses and no claim or points since their last renewal believed that the significant rate increase that occurred several years ago were unreasonable in spite of significant media coverage and communication packages from their insurer.

The current WSIB experience rating plans, for the most part, do restore some of the faith of employers in the WSIB pricing system. An employer with little or no WSIB claims costs is dissatisfied when their rate group's rate moves up by 20% and their upfront WSIB premiums increase by 20%. The dissatisfaction will also be there for the employer in MAP getting a 10% discount. Most of them also got a 10% discount last year, continue to have no claims, understand that on average premium rates increased 2% but are subject to a 20% increase in their premium rate. For employers in CAD-7 or NEER while the 20% increase will apply to their initial premium over time their net cost (initial premium plus experience rating adjustments) will increase by less than 20% as long as their claims costs performance was similar to or better than last year's.

Except for the employers who are driving up the rate group's relative performance the faith in the board pricing system went out the door with the 20% premium rate increase for them and a 2% premium rate increase for Schedule 1 as it does not relate to their own claims experience.

Rationales, such as collective liability, have little credibility when premium rate increases are out of line with Schedule 1 and an employer's recent experience.

E. Ease of Administration

The current WSIB pricing system is not easy to administer, although some parts are easier than others. The decentralization of the employer classification increases the resources required to administer it. Understanding the entire classification system requires significant training. Understanding the rules for multiple classifications for an employer also require significant training. The system is complex and currently the WSIB has insufficient tools to simplify the classification process and rectify many of its "out of date" features.

The WSIB currently has about 175 account specialists trained on the classification system, and the classification of the employer account is only part of their job. Decentralization of the classification only works because the current classification system is basically unchanging and updates to the system and individual classifications are both infrequent and reactionary (the WSIB tends to limit its responses to persistent complaints). If the classification system were kept up to date with re-written scopes, additions of new business activities and collapsing old ones into other scopes it would be practically impossible to keep the account specialist up to date.

An interesting thought is what if the WSIB had centralized classification? What if the WSIB had a "Classification Champion" whose primary function was to maintain the integrity of the classification system through a centralized group responsible for all classification of employer insurable earnings **and claims**? The classification system would likely have a process for periodic updating of scopes,

movement of CUs between rate groups and systematic review of the classification of employer's business activities and thereby be current on an ongoing basis.

The decentralization of the classification system is a weakness of the pricing system.

The WSIB does not have a process for regrouping classification units into rate groups as the claims experience of the classifications units change. The lack of an established process has probably increased the WSIB administration of the rate groups. When employer groups ask the WSIB to review whether they are correctly grouped within their rate group, the WSIB begins a review of the classification units that have been grouped into that rate group. They look at the claims cost ratios for the classification units and the business activities and generally have a difficult time arriving at a decision on reclassification of a classification unit. We understand that one particular re-classification issue has been under review for nearly 10 years without a resolution to the issue even though the CU is fairly large and its performance continues to be sufficiently lower than that of its rate group to justify a move. We respectfully suggest that overemphasis on "similarity of business activity" is the reason for the delay, plus the fact that the WSIB did not establish a rules based process to override "similarity of business activity" when claims cost statistics (even partial credible ones) indicated that their claims costs experience were not that similar.

A weakness of the current rate group system is that it does not put more emphasis on the changing claims cost statistics of the classification units.

The pricing system, in our opinion, should focus on claims costs statistics whenever there is significant partial credibility, (say 25% or more). When claims costs statistics for a classification unit, even a partially credible one, show that there is a significant difference between the classification unit and the rate group and that difference is being sustained over a number of years, it is unfair in the pricing model not to move the classification unit out of that rate group. The grouping of classification units into rates should be a dynamic process that recognizes that industries grow and decline and their claims costs experience also changes over time.

A weakness in the current pricing system is that it only addresses grouping into rate groups when rate groups decline in size.

If the WSIB were to regroup the classification units into rate groups and establish a process for keeping it up to date, the understanding and trust of the pricing system by employers would increase.

The rate setting process, although it has a lot of steps, is probably the easiest aspect of the pricing system to administer. WSIB Actuarial Services has a rate setting team of specialists that are well trained and capable. They are actually trained to do more than they are currently doing in rate setting. For example, we believe that the rate setting team can do a better job of projecting WSIB insurable earnings by class than any external source of projections. The WSIB has actual premiums by rate group because of monthly filing by the large employers. The year to date actual premiums by rate group gives the WSIB very good information to project insurable earnings by rate group. Using these projections, rather

than class projections from external sources applied to rate groups, will in our opinion provide more accurate rates.

Ease of administration and fairness would be enhanced if the current process of projecting levels of employment and earnings of each class was reversed so that the WSIB based its assumptions on class specific information modified by inputs from sources such as sector specific information received from organizations such as Infometrica.

The current experience rating plans require significant administration resources. Having three plans increases the administration, especially when employers cross from one plan to another.

A weakness in premium payments for employers under the NEER and CAD-7 programs is that poorer performing employers enjoy a reduced premium until the surcharge is applied, and better performing employers are surcharged until a rebate is applied.

IX. Appendix C – Specific Recommendations Based Upon Review Criteria, Basic Concepts and Best Practices

Based upon our past experience and reinforced by our analysis of the WSIB's current pricing system and those in other jurisdictions the foundations of all workplace insurance pricing systems are:

- Annual determination of the total amount to be paid by all insured employers with respect to the year in order to maintain the insurance fund; and
- Classification of employer's business activities, their insurable earnings and their claims.

With this foundation, workplace insurance systems can then proceed to establish the methods to be used by employers to calculate their premiums. Although this makes the foundation somewhat independent of the methods used to calculate employer premiums there are linkages. The need for accurate ongoing classification of employer's business activities depends upon the consequences of accurate ongoing classification.

Where employer premiums are solely based upon:

- Group premium rates plus an employer's insurable earnings per group; and
- Group premium rates vary from less than $0.50 per $100 of insurable earnings to well over $10.00 per $100 of insurable earnings

there is an ongoing need to keep all aspects of classification current.

Conversely where employer premiums are increasingly based upon their own experience (spanning all of their business activities) classification becomes a support tool rather than a key element. Specifically, as is the case in Manitoba, classification's primary purpose is to support:

- Premiums for new employers; and
- Accurate coding of the inputs into the data bases needed to efficiently and effectively manage the program.

The methods to be used by employers to calculate their workplace insurance premiums, both historically and in the present era in each province, all use the earnings of the employer's workers and premium rates (net of experience rating adjustments) that have varying degrees of dependence on the average experience of their rate group(s) and their own experience. A typical exception is that new employers and employers with very small premiums pay premiums that are independent of the employer's own experience.

IX - Appendix C – Specific Recommendations Based Upon Review Criteria, Basic Concepts and Best Practices

The following recommendations are prioritized by importance. Thus the Schedule 1 Required Revenue and Premium Rate come first. This is followed by employer centric rating. Then collective liability features. And finally the classification of employers.

1. Schedule 1 Required Revenue and Premium Rate

Recommendation RR1 – While we recommend continuation of the current careful projection of next year's Schedule 1 required revenue, insurable earnings and required average premium rate, we also recommend transparent tracking of the components (new claim costs, overheads, insurable earnings and actual average premium rate).

Schedule 1 required revenue starts with projections based upon assumptions that have a tendency to include margins so as to have a tendency to slightly overstate rather than understate the required revenue. This is seen as essential for any workplace insurance arrangement that has an unfunded liability rather than a surplus. The inclination to build in corporate goals into the projections is understandable but should be resisted if they tend to give rise to an understatement of required revenue. For this and other reasons it is likely advisable to establish alternatives such as "steady state", "continuation of recent trends" and "corporate goals".

Required revenue needs to include all significant items.

It also needs to go through an updating process so that the components of the initial projection are updated at year end and the new claim cost component for each of several subsequent year ends.

In addition to the required revenue update there is also a need to record actual revenue at year end and likely one year later.

The Schedule 1 average premium rate is very high profile and its consequences need to be clearly understood not only by the WSIB Board of Directors and its advisors but by the WSIB's various stakeholders.

2. Employer Centric Rating

Recommendation PR1 – We recommend that a system of employer centric rating be adopted for all employers using the current Manitoba employer centric rating system as a starting point but adding the feature of one premium rate per employer rather than one premium rate per employer rate group.

The current challenges arising from setting annual assessment rates and the growing distrust of those that pay them can be reduced by:

- Understanding and communicating the ongoing increases in the average cost of claims

- Placing more emphasis on an employer's current and recent performance and less on the performance of their "deemed" peers (its rate group)
- Eliminating premium rate increases that are out of line with changes in the Schedule 1 premium rate and out of line with the employer's own performance

We also recommend a detailed examination of a new system, including drafting and testing a "Made for Ontario" program which includes features to migrate from the current system quickly but smoothly.

3. Collective Liability Features

Recommendation CL1 – We recommend that there be collective liability for more recent occupational diseases, fatalities and unpredictable infrequent high cost events.

More recent occupational diseases would include those accepted over the last decade or two where significant exposure prior to their being accepted.

Fatalities would have their actual costs replaced by an average cost and thereby pool the costs of fatalities between employers with a fatality.

With regards unpredictable infrequent high cost events the first protection is provided by graduated annual steps towards what an employer is costing the system where the annual step increases with the number of years moving in the same direction.

The second protection would be upper boundaries which would be set based upon the employer's dominant business activity.

The third protection is to pool all payments on older claims at the Schedule 1 level.

If these were shown to be insufficient pooling of high costs could be added.

4. Classification

Recommendation CL1 – We recommend an overhaul of classification that is coordinated with our recommendations for employer centric rating.

Recommendation CL2 – We recommend, as long as the replacement of the current rate group premium rates and experience occurs in time for 2014 premium rates, that the needed realignment of CUs coincide with the introduction of our recommended employer centric rating. If our recommended employer centric rating is delayed or materially modified we recommend the realignment of CUs be undertaken as soon as possible.

Recommendation CL3 – We recommend the introduction of computer tools to support classification of employers and that overhaul of classification scopes and their full implementation can be phased in over a number of years starting with 2014. As with the previous recommendation, this recommendation is

contingent upon the introduction of employer centric rating in time for 2014 premium rates and if it is delayed or materially modified we recommend the overhaul of classification scopes and their full implementation start as soon as possible.

X. Appendix D – Summary of Findings

This is a summary of the findings extracted from Appendix B – Detailed review of the Current pricing system.

A weakness of the current classification system is that many of its aspects are out-of-date.

A weakness of the current classification system is that it does not ensure correct classification of claims.

A weakness of the current grouping of classification units into rate groups is that there is no automatic mechanism to move or regroup the classification units when their claims cost experience, claim volumes, insurable earnings or business activities change.

It is unfair to keep a classification unit with significantly credibility and claims cost experience that is significantly different from their rate groups in their current rate group.

A weakness of the current rate setting system is that the past claims component has not kept pace with a rising unfunded liability due in part to strong external influences to reduce the average Schedule 1 premium rate in recognition of the 50% reduction in injury rates since 1998 and more recently to limit increases in the average Schedule 1 premium rate for other reasons.

A strength of the current WSIB pricing system is that the insurance terminology (insurable earnings, premiums, claims) has influenced the reduction in WSIB claims and reduced premiums below where they were.

It is fair to both workers and employers that WSIB claims have reduced, influenced in part by the recognition of the WSIB as an insurance company.

Fairness has been challenged by what appear to have been optimistic projections and a lack of allowance for items such as off balances.

Fairness has been enhanced by setting average claim costs by class.

Weaknesses of the triangle are that it puts too much weight on first year costs (payments made in the year of injury) and too little weight on longer term costs (payments made several years after the year of injury).

A weakness in the rate setting is not including at least 1 year of lock in loss of earnings payments in the relative comparison.

It is a strength in rate setting to permit individual rates to move even when the average rate does not.

Not permitting any rates to decrease for 2011 is a weakness in the pricing model. Frozen rates, in the absence of prospective experience rating, will always be viewed as unfair by rate groups with

improving performance especially when they were encouraged by the opportunity to reduce their future premium rates.

The SGP and SCIP incentive plans are a strength of the current pricing system.

The Workwell incentive plan is a strength of the current pricing system.

MAP prospective experience rating has unfair features arising out of its simplicity.

A strength of NEER is that it has a leverage of 3.67 for the very large firm. A weakness of NEER is that it has a leverage of 1.21 for the smallest firms in NEER, which is much lower than the leverage for the firms in MAP.

A weakness of CAD-7 is that it reached maximum leverage for an employer with only about 25 full time employees.

The aggressiveness of CAD-7 to employers with about 25 employees is unfair to both employers and employees.

Three WSIB experience rating plans with uncoordinated boundaries are a weakness in experience rating.

It is a weakness in NEER, CAD-7 and MAP to permit employers to move from maximum refund to maximum surcharge on one bad year of claims experience.

Failure to move classification units whose experience has moved significantly away from their rate group average experience is inconsistent with the concept of collective liability only applying to unpredictable, infrequent large costs.

It is a weakness of the current pricing system that the rate groups can be made up of CUs with predictable different experience.

It is a weakness whenever changes in premium rates, inclusive of experience rating, are inconsistent with recent experience. There are several areas where improvements can be made including movement of CUs, more gradual recognition of an initial change in experience that can nevertheless eventually lead to a larger recognition as the change is sustained.

It is a strength of the current pricing system that the annual rate group premium rates have been fairly predictable and not volatile.

Predictability, at the expense of equity, is unfair to employers.

A weakness in the communication of the WSIB premium rates is that it misses the opportunity to provide a projection of the rates beyond next year, if claim trends level off at the last year's level. This would increase employer predictability of WSIB premiums.

X - Appendix D – Summary of Findings

A strength is that the limited direct communication with employers does not create additional expense for the WSIB.

The current WSIB pricing model is neither transparent nor easily understood.

Rationales, such as collective liability, have little credibility when premium rate increases are out of line with Schedule 1 and an employer's recent experience.

The current WSIB pricing system is not easy to administer, although some parts are easier than others.

The decentralization of the classification system is a weakness of the pricing system.

A weakness of the current rate group system is that it does not put more emphasis on the changing claims cost statistics of the classification units.

A weakness in the current pricing system is that it only addresses grouping into rate groups when rate groups decline in size.

Ease of administration and fairness would be enhanced if the current process of projecting levels of employment and earnings of each class was reversed so that the WSIB based its assumptions on class specific information modified by inputs from sources such as sector specific information received from organizations such as Infometrica.

A weakness in premium payments for employers under the NEER and CAD-7 programs is that poorer performing employers enjoy a reduced premium until the surcharge is applied, and better performing employers are surcharged until a rebate is applied.

XI. Appendix E - The New WSIB Pricing System in More Detail

Although collectively, all insured employers will pay into the insurance fund the year's required revenue, employer centric rating means each employer will pay more or less depending on their own current claims experience and their past claims experience (as reflected in their current premium rate). The goal of the new WSIB pricing system is to set each employer's premium rate based fairly upon their claims experience, encourage employers to prevent accidents from happening in the first place and promote efficient and appropriate return to work programs.

An employer's claims experience will determine where they fit in accordance with the rate range applicable to their industry. The following 5 *Steps* detail how to arrive at an employer's premium rate.

Step 1. *Restated Rate*
An employer's current rate is the starting point to determine their rate for next year. The current rate is "restated" when there is a change to the WSIB average rate for all insured employers. The WSIB overall average rate is set annually. The employer's restated rate becomes the new starting point to calculate the rate for next year. The purpose of restating the rate is to ensure that all employers share in the new Schedule 1 required revenue.

Step 2. *Establish a "Required Rate" for Each Employer*
The required rate is the key factor in determining if an employer is eligible for a rate increase or decrease. For next year's rate setting, it uses an employer's own injury payments over the one year period from July 1, last year to June 30, this year. An employer will move from this year's restated rate toward next year's required rate, but subject to certain limits that are described in the subsequent steps.

To illustrate, if an employer's required rate is above their restated rate, the employer should receive a rate increase. The rate increase is a step toward their required rate, with the size of the step being determined by how many years the employer's rate has been moving in that direction.

Note that employers with no claim costs or minimal claim payments would have a required rate of zero, or close to zero. A rate is still needed because of pooling of unpredictable costs and sharing in the WSIB administration and Ministry of Labour costs.

To evaluate an employer's claim payments, we compare their injury payments to the claim payments of an average employer with the same insurable earnings history. The comparison helps determine how much of the WSIB required revenue should be assigned to each employer. The result is the employer's Required Rate.

XI - Appendix E – The New WSIB Pricing System In More Detail

Required Rate Calculation:

(A) Actual Payments
---------- X (C) WSIB Average Rate = **Employer Required Rate**
(B) Average Payments

6. **Actual Payments** include benefits paid between July 1, last year and June 30, this year on behalf of the employer's workers who were injured over the last 8 years. The ongoing payments on claims older than 8 years are not included in individual employer experience rating but are part of the collective Schedule 1 costs.
7. **Average Payments** are the average claim payments for all employers over the same time period – July 1, last year and June 30, this year (with allowance for the employer's insurable earnings history). This does not take into account the risk of the industry. That risk is considered in step 5.

Step 3. *Apply the Change Limit*
Once the required rate is set, the rate model then determines how close an employer can move to that required rate. The Change Limit prevents an employer's rate from increasing or decreasing too quickly. Consistent claims payments over the years will move an employer more quickly toward their required rate, whereas a random event in one year will have a much more limited impact.

The maximum annual rate change percentage that applies to each employer depends on the number of years in a row their rate has been moving in the same direction.

Year	Decrease	Increase
First*	-5%	10%
Second	-10%	20%
Third	-15%	30%
Fourth	-20%	40%
Fifth +	-25%	50%

**First means the first year that a firm changes from a rate increase to a rate decrease or vice versa.*

Step 4. *Apply the Risk Category Rate Range*

Each employer is assigned to an industry based on their dominant business activities. Each industry is assigned to one of nine *risk categories* based on claim payment experience over a period of several years. Each risk category has a rate range from 40 percent below to 200 percent above the category average rate.

Once an employer's rate has been moved toward its required rate, Step 4 ensures that an employer's rate stays within the appropriate risk category rate range. The average rate for each category is a fixed percentage of the overall Average Rate. If the Average Rate is $2.35 the risk category details would be as follows:

Fixed Percentage of Average Rate	Risk Category Average Rate	Lowest Rate in Risk Category	Highest Rate in Risk Category
15%	0.35	0.21	1.05
25%	0.59	0.35	1.77
40%	0.94	0.56	2.82
70%	1.65	0.99	4.95
120%	2.82	1.69	8.46
200%	4.70	2.82	14.10
300%	7.05	4.23	21.15
500%	11.75	7.05	35.25
800%	18.80	11.28	56.40

Step 5. *Apply the Balancing Adjustment to All Employers*

Before running the employer rate setting model; the WSIB must determine how much Schedule 1 revenue is required, based upon budgets and projections at the Schedule 1 level. Because of the limits, the model will generate too little or too much revenue. To ensure the WSIB meets its revenue requirement, a final balancing adjustment is applied equally to each insured employer. Note that the balancing adjustment can move an employer's rate outside of its risk category rate range.