



PRICING FAIRNESS:

A Deliverable Framework for
Fairly Allocating WSIB Insurance Costs

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ONE | INTRODUCTION

In the Fall of 2012, the WSIB announced that I would be leading a comprehensive multi-phased engagement with stakeholders on reforms to Employer Classification, Premium Rate Setting and Experience Rating.

This WSIB Rate Framework consultation is the next step following the WSIB Funding Review, led by Professor Harry Arthurs. It builds upon the resulting discussion and recommendations outlined in his final report, *Funding Fairness: A Report on Ontario's Workplace Safety and Insurance System*¹.

From my appointment as Special Advisor in September through to the end of 2012, I was engaged in initial discussions with stakeholders as I immersed myself in Ontario's workers' compensation system. In January 2013, my Discussion Paper was released in which I outlined the issues and challenges with the current structures and approaches and identified a number of questions, principles and possible options for stakeholders to consider.

In April 2013, a series of public hearings were held in Toronto and Thunder Bay. I received a number of oral and written submissions from stakeholders across the province. This discussion with stakeholders took place against the backdrop of a number of significant studies on various aspects of WSIB operations. All of these reports are in the public domain and have informed the discussion with stakeholders in various ways. One thing they have done is contribute to a growing sense of urgency and frustration among stakeholders and a genuine desire among many for the WSIB to get on with the task of developing a new classification/rate setting model, which is referred to as the Rate Framework.

I was asked by the Chair of the WSIB to provide the Board with a final Report that identified areas of consensus and disagreement around classification and rate setting reform for Schedule 1 employers. I was asked to identify areas that required further research and analysis and provide recommendations on a new Rate Framework. What I am providing in this Report is a conceptual framework for that new system of classification and rate setting. The transition from concept to working model requires much more work by the WSIB to test its suitability and tailor it to Ontario's requirements. For the second phase, the WSIB will need to work through the development of a working model and engage stakeholders as this initiative moves forward. I have tried as much as possible to provide guiding principles for future decisions in the development of that new Rate Framework. Prior to moving toward implementation of a new Rate Framework, and through a dedicated third phase, they will also have to develop an approach and seek input from stakeholders for the phasing in of a new system to ensure an orderly transition for Schedule 1 employers.

As such, the phases identified below, developed with the WSIB, are intended to provide a general guide for this initiative:

- Phase 1 (2013) – Initial Public Consultation & Conceptual Framework Development
- Phase 2 (2014) – Public Consultation on New Rate Framework
- Phase 3 (2015) – Public Consultation on Transition Towards New Rate Framework
- Phase 4 (2016) – Gradual Implementation of New Rate Framework

I have tried to provide a Report that the average stakeholder with an understanding and interest in workers' compensation might be expected to read so that they might contribute to this process.

1 <http://www.wsib.on.ca/files/Content/FundingReviewFundingFairnessReport/FundingFairnessReport.pdf>

TWO | CONTEXT FOR CHANGE – WHY NOW?

When this exercise began, the WSIB had just gone through the *Funding Fairness* consultation exercise with Harry Arthurs. In 2011, the WSIB was turning the corner on funding². Some stakeholders asked the questions: Is this the appropriate time to be addressing these issues? Will this exercise detract from addressing the funding shortfall? I had heard from many other stakeholders that the existing system was not “fair” in the sense that it did not result in their paying a “fair share” of the premiums required to fund the system. For these employer stakeholders, these issues could not be addressed soon enough. Some injured worker stakeholders asked the questions: Why is it so important that the system be “fair” for employers? What about “fairness” for injured workers?

My response is that getting to full funding is clearly still the objective. Reaching that goal is important for injured workers because that is what provides for security of benefits and the ability to respond to emerging needs and circumstances as the economy changes. It is important for employers because it brings an end to the intergenerational subsidization that is occurring under the present system. Currently, costs of the system are being transferred to future generations of employers. However, it will be extremely difficult to achieve that full-funding goal through a system that is not seen as fairly distributing the costs. Workers’ compensation occupies a unique space in Canadian public policy. The policy and the legislation that implements it was the result of a great compromise or social contract developed by William Meredith over a hundred years ago. That social contract is only sustainable as long as both stakeholder groups accept that the system continues to work in their best interests, and is the most secure and efficient means to compensate injured workers for the losses they suffer in workplace accidents.

I was asked to inquire into a fair system for assessing Schedule 1 employers for the costs of the system, those costs being the benefits to which injured workers are entitled under the *Workplace Safety and Insurance Act, 1997* (WSIA). When I talk about fairness for employers in relation to “classification and rate setting” I am talking about fairness to employers vis-à-vis other employers. Not fairness to employers at the expense of fairness to injured workers. This is not an effort to reduce the costs of the system, but an effort to ensure that the WSIB continues to have the support of employers in raising the funds necessary to pay the benefits that injured workers are entitled to. This was Meredith’s most important objective – the security of benefits for injured workers. The challenge to the WSIB today is to raise sufficient funds to ensure that the money will be there in 2024 to pay the wage loss and medical benefits to a worker injured in 2013, without imposing those costs on 2024 employers.

“This is not an effort to reduce the costs of the system, but an effort to ensure that the WSIB continues to have the support of employers in raising the funds necessary to pay the benefits that injured workers are entitled to.”

From my perspective, it goes without saying that injured workers are entitled to the benefits outlined in the legislation and to have their employer recognize that entitlement. Injured workers have a right to the fair administration of that legislation by the WSIB, to the expeditious resolution of their claims and to dignity and respect in the process. Schedule 1 employers have the collective responsibility to fund the system and they are entitled to a fair assessment of those costs on them as individual employers. Collective liability is necessary for the sustainability of the workers’ compensation system, and employers are entitled to the protection that system makes possible.

2 For the first time since 1997, the WSIB did not have to withdraw from the Investment Fund to help cover the costs of its operations. (WSIB Annual Report, 2011)

MEREDITH ON RISK AND SUBSIDIZATION

The most revolutionary aspect of Meredith's Report is often overlooked as it is simply stated and concluded in the first four paragraphs of a Report that runs to over 80 pages. Meredith notes that workers and employers agree on two revolutionary ideas. I summarize them as follows: first, that the system of tort law was totally inadequate for injured workers seeking to make injury claims against their employers; second, that risks of injury to workers were the "risks of the industries" and that compensation for those risks ought to be paid by the industries.

Having said that, Meredith then goes on to consider what is the most efficient way of levying those costs on the various industries and employers. Today we take for granted the fundamental revolutionary aspect of the system, that employers are financially responsible for the risk of injury to their workers.

Meredith looked at two options for how employers would actually pay the losses suffered by injured workers: one, simply legislate that employers were responsible for compensating their injured workers; or two, establish a system of collective liability. Those opposed to collective liability said it was unjust to impose on one employer the costs of another, what we refer to as subsidization. Those in favour of collective liability argued that it was the only way to ensure compensation would be secure and that small employers were not ruined financially by the burden of compensation.

Meredith came down in favour of "collective liability" and said that the injustice of the inherent subsidization involved in collective liability could be remedied by ensuring that employers in classes or subclasses did not pay a "uniform rate" but a rate that takes relative risk into consideration. He said that sections of his Draft Bill did that. He went on to say that "if insurance is to be mandatory I see no reason why the cheapest form of it – mutual insurance – should not be prescribed".

Meredith in a nutshell:

We recognize that individually employers are responsible for compensating employees injured in their workplace. In order to ensure compensation is payable to injured workmen and to ensure no employer is faced with a cost they cannot bear, we will require employers to mutually pay each other's costs, provided we can calculate their mutual contributions based on the risk they present to the group.

THE ROAD TO FULL FUNDING

Harry Arthurs' *Funding Fairness* report was an important milestone that has greatly contributed to the WSIB being on the course to full funding. His point of departure was the 2009 Annual Report of the Auditor General, which said that:

The WSIB may need to find a new approach to deal with [its unfunded liability]. Failure to do so could result in the WSIB ultimately being unable to meet its commitments to provide workers with the benefits to which they are entitled.

This is what the system faces when it is not fully funded; the benefits of injured workers are at risk. But there is an equally dangerous system risk. As the funding level deteriorates, there is a gradual erosion of stakeholder confidence in this piece of public policy put together by Meredith in 1915. Employer and workers stakeholder groups will question whether this still is the most secure and efficient means to

compensate injured workers. Injured workers will lose confidence in the system if it does not provide adequate security of benefits. Employers will lose confidence in a system that increasingly asks them to pay – not just the current costs of the system, but the costs generated by a previous generation of employers, employers in other industries, and employers that no longer exist or, if they do, are a shadow of what they once were.

The introduction of Ontario Regulation 141/12 is a clear signal that the WSIB's unfunded liability (UFL) is of public concern. There is now legislative accountability for the WSIB to attain full funding in the insurance fund within a specific timeframe, where previously there was none. To fulfill this requirement, the WSIB has developed a plan to achieve full funding, which includes a Funding Policy, as well as a Sufficiency Plan³.

With the implementation of the Funding Policy, the WSIB aligns itself with most other major workers' compensation boards in Canada. The funding policy includes principles that support the attainment of the regulated funding requirements, leading to the goal of achieving full funding by 2027. In order to ensure transparency, the policy includes principles on governance of the premium rate setting process, and the roles and responsibilities of the Board of Directors, the Chief Actuary, and WSIB management. This is a significant milestone for the Board, and should help to instill further confidence in the Board's ability to meet its obligations to workers and employers.

CLASSIFICATION – WHY NOW?

In the introduction to my Discussion Paper I asked the question "Why and Why Now?" I cited the numerous studies of one or another aspect of classification, rate setting and experience rating that the WSIB had undertaken between 1989 and the 2010 Funding Review. The list includes:

- 1989 Revenue strategy: A Framework for the 1990s and Beyond
- 1998 Consultation Report on the WSIB Funding Policy
- 2008 Recommendations for Experience Rating, Morneau Sobeco
- 2009 Chair Mahoney's Report on Stakeholder Consultations
- 2010 WSIB Funding Review

I said that the time had passed for asking "is there a problem" and that we should move on to how to solve the problem. Some stakeholders challenged the conclusion that the need for change was self evident, and I undertook to re-examine that notion.

In doing that, I revisited Harry Arthurs' report and sought to put that exercise into proper context. I asked the WSIB to respond to the question "why now?" and they produced a document that was then posted on their website entitled, *WSIB Classification and Pricing System: The Case for Change* (Case for Change) . That document is not just the WSIB's perspective on problems with the classification system. It documents real examples of practical problems that individual employers and groups of employers have with the present classification system. The Case for Change document echoes much of what was observed by Harry Arthurs in his report, *Funding Fairness*.

Two fundamental issues are raised by Arthurs, the WSIB, employers and stakeholders that make the case for change compelling. The first of these is that the present classification system, based on Standard Industry

3 <http://www.wsib.on.ca/en/community/WSIB/ArticleDetail?vnextoid=3b05a0d9940af310VgnVCM100000469c710aRCRD>

Classification (SIC) codes, is no longer relevant due to the changed Ontario economy. Harry Arthurs said that:

[The present system] rests on a foundation of anachronisms and ambiguities, permits the impression and/or reality of serious abuses, encumbers the system with unnecessary transaction costs, sometimes produces results that seem indefensible, and – especially – fails to support the integration or articulation of premium rate setting and other activities related to the enhancement of safe working conditions and practices.

The Case for Change document is replete with examples that reinforce this point. In addition, the satisfaction of small employers in Ontario, as surveyed by the Canadian Federation of Independent Business (CFIB), with respect to the accuracy of the classification process is among the lowest across Canadian jurisdictions⁴.

The second principal issue raised by stakeholders, Arthurs and the Case for Change document, is the problem that the present premium rate-setting model is based on an assumption which has been proven to be wrong in many instances - the assumption that employers undertaking a similar business activity or engaged in the same industry will present a similar “risk” to the system. When groups (for example the spray-wash businesses and the mushroom growers who presented briefs during the public consultations) complain about their premium rate being unfair, it is because that rate is being affected by a larger component of employers in the rate group that they are bound to by the classification system; and that larger component of employers has a higher risk profile that is statistically verifiable. They know that they present less risk to the system than those other employers in their rate group and that they are, in effect, subsidizing them.

Arthurs says:

At present, all Schedule 1 employers are assigned to one of 154 RGs [rate groups], each of which is assigned its own average premium rate. The rationale, presumably, is that firms in each RG participate in similar business activities and/or expose their workers to roughly similar risks and/or generate roughly similar claims costs for the WSIB. However, this element of commonality is simply assumed and then ascribed to the firms in the group; it is not derived from an empirical assessment of what they and their employees actually do. In fact firms in many RGs often differ considerably from each other in each of the three respects mentioned.

The Case for Change document illustrates a point made by Meredith 100 years ago: advances in technology can dramatically distinguish two firms in the same business. If one of those firms has adopted new technology, their “risk to the system” might be dramatically different. There are real examples of this in Ontario today.

In effect, under the present system, an employer’s premium is driven by the classification system. That means that the premium an employer pays is largely driven by their SIC classification and the performance of their cohorts in that classification. As the Case for Change document makes clear:

Since the WSIB’s pricing system is underpinned by the classification scheme, the lack of precision in classification produces premium rates that result in significant cross-subsidization among employers within rate groups given the much weaker link between business activity and risk that exists at present compared to the Ontario of the late 1980’s.

4 <http://www.cfib-fcei.ca/cfib-documents/5520.pdf>

An example of that cross-subsidization within a rate group is provided in the WSIB's Case for Change Document:

Employers who were first in their rate group to acquire new automated processes, such as computer-guided laser cutting, would continue to pay the same premium as their competitors whose workers continued to use hand-held jigsaws.

Another example of this cross-subsidization was provided by Mushroom Canada in their submission to me, stating that “many of the classifications and rate groups, specifically in the agri-food sector, do not fairly reflect the reality of the industry⁵.” Specific examples and feedback I received demonstrate that the current classification system contributes to an unfair distribution of costs to today's employers and undermines employer confidence. It is possible to remove these elements of “subsidization” and preserve the important element of collective liability in the system. This change to the WSIB's classification and pricing system is required to achieve confidence and fairness which are critical to any system.

RATE SETTING – WHY NOW?

In *Funding Fairness*, Harry Arthurs recognized that one of the contributing factors to the WSIB's UFL was the failure to develop a rate setting process that allowed the WSIB to accurately assess the premium revenue they needed and to translate that into an appropriate rate for each employer. Arthurs said:

In Chapter 2, I asked why the WSIB had to abandon its 1984 plan to achieve full funding by 2014. While many explanations have been proffered, one important factor was its failure or inability to set premium rates in accordance with the logic of its funding policy. Rate setting, in other words, is the Achilles heel of any funding strategy.

In reality, the WSIB does not have a rate setting process designed to deliver the revenue required in any one year. There is a process that establishes a rate and some employers then participate in programs that increase or decrease their individual rate.

The WSIB is in real need of a new rate setting process. The practice of the last several years of “across the board” rate changes or “rate freezes” is acceptable only if the risk relativities and employer premium rates are acceptable and unchanging. We know that is not the case. Freezing rates deprives some employers of the opportunity for a lower rate that reflects their risk profile. More importantly it fails to impose higher rates on employers who ought to be paying a higher premium based on deteriorating performance. I discussed the problem of “subjective overlays” to the rate setting exercise in my discussion paper where I said:

Freezing rates might be an acceptable response when you know an overhaul of the system is imminent. However, it exacerbates any inequities in the system and may result in more dramatic rate changes when a new system is implemented making a transition more difficult.

“The WSIB has anticipated rate-setting reform and any further delay in implementing a new process runs the risk of compounding elements of inequity that exists in the present system.”

The WSIB has anticipated rate-setting reform and any further delay in implementing a new process runs the risk of compounding elements of inequity that exists in the present system.

5 <http://www.wsib.on.ca/files/Content/SubmissionsMushroomsCanada/MushroomsCanada.pdf>

EXPERIENCE RATING – WHY NOW?

The Need for Reform

Experience rating means different things to different people. A good definition of what I refer to as “insurance based” experience rating is found in legislation in the State of California where they refer to a “pure premium rate” and they define experience rating as:

A rating procedure utilizing past insurance experience of the individual policyholder to forecast future losses by measuring the policyholder’s loss experience against the loss experience of policyholders in the same classification to produce a prospective premium credit, debit or unity modification.

The definition of “experience rating” from the California legislation is often referred to as “insurance equity” and it is the basis of experience rating programs in many of the other jurisdictions in Canada.

In Ontario, stakeholders have come to think of experience rating in terms of the existing programs that are designed with the objective of driving certain employer behavior (these programs include NEER and CAD-7). These kinds of programs are characterized by a retrospective look to determine whether the policyholder met defined objectives and thereby qualified for a premium rebate. Those standards may or may not reflect “cost” and the behavior being incentivized may or may not relate directly to costs.

Experience rating was the principal concern of a great number of stakeholders who responded to my discussion paper. In my paper, I asked stakeholders about insurance equity – a system where premiums paid are fairly adjusted to more accurately correspond with the insured’s expected claim costs and related expenses. Employer stakeholders are strong advocates of insurance equity, as outlined in their submissions to me.

The Employers Advocacy Council (EAC) favoured replacing the current system with a system of rate setting incorporating risk banding similar to British Columbia⁶:

EAC believes that there could be some merit in the option that replaces the current experience rating programs with a rate-setting model incorporating both risk banding and experience rating, like the model adopted in British Columbia, which also involves prospective adjustments.

Employer members of the Workplace Safety and Prevention Services (WSPS) Advisory Committees supported the use of “insurance features” and simplicity in experience rating⁷.

The Ontario Hospital Association (OHA) advocated replacing the existing system with experience rating through risk banding⁸:

... replacing the current experience rating programs with a rate-setting model incorporating both risk banding and experience rating is the best option for Ontario and Ontario hospitals. As discussed earlier, correctly classifying organizations by business activity and risk would allow for a more transparent, understandable and accurate means of determining base rate. With these

6 <http://www.wsib.on.ca/files/Content/SubmissionsEmployersAdvocacyCouncil/EmployersAdvocacyCouncil.pdf>

7 http://www.wsib.on.ca/files/Content/SubmissionsWSPSAdvisoryCommitteesSubmission/WSPS_AdvisoryCommittees.pdf

8 <http://www.wsib.on.ca/files/Content/SubmissionsOntarioHospitalAssociation/OntarioHospitalAssociation.pdf>

measures in place, risk banding could then be used to further distinguish the level of performance, relative to similar organizations.

The Ontario Business Coalition (OBC) spoke in favour of experience rating designed to enhance pricing equity⁹:

It is an absolute necessity that experience rating be maintained. The program must be cost based – not activity driven. The purpose is to enhance pricing equity whether or not it has any measurable impact on accident prevention or return to work. If the legislation needs to be changed then it should be changed.

I asked specific questions in my discussion paper about small employers because the biggest challenge in developing a rate setting and experience rating system is to build a system that accommodates and is fair to both the very small and very large employer. Small employers in Ontario do not have confidence that the current system is fair to them.

From this input from stakeholders, there is strong support for experience rating that is closely linked to setting a fair premium reflecting an individual employers risk to the system. They identified specific challenges with the current programs (CAD-7, NEER), including the lack of availability for all employers, large and small. In Ontario, 110,000 registered employers are unable to participate in any experience rating because of their size of payroll or claims experience.

Harry Arthurs recommended that the WSIB should immediately begin considering the redesign of its existing Experience Rating programs and other employer incentive programs because, as he put it: “no one knows whether these programs are in fact achieving the purpose the statute requires them to achieve”. Arthurs’ view was that these programs were principally financial incentives for employers to reduce accidents and improve return to work outcomes, not mechanisms for fair premium rate setting. My perspective on these programs is outlined in the conclusions below.

“In Ontario, 110,000 registered employers are unable to participate in any experience rating because of their size of payroll or claims experience.”

Supporters of these programs point to declining accident frequencies in their industries. However, accident frequencies have been declining in jurisdictions in Canada which do not have similar experience rating programs, which suggests other factors are at play.

Others are equally critical of the existing experience rating programs because they do not meet the objective of enhancing insurance equity. To the extent that the financial incentives are not exclusively related to “costs” and to the extent that not all employers who pay a premium have access to the financial incentives, these programs are not “rating” all policyholders on the basis of their costs to the system. The CFIB, for example, points out that many small employers have no access to these existing programs.

Labour/injured worker stakeholders are critical of any experience rating on the basis that they believe it encourages a range of undesirable employer behavior such as:

- Forcing workers back to work too soon at a risk to the worker and co-workers;
- Offering inappropriate work to the worker; and

9 <http://www.wsib.on.ca/files/Content/SubmissionsOntarioBusinessCoalition/OntarioBusinessCoalition.pdf>

- Paying less attention to return to work for claims eligible for cost relief.

As well as cost avoidance strategies, including:

- Failure to report accidents;
- Putting pressure on workers not to report claims;
- Employer aggressive appeals on claims;
- Primary focus on getting cost relief potentially taking resources away from prevention efforts; and
- Misrepresentation of claims (attempt to take advantage of features of the system or behaviour detrimental to the care required by the injured worker).

The WSIB has, in response to Arthurs, investigated the concerns surrounding claim suppression. They commissioned an independent study of workplace injury claim suppression and released the related final report in April 2013, *Workplace Injury Claim Suppression: Final Report*¹⁰. The study found that claim suppression is a complex, multi-faceted issue and it is particularly challenging to quantify or infer motivations.

The study did not find any Canadian literature that endeavored to find a direct link between experience rating and claim suppression. However, from a review of the literature on experience rating in workers' compensation, and the various studies of the existing experience rating programs, certain design elements of programs that use experience are identified as potentially contributing to these negative behaviours. Those design elements should be avoided in any new Rate Framework. However, employers may fail to report claims and workers may fail to report accidents for a variety of reasons. Addressing the design elements in experience rating that might potentially contribute to negative behaviours should not be the only response from the WSIB to the problem of non-reporting of accidents.

MY CONCLUSIONS

My conclusion is that this is an opportune time for the WSIB to re-examine its approach to the rate setting process, including the classification structure and experience rating. First, recent reports have suggested that these programs exhibit intrinsic design flaws and could contribute to the under-reporting of claims. Second, there is stakeholder support for a more universal rate setting process that uses risk as an element of rate setting for all employers – an integrated system (as opposed to a separate program). This is consistent with the objective of a simpler, more transparent system of rate setting.

The WSIB has broad statutory authority in assessing premiums on employers in Schedule 1. In exercising that power to assess the cost of the system on employers, they must be seen to be doing it in a way that ensures everyone pays their fair share. In my discussion paper I said:

Meredith recognized that any system of collective liability might result in some employers sharing an unfair burden of accident costs and he introduced into the legislation provisions to guard against that unfairness. Understanding how that works and why a system of grouping employers together is necessary to achieve fairness requires an understanding of how we use risk as a measure, and what it is a measure of.

The reality is that “risk factors” have been a consideration in the premium rate setting process since the very beginning of the system. Meredith accounted for those “risk factors” through the very rough mechanism of

¹⁰ <http://www.wsib.on.ca/files/Content/FundingReviewClaimSuppressionStudy/WSIBClaimSuppression-FinalReport.pdf>

“employer classification”. Employers were put into groups, based on a description of their business, on the assumption that they presented a similar “risk” and should share costs and pay a similar premium. In my discussion paper (at page 21) I talk about the “confusion” over the goals of experience rating that emerged in the 1980’s when “financial incentives to improve health and safety” were developed with clearly different strategic objectives.

We understand more now about the imperfections of using a system of descriptive “classification” as a tool for categorizing employer risk and we have an ability to determine relative risk in much more sophisticated and reliable ways. The tools are available to do a better job of premium rate setting and to avoid individual employers and groups of employers sharing an unfair burden of the accident costs.

My conclusion is that the WSIB needs to re-focus on the insurance fairness aspect of experience rating: risk introduced into the system and the fairness of allocating the associated costs. Going forward I will refer to this concept as “risk adjusted premium rate setting”. The reason for recommending that focus is to restore and maintain employer confidence in the system, which in turn is essential to the achievement of funding requirements mandated for the WSIB in legislation. Today’s employers are being asked to absorb the considerable legacy costs of the system. My view is that getting employers to agree to shoulder that burden will depend on there being in place a system that is seen by them to fairly distribute the current costs of the system.

Financial incentives for employers to improve workplace safety, support for employer involvement in health and safety promotion and education are still important public policy objectives and I deal with that issue at the end of this report in a section entitled “Financial Incentives Funding and Support for Prevention.”

THREE | CURRENT SYSTEM: PERSPECTIVES AND MY CONCLUSIONS

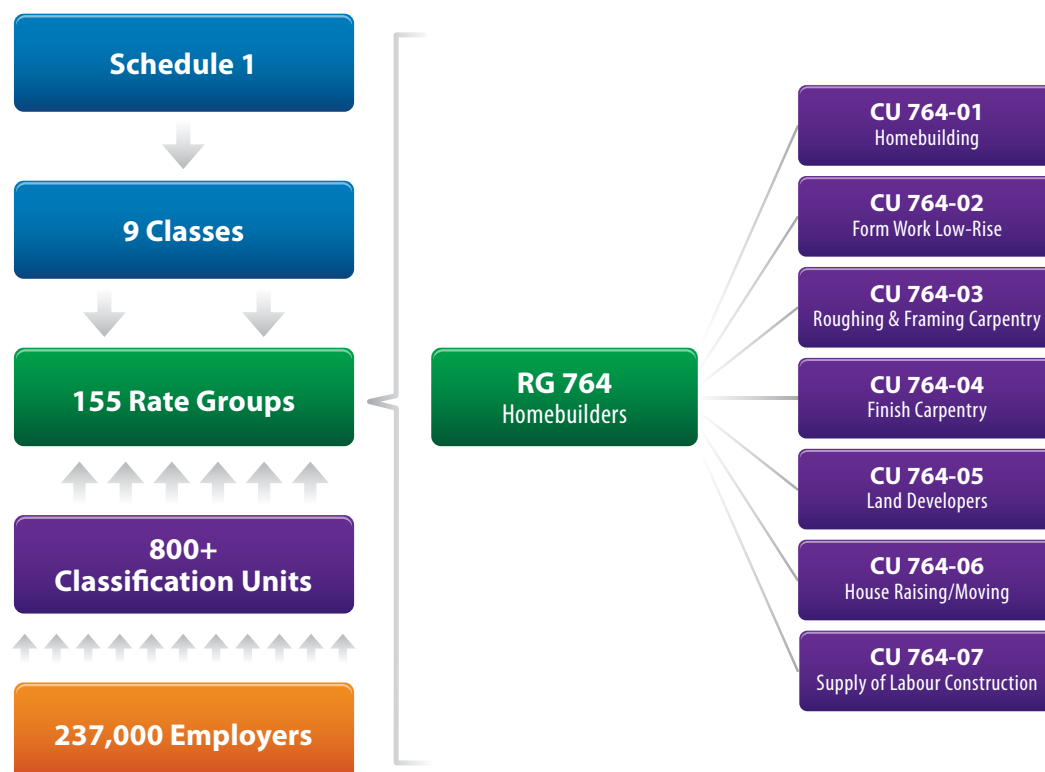
CLASSIFICATION

When Meredith made his recommendations, he was influenced by the fact that, at the time in Ontario, many industries were small and unstable. Collective liability based on class of industry, was thus the only practical way to secure benefits for injured workers. Today, the size of employers and the scope of their activities are very different and pose different challenges in the design of the system. There are still a very large number of small employers in Ontario and there is a 20% turnover in employers every year. However there is a real difference today in terms of the diversity of employers and the numbers of very large and very stable employers in mature industries. These larger employers have statistically predictable risk.

The existing classification system is based on the Standard Industrial Classification (SIC) coding of all industries and employers are then further divided into rate groups and sub-divided into classification units (CUs). The WSIB currently has 155 rate groups for which premium rates are set and over 800 CUs into which individual employers are classified and for which statistics are kept. See Figure 1 below for an example of how classification units described by an SIC five digit code are rolled up into a rate group for "Homebuilders".

The SIC was developed by North American government statistical agencies who have since abandoned its use in favour of a new industrial coding system called North American Industrial Classification System (NAICS).

Figure 1: Current Classification Structure – Example



For those stakeholders who had real problems with the present system, I heard that classification is the source of their problems and that there is no system fix open to them. In practice, the present system has become very restrictive and the limited flexibility that was intended to be built into the system around CUs was never exercised. The Case for Change document admits:

In principle, the classification system was designed to automatically monitor the relative risk of individual CUs so that if the accident costs of a particular CU diverged from the rate group average, it would be flagged and potentially moved to another rate group that is more reflective of its current risk. However, in practice, notifications of such disparate CUs rarely occurred and even rarer, when a CU was relocated, it was done through a laborious manual process.

It is not the SIC system itself, but this lack of systematic monitoring and maintenance that has created a problem. There are jurisdictions that still use the SIC structure but have in place a maintenance system to ensure that the classification system remains relevant over time. For example, both the Yukon and PEI continue to use the SIC structure (or a similar version thereof) to the satisfaction of employer stakeholders¹¹. Those jurisdictions do not have the problems that Ontario has today because over the past five years those Boards have moved to an annual system that maintains a disciplined classification review process where industries are moved to different rate groups if there is supporting evidence to warrant a change in the rate group they are assigned to.

I asked the question in the discussion paper whether “rate shopping” (often cited as a problem in Ontario) is a symptom of a more fundamental problem. I conclude it is a problem that arises from the absence, in Ontario, of systematic maintenance of the classification system and a process for adapting it to changing circumstances. Consequently, there is no valid mechanism for employers to be rewarded for improved experience and industries are not held fully accountable for deteriorating experience. The current experience rating programs, which apply to individual employers but not all employers, cannot be relied on to provide the remedy for the inequities arising out of the rigidity of the classification system.

These classification problems could be resolved through ad-hoc classification decisions or the development of a maintenance program. However, these solutions simply perpetuate a system that continues to be outdated, is ill suited to addressing the challenges of the changing industrial landscape in Ontario and would be costly and difficult to administer. In the long-term, ad-hoc decision-making is inconsistent, arbitrary and unfair. The diversity of employers in Ontario as well as their numbers and the diversity within “classifications” stand in marked contrast to the much smaller systems in PEI and the Yukon. The administrative burden of trying to fix the current system through the kind of systematic review that exists elsewhere (and was originally intended for Ontario) would be substantial. More importantly, however, that approach fails to address the real source of the problem.

I have come to the conclusion that if “rate setting” is the Achilles heel of a funding strategy (as Arthurs suggested) then the inability of the system of classification in Ontario to adapt to changing circumstances is the Achilles heel of fair rate setting. The inflexible link between classification and premium rate setting which is a feature of the present system has to be replaced with a different approach.

11 In a statutory review of the PEI system in 2011, “classification” was not raised as an issue by any stakeholders.

CURRENT RATE SETTING AND EXPERIENCE RATING PROGRAMS

As noted previously, in section 2, there is stakeholder frustration with the existing experience rating programs (NEER, CAD-7, and MAP) and legitimate questions raised as to whether they achieve the goal of safer workplaces. One employer organization said that recent changes to NEER, which reduced its rebates and increased its surcharges, have “removed safety incentives, fairness and equity from the system”. In addition, the changes have made rates “less predictable” for employers. Other stakeholders were critical of changes made to the programs that were not transparent, one describing the changes as “clandestine”.

There was support from employer organizations for one “cost-based ER system” and support for integrating cost experience with rate setting. One organization specifically said that experience rating programs should not be “event or process driven”. Others were critical of the existing programs for their lack of transparency. Rebates and surcharges, the distinguishing features of the present experience rating programs, are not a feature of the current system that is universally supported by employers. To the extent that they contribute to unstable and unpredictable rates, I heard employers tell me that they are not in favour of them. Under the present system, an employer who goes from a rebate in one year to a surcharge in the next can see their WSIB cost vary by as much as 35 percent in one year.

DESIGN ELEMENTS OF EXPERIENCE RATING PROGRAMS

Experience rating has not become a controversial issue in other Canadian jurisdictions to the extent that it has in Ontario (with the exception of Manitoba, where the issue was recently the subject of a brief study¹²). In my discussion paper, I cite the conclusions of the 2008 Morneau Sobeco study that reviewed the existing WSIB experience rating programs. Morneau’s key conclusions were:

The three experience rating programs produced very different results for otherwise similar employers on either side of the \$25,000 Merit Adjusted Premium (MAP) threshold. This issue should be addressed as part of the long term considerations in a review of these programs.

Both CAD-7 and NEER are highly sensitive to claims experience. In both cases there is a multiplier effect which means that the impact on experience rating can be greater than the variance in claims costs. This has important implications both for the effectiveness of the programs in motivating desired behaviors and on their potential to result in some undesirable behaviors.

There are reasons to be concerned about the size of the financial incentive because increased use of the Second Injury Enhancement Fund (SIEF) has caused a smaller portion of the premium to be experienced rated. The experience rating programs, because of the way they are designed, provide some low cost opportunities to optimize incentives through efforts that are not necessarily focused on prevention and return to work outcomes. There are several other design issues that are not an immediate concern, but which should be carefully examined as part of a longer term review. For example, the WSIB should consider the impact of a fixed amount for fatality claims regardless of the true cost.

I have to conclude that simply using past cost experience as a measure of a “risk factor” in rate-setting is not the source of controversy over experience rating. However, design elements of incentive programs may

12 http://www.gov.mb.ca/labour/safety/pdf/2013_fair_compensation_review_report.pdf

create an environment more conducive to undesirable behavioural responses, like the non-reporting of claims. It is not the use of experience rating per se, but rather how Ontario's programs use experience rating in the design of their current programs that contributes to the controversy.

In the following sub sections I identify particular design elements and other issues that are problematic from an outcomes, transparency and fairness perspective.

Small Employers

I was urged by stakeholders to ensure that small employers participated in, and were able to take advantage of experience rating in any future framework. Presently 110,000 employers, or roughly half of all employers in the system, are not able to participate in any the existing programs and new employers in Ontario must wait three years before being eligible to participate.

In addition, the satisfaction of small employers in Ontario (as surveyed by the Canadian Federation of Independent Business) with respect to their level of understanding of the premium rate setting processes is the lowest among Canadian jurisdictions. This is consistent with the WSIB's own surveying (via Ipsos-Reid) of the perceived fairness of premium rates and rate setting process which has steadily declined from approximately 65% to 50% from 2008 to 2012¹³.

“...the WSIB's own surveying (via Ipsos-Reid) of the perceived fairness of premium rates and rate setting process which has steadily declined from approximately 65% to 50% from 2008 to 2012.”

Prospective Versus Retrospective

It was suggested by a significant number of stakeholders that the WSIB ought to move towards a system of prospective rate adjustment as opposed to retrospective rebates and surcharges. I was struck by the fact that the individual employers I spoke with (as opposed to employer associations) were in favour of a prospective system. Those individual employers cited the uncertainty of retrospective rebates/surcharges and rate stability as the reason for that preference. This included large employers who were in receipt of rebates but understood that rebates were only possible through surcharges and had experienced going from a rebate to a surcharge situation. To paraphrase what I was told by one: “I would rather have the WSIB properly price the product and set the premium, than be told I paid too much and I am getting a rebate”. Associated with some of the dissatisfaction with the present system of rebates, were the arbitrary rules (for example those around the Fatal Claims Policy) that resulted in some earned rebates not being paid and the uncertainty and instability that accompanied the existing programs.

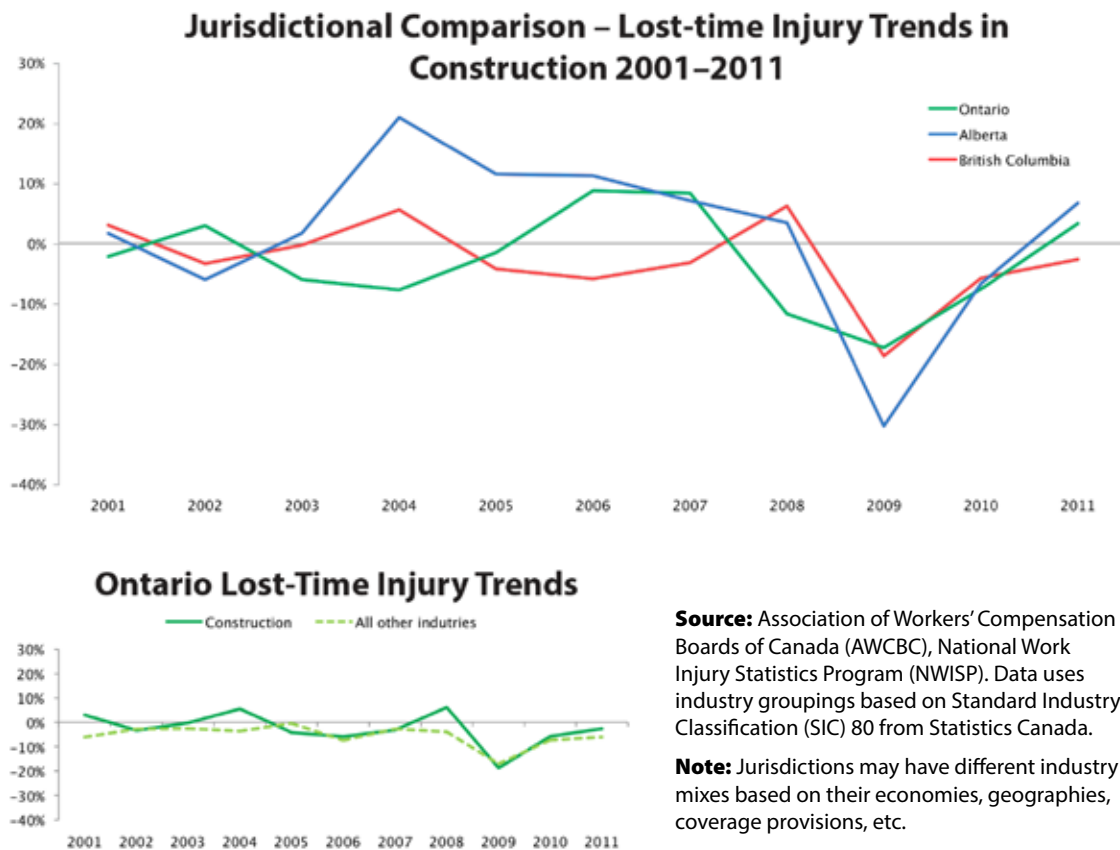
The use of experience rating is not unique to Ontario. What is unique in Ontario, however, are certain design features of the existing programs, including the retrospective nature of NEER and CAD-7. Eight other jurisdictions in Canada have a system of prospective rate adjustment based on an employer's experience relative to their cohorts in a “rate group” or “risk band”. Experience rating in these jurisdictions is very close to the California definition cited above.

“I was urged by stakeholders to ensure that small employers participated in, and were able to take advantage of experience rating ... It was suggested that the WSIB ought to move towards a system of prospective rate adjustment as opposed to retrospective rebates and surcharges.”

13 WSIB Customer Satisfaction Survey Q2 2013.

Proponents of the existing programs, particularly in the construction industry, point to their success in reducing accidents. The graphs in Figure 2 demonstrate that the same trend can be observed in other Canadian jurisdictions with a variety of experience rating programs that are very different from CAD-7 and NEER.

Figure 2: Lost-time Injury Trends in Construction



Second Injury and Enhancement Fund (SIEF)

In considering potential reforms towards a new Rate Framework, the WSIB should also consider whether it is appropriate to continue the SIEF program.

The extent to which some employers use SIEF, and its relationship to the current experience rating programs, was examined by Morneau Sobeco (now Morneau Shepell) in their 2008 review of those programs. Morneau concluded that the fairness of the existing programs was skewed by some employer’s excessive resort to SIEF to reduce their claims costs. In effect, those employers would be subsidized by employers that were not utilizing the program. Morneau identified that the use of SIEF, predominantly by large employers, resulted in an inequity in the sharing of common costs that had the potential to undermine initiatives in other areas such as prevention and return to work.

The Morneau Report flagged that the WSIB had itself concluded SIEF and experience rating were not always compatible. In referencing a previous WSIB Study, the Morneau report noted:

The clear intent of the (experience rating) programs is to focus assessment costs on employers with the worst accident experience – not to spread this risk amongst others employers. Therefore

experience rating and SIEF may not always be compatible. (...) This practice undermines the ‘risk focusing’ intent of experience rating programs.

More recently, in *Funding Fairness*, Arthurs recommended that the WSIB: “abolish SIEF or replace it with a program of wage subsidies for injured workers seeking to return to work with their original (or another) employer”.

As the WSIB considers my recommendations to abandon the current experience rating programs and adopt risk adjusted premium rate setting, it should consider whether to continue SIEF. In its place they might consider what, if any, measures are necessary to support return to work efforts, in a manner that does not impact the fair attribution of claims costs to employers.

The Experience Rating Window

In my engagement with stakeholders, I also heard about certain back-to-work activities being perceived as undesirable employer behaviour. Discussions with employers confirmed that these back-to-work activities do take place, and I also learned that they are not simply driven by a desire to avoid costs associated with workers’ compensation. As I noted in my interim discussion with stakeholders in June 2013:

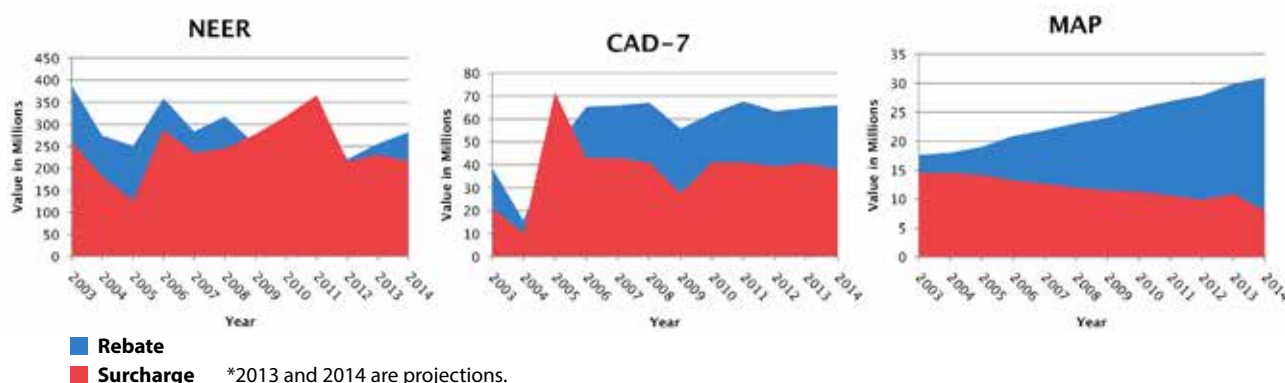
Not all back-to-work efforts should be seen as suspect; “legitimate” return to work programs should be encouraged.

That said, it is important for the WSIB to remain vigilant in this respect and for it to monitor return-to-work activities as they coincide with the elements of existing experience rating programs and as part of any new Rate Framework. Specifically, the WSIB should consider the impact of the four-year “window” for a program such as NEER. This program feature may be a negative contributing factor given the gap between the experience window and what is commonly referred to as the “72 month lock-in”. In conjunction with any future consideration of the 72 month lock-in, the WSIB should review this issue with respect to the existing experience rating programs.

The “Off-Balance”

The “off balance”, a problem with the existing programs that has been identified in studies by Morneau, Arthurs, and others, was also of concern to some employer stakeholders.

Figure 3: Historical Off-Balance – WSIB Experience Rating Programs (2003 to 2014)



Those stakeholders who commented on “revenue neutrality” supported the concept that any experience rating should be revenue neutral. The Construction Employers Coalition made the following recommendation in their submission to me:

Recommendation: Cost based ER founded on a principle of “revenue neutrality” (no off-balance – surcharge or rebate) must continue. Subjective audit based systems are not supported as a replacement vehicle for ER, although they (Safety Groups, etc.) may work as stand-alone complementary initiatives.

Arthurs specifically identified the magnitude of this “off-balance” between the surcharges collected from and the rebates issued to employers:

For present purposes, what is material is that, in the 15 years prior to 2010, rebates exceeded surcharges by a cumulative total of \$2.5 billion – a substantial contribution to the WSIB’s UFL. Virtually everyone is agreed that these programs should not generate such an “off-balance,” and in 2010 the WSIB made considerable progress towards eliminating it.

Unfortunately, the more recent experience with respect to NEER, CAD-7 and MAP has been less than successful. The WSIB’s current estimate for a negative off-balance for 2013 is over \$70 million, with the 2014 forecast at over \$100 million. As such, the WSIB should be expected to address this concern, given its magnitude, ahead of any new Rate Framework. Failing to address it could contribute to a failure to meet the legislated funding requirements and could result in all employers subsidizing those employers who participate in these programs and contribute to the off-balance.

The element of subsidization (the fact the programs are not revenue neutral) should be addressed by the WSIB in advance of any new system for Schedule 1 employers, and doing so may also smooth the transition to a new system. To the extent that the experience rating programs can be made to be revenue neutral, an effort should be made to achieve that result so they do not continue to contribute to the UFL.

Temporary Employment Agencies

Temporary employment agencies (TEAs) “employ people to assign them to perform work on a temporary basis for clients of the agency. Work assignments may be short-term, long-term or open-ended.”¹⁴ Currently in Ontario, the WSIB recognizes TEAs as the employers of record. TEAs are included in the employer classification scheme, for premium rate setting and the current experience rating programs. Issues around the employer-worker relationship introduced to the workers’ compensation system by TEAs merit further examination, particularly as they relate to experience rating.

The Law Commission of Ontario has expressed concern that TEAs are deemed the employers for WSIB purposes and are considered to be the accident employers when accidents occur on a third party worksite, which the TEAs have little control over. The Commission expressed a concern that this could create an incentive for employers to contract out more dangerous work to TEAs, thus avoiding higher WSIB premium rates or the consequences of those claims on their current experience rating programs¹⁵. In its final report on *Vulnerable Workers and Precarious Work (2012)*, the Law Commission of Ontario recommended that the Ontario government and the WSIB review the impacts of WSIB policies and practices to determine the effects of the experience rating program and other policies on vulnerable workers.

14 <http://www.labour.gov.on.ca/english/es/pubs/guide/tempagencies.php>

15 <http://www.lco-cdo.org/en/vulnerable-workers-final-report>

This same concern surfaced during Arthurs' engagement with stakeholders during the WSIB Funding Review. Arthurs relayed this perspective in his report:

Workers' representatives, for their part, pointed to the links between the workplace insurance scheme, labour market developments and social policy outcomes. Some examples: Increasing numbers of workers are dispatched by temporary agencies to work sites operated by a third-party employer; these temporary workers are likely to be unfamiliar with working conditions and safety hazards on those work sites, which increases their risk of suffering workplace injuries.

MacEachen et al, (2012) studied this issue in greater detail and expressed their concerns with shifting work with greater risk from client employers to TEAs to avoid higher premium rates within the current WSIB system, as well as to avoid potential implications under the current experience rating program.

These observations raise concerns with respect to the fairness of premium rate setting processes, between employers utilizing different employment approaches, and the integrity of the system. The WSIB needs to examine the responsibilities of temporary employment agencies and client employers with respect to employer classification and experience rating, and consider amendments to the current policies and practices to ensure that appropriate premiums are assessed and that costs are attributed to the appropriate employer.

MY CONCLUSIONS

Based on the above issues and corresponding challenges for the rate setting system, I am recommending the existing WSIB experience rating programs be abandoned in a new WSIB Rate Framework. Rebates and the use of claims frequency as a qualification for rate adjustment are examples of design elements that should be avoided in a new system. I want to be clear: I am recommending that an element of cost experience be integrated into the Ontario rate setting model to further "insurance equity". My objective is to recommend a system that is responsive to an employer's increasing/decreasing risk to the system.

“Based on the above issues and corresponding challenges for the rate setting system, I am recommending the existing WSIB experience rating programs be abandoned in a new WSIB Rate Framework.”

What Are We Trying to Build?

The conclusions I have drawn from my research, analysis and consultations with stakeholders are that the WSIB ought to design and implement a new and disciplined risk adjusted rate setting process:

1. A system that collects sufficient funds on an annual basis to pay present and future benefits to injured workers and makes up the inevitable annual gains/losses in a timely and prudent manner (**Sufficient and Timely Funding of Benefits**);
2. A system that imposes those costs on employers in a fair and equitable manner and strikes a reasonable balance between fair premium rates and collective liability (**Fair and Equitable Allocation**);
3. A system with clear fundamental goals that is monitored and evaluated against those goals (**Monitored Against Fundamental Goals**);
4. A system that is responsive to an employer's efforts to reduce workplace injuries but not one that encourages an employer to suppress claims (**Reasoned Responsiveness and Flexibility**); and

5. A system that is clearly understood by stakeholders, allows stakeholders to engage with confidence, and reduces the administrative burden to both employers and the WSIB (**Clear Understanding and Ease of Engagement**).

My conclusion is that the present system does not deliver on each of these essential points, which I consider as Fundamental Goals for any reform of the current system. As illustrated below (in Figure 4), I have summarized the assessment of the current system against these Fundamental Goals as I begin to outline a new Integrated Rate Framework in the following section.

Figure 4: Assessment Against Fundamental Goals

FUNDAMENTAL GOALS	ANALYSIS OF CURRENT SYSTEM
Sufficient and Timely Funding of Benefits	<ul style="list-style-type: none"> Historically, there has been a steady decline in funding level, clearly demonstrating that the existing rate setting process was not assessing sufficient premiums on an annual basis to pay present and estimated future benefit costs of that accident year. Until the recent adoption of a funding policy there was no disciplined approach for the systematic recovery of the unfunded liability or of annual gains and losses.
Fair and Equitable Allocation	<ul style="list-style-type: none"> The classification system contributes to an unfair distribution of costs to today’s employers and undermines employer confidence in the system. Existing experience rating programs are not available to all employers, they are not always based on an individual employers risk experience, are overlaid with arbitrary rules and include design elements that contribute to a complex system that lack transparency.
Monitored Against Fundamental Goals	<ul style="list-style-type: none"> There does not appear to be one overriding objective of “fair premium rate setting”. Currently, there is not “one system” of rate setting with clear strategic objectives. There is no systematic maintenance of the classification system and it has long since ceased to serve any strategic objective. There is no measure of whether existing financial incentives are achieving a clearly stated strategic goal.
Reasoned Responsiveness and Flexibility	<ul style="list-style-type: none"> Changes have been made to the current system on an ad-hoc basis year to year to address immediate issues with little regard to longer-term consequences. There is a lack of responsiveness to employer’s efforts to reduce workplace injuries. The design of existing programs may promote underreporting of claims.
Clear Understanding and Ease of Engagement	<ul style="list-style-type: none"> There is not one system that sets rates, incorporating insurance equity, but several systems with changing and different rules that are also artificially constrained by a classification system that fails to differentiate employers based on their risk profile. Arbitrary rules and design elements contribute to a complex system that lacks transparency.

RECOMMENDATION 3.1:

The WSIB should adopt the NAICS system of classification for the purpose of all data collection.

The existing experience rating programs (NEER, CAD-7 and MAP) should be abandoned and replaced with a prospective, risk adjusted premium rate setting system.

There should be a drive to maximize the participation of employers of all sizes.

I recommend that the WSIB, as interim steps to any new Rate Framework:

- ***Examine the current experience rating programs (NEER, CAD-7 and MAP) and consider appropriate mechanism(s) to address the off-balance; and***
- ***Examine the “window” for the current experience rating programs as it relates to return to work activities and the 72 month lock-in provisions in WSIA, and consider appropriate program amendments.***
- ***Examine the responsibilities of temporary employment agencies and client employers with respect to employer classification and experience rating, and consider amendments to the current policies and practices to ensure a fair representation of risk and cost within the current rate setting approach, and as part of any new Rate Framework.***

FOUR | INTEGRATED RATE FRAMEWORK

I have found that employers are willing to pay their fair share of the costs of the system. Further, that there is acceptance that it is fair that the premium paid by an employer reflects the costs to the system that the employer has generated. There is also general acceptance of the notion that the rate setting process should protect small employers from adjustments based on events that do not reflect real and sustained trends.

In addition to trying to provide a conceptual model for classification and rate setting, I have also given considerable thought to Harry Arthurs' comment in *Funding Fairness* that:

No strategy, however well considered, will succeed if rate setting is not driven by the achievement of strategic objectives, executed to the highest professional standards, perceived as transparent and intelligible by the employers that pay the premium rates, sufficiently stable to allow them (and the WSIB) to plan their affairs; and conducted with integrity and determination.

If the WSIB is going to meet its funding objectives it must also give serious consideration to those principles in the execution of the rate setting system. That must be:

Driven by Fundamental Goals

The WSIB now has a clear strategic objective. It has developed a Funding Policy and it has requirements for the recovery of the UFL. Based on my discussions with stakeholders, I have identified further Fundamental Goals specific to the Rate Framework that serve the purpose of assessing the merits of the integrated Rate Framework that I am proposing, against those of the current system.

Executed to High Professional Standards

The annual rate setting exercise is a disciplined accounting and actuarial exercise. It should be based on sound accounting and actuarial standards that are consistently applied from year to year. The premium rate should be what that disciplined process tells you it should be.

WHAT IS A DISCIPLINED, TRANSPARENT PROCESS?

When I refer to rate setting being a disciplined and transparent process, I mean a process driven by policy. Rate Setting is the WSIB's most important responsibility and I recommend the process be clearly established in WSIB Policy. The policy should give direction to staff on the formula to be used in developing the rate and direction to the Board on how the rate is set for the coming year. Although I have used the analogy of a clock-like mechanism, in reality rate setting is still not a precise exercise because there are certain assumptions that have to be made. The WSIB's rate setting policy ought to recognize that there is a range of reasonable assumptions made in the development of a rate by the WSIB's Actuary and Chief Financial Officer. For example, what is the trend in accident frequency, medical costs and change in expected investment returns? Because there is a range of reasonable assumptions, there is going to be a range of reasonable rates resulting from the exercise and it should be the WSIB's staff responsibility to define that range for the WSIB Board. The WSIB Board ought to retain responsibility for making the rate decision within that reasonable range.

I recommend that some time after the rate is set and announced, the WSIB meet with stakeholders to go through the math, disclose the assumptions being made and explain how the rate was arrived at.

Perceived as Transparent and Intelligible

Workers' compensation legislation in Ontario was born out of a consensus between employer and worker stakeholders that it was the most secure and efficient means to compensate injured workers for the losses they suffer in workplace accidents. In order to sustain that consensus, the employers who bear the costs of the system must be able to see and understand the costs of the system and how those costs are being apportioned. It is reasonable that stakeholders expect to be able to see the amount of each component of the average rate. The link between an employer's rate and the overall cost of the system should be explainable and defensible.

Supportive of Rate Stability

Employers want premium rate stability. A dramatic rate reduction in one year is nice. However, if it means that it could be followed by an equally dramatic rate increase the next year, it is unsettling and unwelcome. Relative rate stability is also desirable for the WSIB.

Conducted with Integrity and Determination

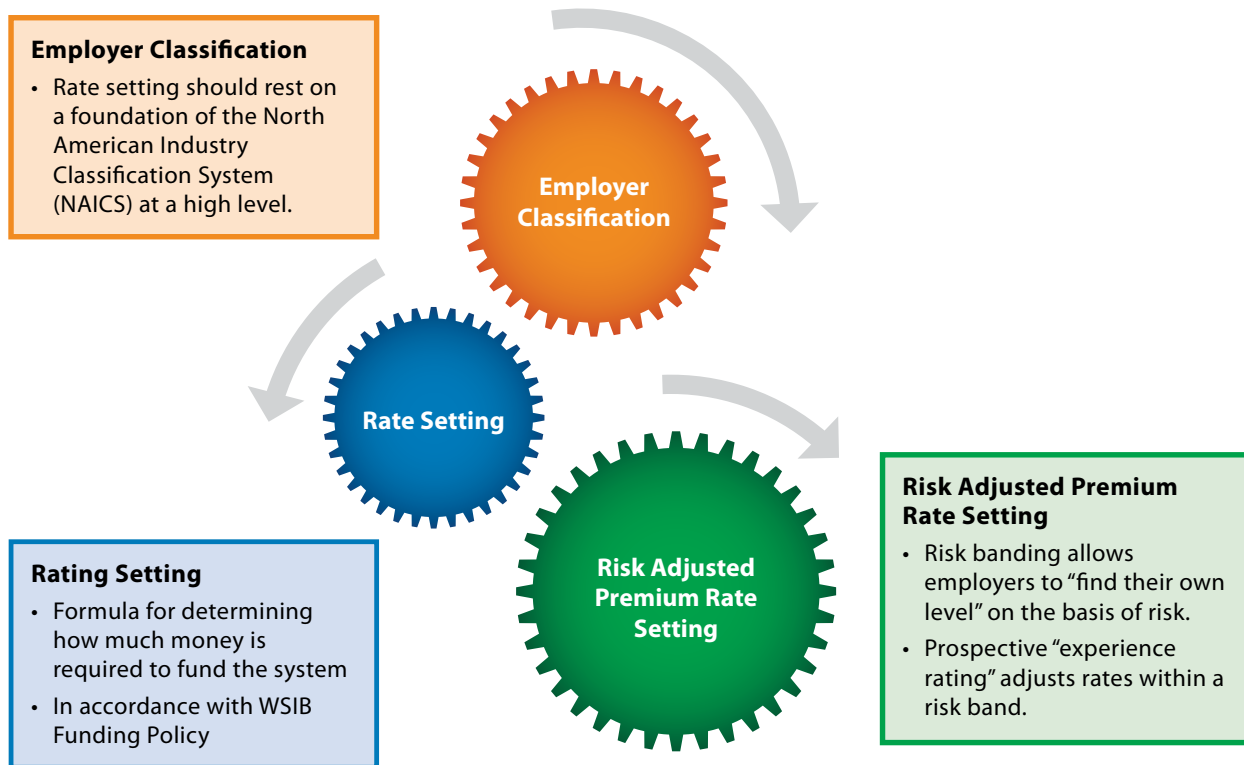
Workers' compensation systems must be designed and administered with the long-term interests of stakeholders in mind. There is always a temptation among stakeholders, government and compensation administrators to sacrifice a long-term interest to achieve a short-term goal. The WSIB is the steward of the system and must always resist that temptation.

WHAT WOULD A NEW RATE FRAMEWORK SYSTEM LOOK LIKE?

I am satisfied, based on an assessment of earlier studies and the stakeholder consultations I have undertaken, which have driven my own analysis and conclusions, that the WSIB needs a fundamentally new system for the assessment of premium revenue for Schedule 1 employers.

I heard over and over again from stakeholders that they want a “simple and transparent system”. I like the analogy of a clock, a mechanism that is complex but at the same time conceptually transparent and simple to understand. One wheel drives the second hand, another connected wheel drives the minute hand and another, the hour hand. Behind the mechanism are all the complexities of springs and gear ratios that ensure the clock tells the right time, but you do not need to know all that to understand how the clock works.

Figure 5: A Conceptual Integrated Rate Framework (Schedule 1 employers)



The objective for a classification system is to assign employers to groups that are large enough to ensure sustainable collective liability, with clear rules for distinguishing between different classification groups. At this level, it should not be a source of complexity in its application. It should be a foundational component to the framework that introduces employers to an understandable process/formula for setting premium rates based on reliable claims experience for individual employers, classes of employers and industries.

Rate setting must be a transparent disciplined process. Again using the analogy of the clock, this is a process that first tells you how much premium revenue you need to raise, second what the average rate should be and third what individual employer premiums should be, in the same way a clock tells you what

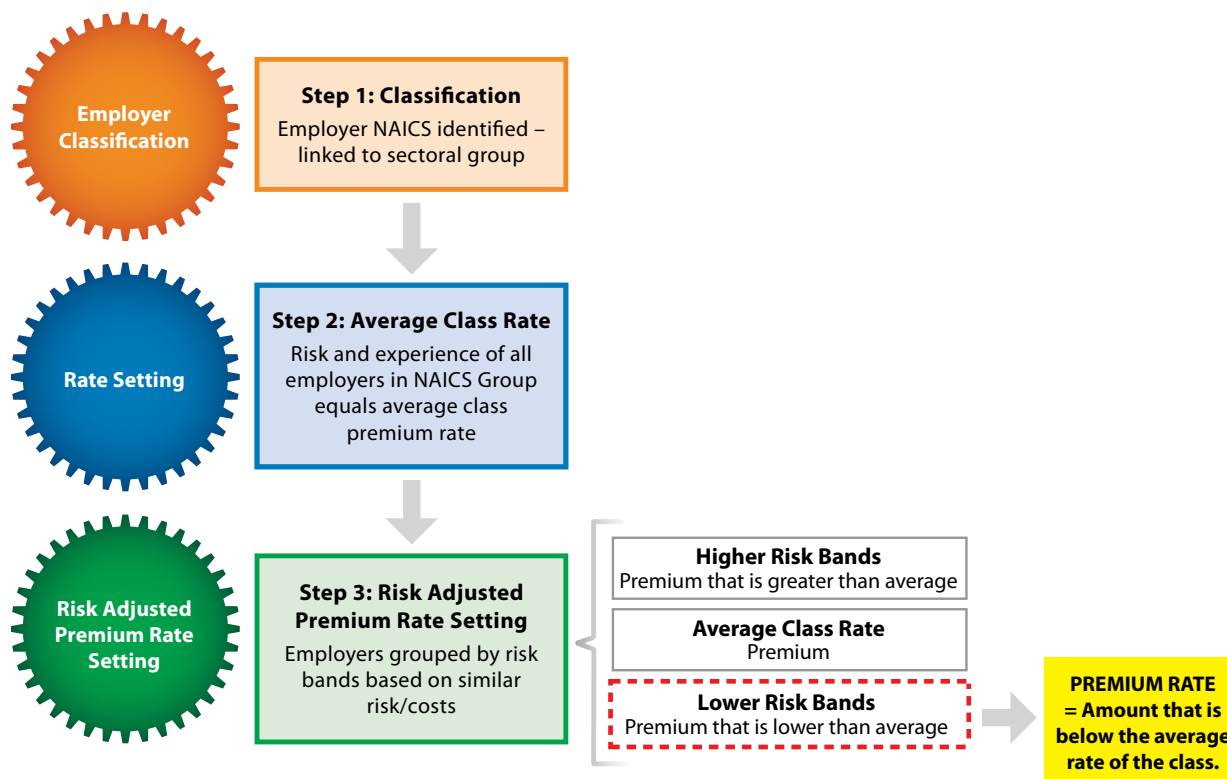
time it is. In order for the WSIB to achieve its financial goals, there cannot be any ad hoc, subjective overlay to the process. The WSIB’s rate setting policy and process needs to identify the premium revenue required to fund the entire system.

“If the WSIB is going to achieve its financial goals, there cannot be any ad hoc, subjective overlay to the process.”

I explored this issue specifically in my discussion paper¹⁶. Stakeholders recognize that holding rates artificially low, for reasons unrelated to the funding of the WSIB, does not make the costs go away. Someone at some time will have to pay those costs. Those employers who plan on being in business for the long term, and who take a long view, realize that if rates are not properly set those costs will ultimately come home to them.

Figure 6 below provides a more detailed expansion of the Conceptual Rate Framework to demonstrate the process or simplified stepped approach to integrating its three components.

Figure 6: Stepped Approach to the Conceptual Rate Framework (Schedule 1 employers)



Although this model uses NAICS as a basis of classification, rates are not assigned to a “Classification Unit”. In this system the employer gravitates to a rate within a range of rates in their classification, based on their risk to the system relative to the other employers in the classification.

16 <http://www.wsib.on.ca/files/Content/RateFrameworkConsultationRateFrameworkDiscussionPaper/WSIBRateFrameworkDiscussionPaper.pdf>; Chapter Four

EMPLOYER CLASSIFICATION

I suggested earlier that classification is the Achilles heel of the present rate setting system. The problem is not with the classification matrix itself, but with the fact that it is the matrix that drives the employer's premium rate. I am recommending that North American Industry Classification System (NAICS) replace Standard Industrial Code (SIC) as the basis to classify employers. However, the real significance of my recommended approach for employer classification is that classification becomes a passive foundation for rate setting as opposed to the driver of it. This addresses the fundamental problem with the existing system that dictates rates for employers based on their classification and the performance of all employers in that classification regardless of any differentiation in the risk to the system posed by those employers.

Stakeholder perspectives on this are varied. Some have a keen sense of the challenges of the current narrow link between the general description of a business activity and the premium rate. The Ontario Painting Contractors Association crystallized this point specifically when it identified that a performance-based system (over a classification based system) would provide an unprecedented level of fairness and transparency to the system.

Some stakeholders have asked: Why have a classification system at all? The WSIB needs a classification system for the collection and analysis of accident data and the costs of claims. The 1990 study that recommended the adoption of the SIC classification code said as follows:

Basing the classification structure on the SIC has a number of advantages. It is a well-established scheme, it provides a much more detailed breakdown of industry than the current Ontario scheme and it would facilitate interprovincial comparisons since the classification schemes in several other provinces are also SIC based. In addition, updated lists of new Ontario firms, complete with SIC codes are available on a regular basis from Statistics Canada.

The SIC code is no longer used by North American statistical agencies (Statistics Canada, Mexico's Instituto Nacional de Estadística y Geografía (INEGI), and the Economic Classification Policy Committee (ECPC) of the United States Office of Management and Budget) who chose to replace it with the NAICS code. As such, the SIC is no longer updated to account for new or emerging industries, leaving the WSIB's current system exposed to the risk of becoming outdated. Seeking to update the SIC-based classification scheme in Ontario, rather than replacing it with NAICS, would be a challenging exercise.

NAICS was "created against the background of the North American Free Trade Agreement, [and] it is designed to provide common descriptors of the industrial structure of the three countries [...]"¹⁷. NAICS has a single principle of aggregation - that producing units that use similar production processes should be grouped together. NAICS is updated every five years to reflect the significant changes in technology that continue to take place in North American industry and the diversification of services that has taken place. The advantages identified in 1990 of adopting the SIC as the basis of employer classification now apply to the adoption of NAICS.

There was a substantial amount of support amongst stakeholders for using the NAICS system for classification and many stakeholders are familiar with it and use it.

¹⁷ <http://www.statcan.gc.ca/subjects-sujets/standard-norme/naics-scian/2012/introduction-eng.htm>

NAICS is a hierarchical system composed of:

- Sectors, two-digit code
- Sub-sectors, three-digit code
- Industry groups, four-digit code
- Industries, five-digit code

There are 24 two-digit sectors in the NAICS system. I recommend that the WSIB adopt the NAICS system of classification for the purpose of all data collection. I recommend that it be used at the two-digit sector level as a foundation for rate setting. Where appropriate, the WSIB should consider the statistical or actuarial credibility of the groupings at this level to ensure that they will be a sound basis for rate setting purposes moving forward. Ensuring that each class has an acceptable level of insurable earnings, employer and worker counts, and claims data, relative to others is important.

As an example, at the two-digit level, the NAICS includes Sector Code 55 – Management of Companies and Enterprises, which in Ontario consists of only 17 employers with \$8 million in insurable earnings, over 200 workers and 0 claims in 2011. This would not be sufficiently credible as a stand-alone grouping, making them a candidate for amalgamation with other similar sectors. Conversely, Sector Code 23 – Construction, consists of over 52,000 employers with nearly \$15B in insurable earnings, nearly 300,000 workers and just short of 18,000 claims in 2011. This information may support the division of the sector to the three-digit sub-sector level that expands to three sub sector groups (236, 237, 238) and mirror the three groupings found in manufacturing (31, 32, 33) and wholesale/retail trade (41, 44, 45) – which are also very large industries in Ontario.

Whatever the final classification scheme is determined to be, these large sectoral groups should form the basis for premium rate setting much like the current rate groups. This would lead to a significant consolidation of rate groups from the current 155 down to 20 to 25 groups, and provide a sound and credible basis for setting premium rates. This would remove any future need to consolidate rate groups as the earnings bases shift from one sector to another. Such consolidations were required to be undertaken from the original 219 rate groups that were initially developed in the early 1990s with the current system. The WSIB would need to conduct further testing and analysis to arrive at a final, workable structure, considering the variability of size of employers and disparity of risk within classes

Figure 7: Current vs. Integrated Rate Framework

	CURRENT SYSTEM	INTEGRATED RATE FRAMEWORK
Classes	9	20-25
Rate Groups (RG)	155	20-25 (same as above)
Classification Units (CU)	800+	711*

* Similar to current CUs, NAICS coding down to the 5-digit industry level could provide the statistical reference point that is similar to CUs but have no relation to the rate setting process.

With this approach, many of the challenges identified with the current classification system, expressed earlier in this report and in the Case for Change document, would simply go away. Employer classification would become the starting point and not the end point, as it is in the current system.

The WSIB previously considered reducing the number of rate groups within the existing classification system¹⁸. While a consolidation of rate groups within the existing system may lead to perceived simplicity, it would come with the addition of a level of subsidization even greater than in the current system. In the next section, the Integrated Rate Framework that I am recommending addresses this challenge. I propose risk adjusted premium rate setting using risk bands that counters any further subsidization by grouping employers with similar risk and claims experience.

Multi-Rating

In the current system, employers who have multiple business activities are assessed different premium rates under various rate groups and classes. If an employer is providing a number of services or products, they are assigned a classification unit (CU) for each business activity that they perform. The Case for Change document also identifies that:

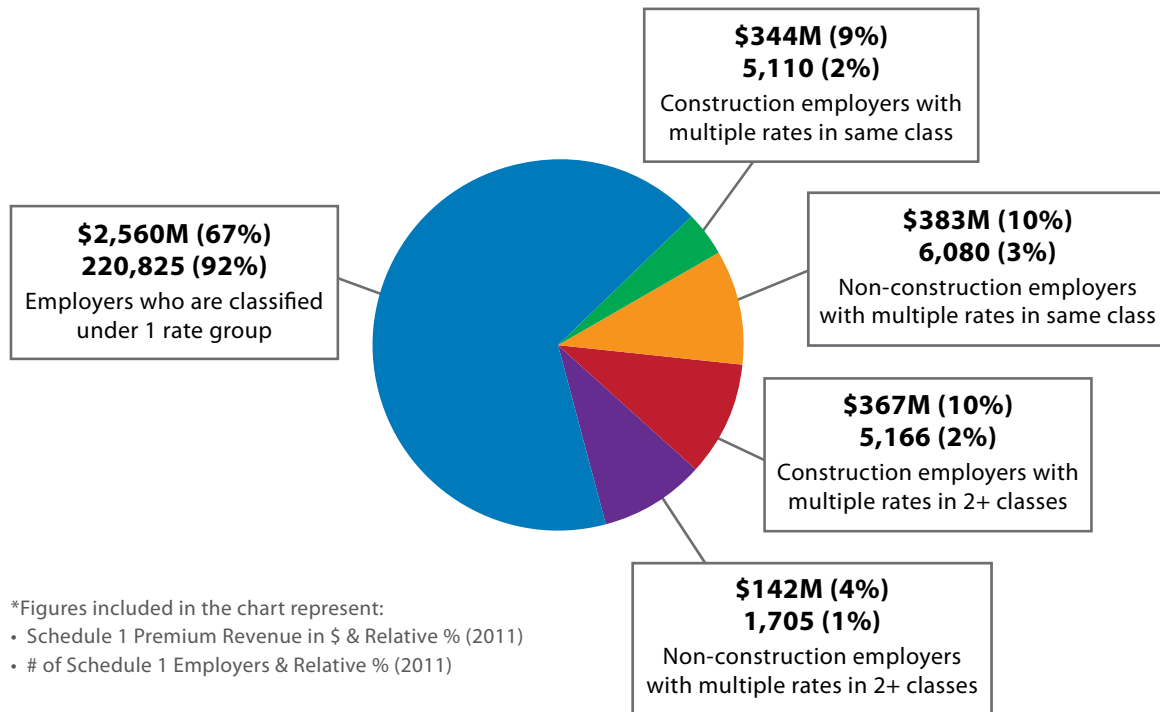
At the same time, the complexity of the current classification scheme and the supporting Employer Classification Manual can lead to inconsistent interpretation and application. This is because many CU definitions could reasonably be considered to include multiple and overlapping business activities, and create confusion for employers with multiple business activities.

This approach is further complicated by different rules based on the size of employers, but also on their ability to segregate their insurable earnings amongst their multiple business activities. Generally, employers with multiple CU's are required to segregate their annual insurable earnings based on the amount of labour directly allocated to each business activity. Accordingly, these employers would have multiple premium rates. However should an employer be unable to segregate their earnings, the current approach treats large and small employers differently:

- **Large Employers:** Single rate groups for aggregated payroll in all business activities, based on highest premium rate;
- **Small Employers:** Single rate groups for aggregated payroll in all business activities, based on predominant business activity.

18 Page 12: <http://www.wsib.on.ca/files/content/FundingReviewFRRGsClassification/Funding%20ReviewRateGroupsClassification.pdf>

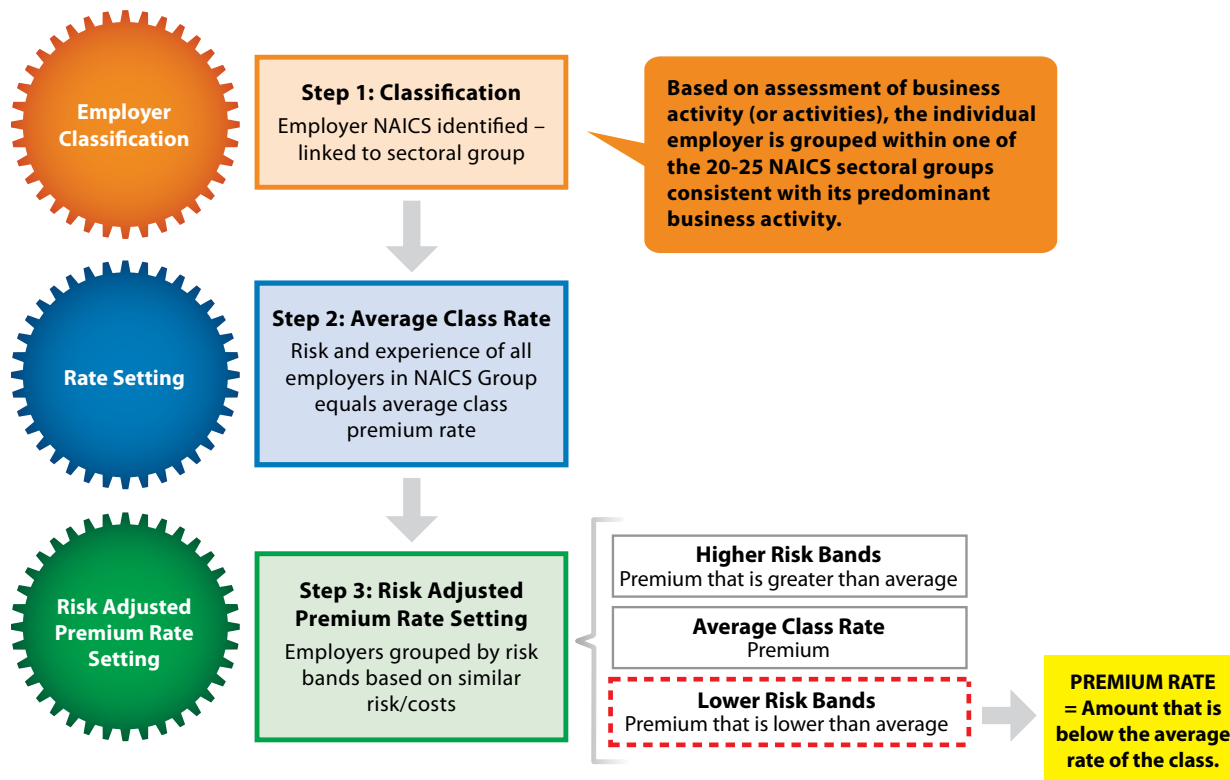
Figure 8: Employers with Multiple Business Activities*



I recommend that the WSIB use an employer’s predominant business activity, with no distinction for size of employer or their ability to segregate their earnings, for both classification and rate setting purposes. In addition to it being a more simple approach, multi-rating employers becomes an irrelevant issue, in a system where an employer’s overall risk profile determines their premium.

Using this stepped approach, Figure 9 describes the Integrated Rate Framework activities in this section:

Figure 9: Application of the Stepped Approach for the Integrated Rate Framework (Schedule 1 employers)



RECOMMENDATION 4.1:

The NAICS system should be used at the two-digit, sector level for rate setting, with a sector-level premium rate set for each defined sector (replacing the current rate group approach), as a foundation for risk adjusted premium rate setting. From this starting point, employers that share similar risks and claims costs will be risk-banded as described in the next section.

Where appropriate, the WSIB should consider the statistical or actuarial credibility of the groupings at this level to ensure that they will be a sound basis for rate setting purposes moving forward. It is important to ensure that each class has an acceptable level of insurable earnings, employer and worker counts, and claims data, relative to others.

The WSIB should cease the practice of having multiple rates for single employers, which provides a significant amount of complexity in the system and can lead to adverse implications related to the fairness of the current system.

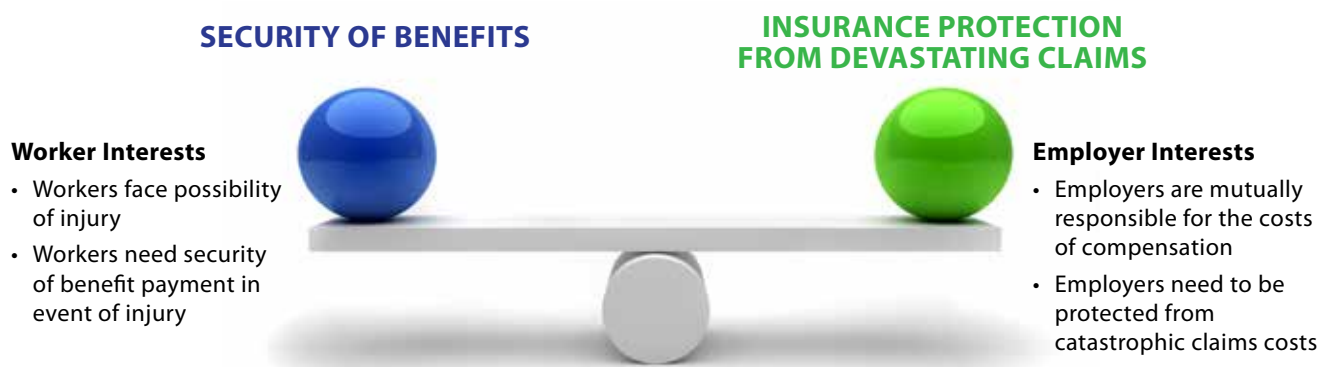
AN INTEGRATED PROCESS FOR RISK ADJUSTED PREMIUM RATE SETTING

In the model I recommend, employers will be aggregated on the basis of their NAICS sector. Each sector will have a series of bands with associated premium rates. Each employer will have a risk profile calculated. The risk profile will determine which “band” the employer will fall into and consequently what premium rate they will pay. An employer whose risk profile improves/deteriorates over time will move down/up in the hierarchy of bands in accordance with clearly defined rules that ensure that the “trend in risk performance” is real and statistically reliable, and that rate stability is not being sacrificed. This does not mean there is no “collective liability” in the system. This is important for all employers to realize but particularly small employers who will pay premiums but may never have a claim.

Protection for Small Employers (and Why Everyone Pays)

A slip and fall, a blow to the head that renders the person permanently and totally disabled. Not common thankfully, but on the other hand not unheard of. Over its life, this claim could cost millions of dollars in wage loss and medical treatment and care. It is also the type of claim that can and does arise in any workplace large or small. The WSIB can expect to receive a significant number of catastrophic claims every year, each of which could – over its life – cost the system millions of dollars. If it does happen in the small workplace, in the absence of our system of workers’ compensation, the injured worker has no security of benefits and the small employer could be financially ruined by the claim. What workers’ compensation does is secure those benefits for the worker and protect the small employer from a claim that would devastate the business financially. Collective liability means that everyone in the system shares the risk of these claims.

Figure 10: Balancing Worker and Employer Interests



There is an inherent cost sharing in any mutual insurance system – the premiums of the many pay the claims of the few. That element of subsidy is acceptable because of the randomness of the events. However, when the losses become “predictable”, the case can be made that those workplaces that have higher “predictable” losses should pay higher premiums. Thus, Meredith said those industries and those workplaces where the risks of loss was higher would pay higher premiums.

The more refined and accurate you can be in measuring those risks the fairer the system will be to those paying premiums. To the extent that this system establishes larger pools and is able to adjust all employer premiums based on risk, it should produce fairer rates for all employers.

In the development of a working model from this conceptual framework, care should be taken to ensure that employers that find themselves with less predictability in their accident experience (typically smaller employers) are not subsidizing employers with greater credibility (typically large employers). Not doing so would result in an unfair burden on small employers that could jeopardize their sustainability. In addition, incorporating larger pools of employers by specifically reducing the number of employer groupings (from the existing 155 rate groups to the proposed 20-25 employer groupings considering actuarial credibility and risk disparity as described above), will provide greater stability and protection for small employers with variable experience. In the current system, with a greater number of employers groupings, an employer's claims experience will have a more significant impact on the rate group's premium rate, compared to the proposed Rate Framework, where the fewer number of employer groups would be less sensitive to an individual employer's claims experience. The introduction of appropriate rules that recognize sustained experience as part of the risk banding approach, as well as the Credibility Scale, both noted below, would further temper the implications and provide greater stability and protection for small employers as a whole.

NAICS Sectors

Employers would be classified and aggregated on the basis of their NAICS sector for the purpose of rate setting. An average premium rate based on the collective claims experience and the required premium revenue for each sectoral group will be determined. This is similar to the current premium rate process at the class-level.

Risk Bands

Risk bands are a hierarchical series of divisions of the employers in the foundational NAICS sector from the very low level of risk to the very highest level of risk. The number of bands will depend on the scope of the risk in the Sector. The broader the scope the more bands you create. Based on the calculation of an employer's risk profile they fall into one of these sector risk bands.

Risk Profiles

The second part of the process introduces the experience of individual employers. Each employer will have a risk profile calculated. The risk profile will determine which "band" the employer will fall into and consequently what premium rate they will pay. An employer whose risk profile improves/deteriorates over time will move down/up in the hierarchy of bands in accordance with clearly defined rules that ensure that the "trend in risk performance" is real and statistically reliable, and that rate stability is not being sacrificed.

Similar to the notion of statistical or actuarial credibility noted in the Employer Classification section above, when considering the risk profile of an employer, measuring its credibility to ensure it is reliable for rate setting purposes is important. This is particularly true in Ontario where the small and very large employers can be separated by billions in insurable earnings, and have very different claims experience.

Weighting Credibility

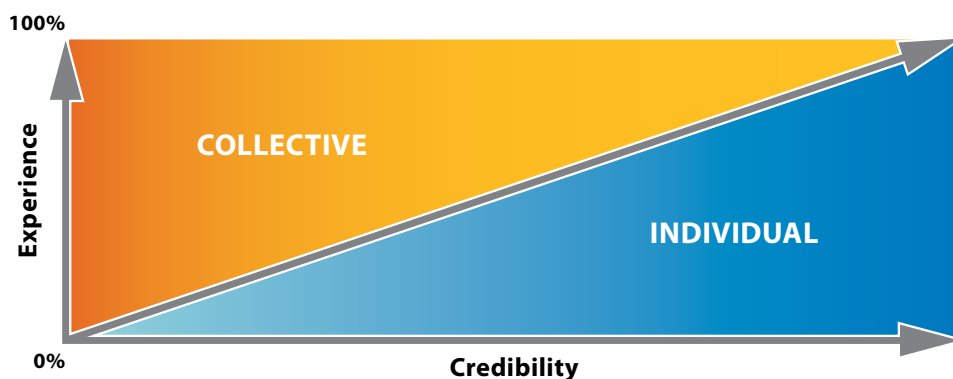
Because I am recommending that all employers be assigned to this framework individually based on their risk, and because the measurement of risk is difficult with varying degrees of credibility or size of employers (from an experience rating program perspective, based on criteria for MAP, the current threshold for small employers could be generally defined as those employers paying \$25,000 or less in premiums), a system of

weighting credibility on a sliding scale, such as is done in BC¹⁹, would be required.

Based on an assessment of insurable earnings and claims information to ascertain their level of actuarial credibility, an employer would be attributed a percentage for their individual credibility, with the balance, consisting of the collective experience of their sectoral group.

Figure 11 below identifies an illustrative example of a credibility scale. Based on this scale every employer would participate in risk adjusted premium rate setting and benefit from the risk banding approach described above using the appropriate blend of individual and collective claims costs.

Figure 11: Illustrative Credibility Scale



The important feature is that all employers regardless of size have access to a system that adjusts their premium over time based on their performance. As previously noted, presently 110,000 employers, or roughly half of all employers in the system, are not able to participate in the current experience rating program and new employers in Ontario must wait three years before being eligible to participate. For these employers, introducing this weighted scale will allow all employers to participate in the Integrated Rate Framework, including risk adjusted premium rate setting. For employers with a high level of credibility (usually large employers) this system will generate a premium rate that is as close to a “real” risk based rate for that employer as you can get. It is a rate that reflects what they are costing the system.

“The important feature being that all employers regardless of size have access to a system that adjusts their premium over time based on their performance.”

I heard from stakeholders that rate stability is something they would like to see being enhanced in a reformed system. Appropriate rules associated with the allocation of claims costs to individual employers and to sectoral groups (similar to the current practice of allocating certain costs to employers, rate groups and classes of employers) will need to be considered. In addition, movement of employers within risk bands will require standards that strike a balance between rate stability and responsiveness to an employer’s actions to improve the safety of their workplaces.

19 www.worksafebc.com/employers_and_small_business/Assets/PDF/empclass.pdf

Figure 12: Illustrative Example of Risk Banding

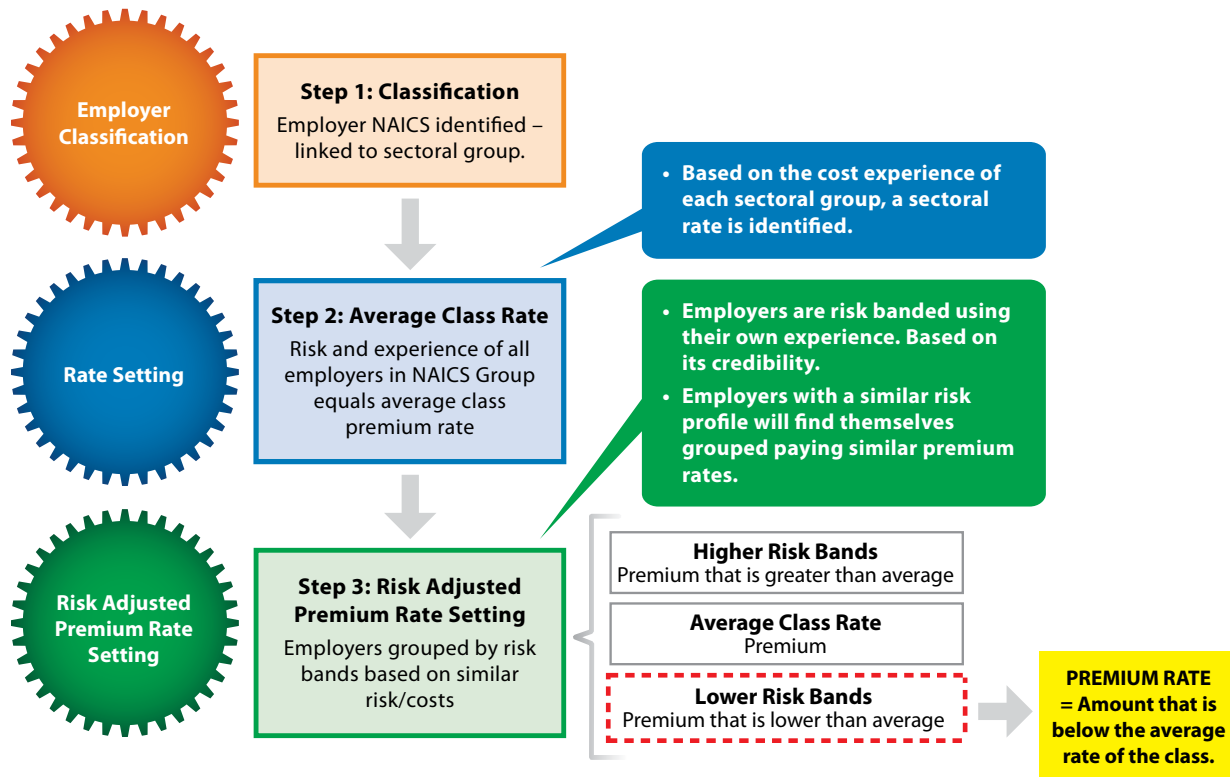
This is a system that meets Meredith’s principle that “Under a just law the risks arising from [just compensation for those employed in industries who meet with injuries contracted in the course of their employment] should be regarded as risks of the industries and that compensation for them should be paid by the industries”. Meredith endorsed a system where employers were not required to do more “than contribute with other employers to the payment of compensation according to the hazard of their respective businesses”. However, it was simply not administratively possible in Meredith’s time to actually calculate that hazard at an individual-firm level. While collective liability is necessary for the sustainability of the workers’ compensation system, and employers are entitled to the protection collective liability makes possible, the system must find the appropriate balance between collective liability and avoiding industry- or employer-level cross subsidization. Finding that balance is manageable with improved actuarial practices.

As described in my Discussion Paper, the WSIB, along with other Canadian jurisdictions, takes the position that premium rates should, to some degree reflect the differential claim costs risk imposed on the workplace insurance system. In Manitoba, experience rating is embedded in the premium rate at the individual employer level (employer-centric), whereas in British Columbia (BC), risk banding is used at the industry level and then employers are experience rated²⁰.

The system that I am recommending combines some of the best features from other provincial systems (i.e. Manitoba’s employer-centric rates and BC’s risk banding), avoids some of the undesirable features and adapts the ideas based on what I heard from Ontario stakeholders.

20 http://www.wsib.on.ca/files/Content/RateFrameworkConsultationDiscussionPaperAppendixB/AppB_ExperienceRatingProgramsInCanada.pdf

Figure 13: Application of the Stepped Approach for the Integrated Rate Framework (Schedule 1 employers)



This system will meet the five bullet Fundamental Goals set out in the previous section of the report, objectives which were identified by stakeholders as being what the WSIB ought to have in place and which are absent in the present system.

Figure 14: Assessment Against Fundamental Goals

FUNDAMENTAL GOALS	ANALYSIS OF NEW INTEGRATED SYSTEM
<p>Sufficient and Timely Funding of Benefits</p>	<ul style="list-style-type: none"> • Provided the WSIB properly estimates new claims cost on an annual basis, this proposed rate framework would allow the WSIB to collect sufficient premiums on an annual basis to pay present and future benefits to injured workers. • Coupled with clear rules in a funding policy it is a system that allows WSIB to make up the inevitable annual gains/losses in a timely and prudent manner.
<p>Fair and Equitable Allocation</p>	<ul style="list-style-type: none"> • The fair and equitable allocation of the costs of the system is the clearly stated overriding strategic objective. • This recommended system would allocate those costs to employers in a fair and equitable manner because every employer is assessed based on the same experience related criteria without any artificial rate grouping based on irrelevant criteria. • Risk-adjusted premium rate setting using risk bands groups employers with similar risk and claims experience and avoids the subsidization that is endemic in the current classification system.
<p>Monitored Against Fundamental Goals</p>	<ul style="list-style-type: none"> • The system is easily monitored to ensure that sufficient funds are raised annually and that the premium burden is being fairly allocated. • The same premium rate setting system, based on their individual employer’s risk experience, is available to all employers. • The model can be designed with the objective of removing incentives to under report claims.
<p>Reasoned Responsiveness and Flexibility</p>	<ul style="list-style-type: none"> • This is a system that responds to changes in industry mix, variations in accident frequency and real risk profile differences between otherwise similar employers. • Most importantly it is a system that is responsive to an employer’s efforts to reduce workplace injuries and the associated costs. • Rate stability at the individual employer level should be enhanced by this model.
<p>Clear Understanding and Ease of Engagement</p>	<ul style="list-style-type: none"> • It is a system that is simple, intuitive, and should be clearly understood by stakeholders while at the same time reducing the administrative burden to them and the WSIB. • This is a system that allows the WSIB to easily demonstrate to all employers what their risk to the system is, consequently what their fair premium rate is and why that rate might be going up or down in relation to other employers. • Although it is not over-responsive an employer can see a clear line between improving health and safety in the workplace and the possibility of reduced premiums.

Basing a risk banding system on the foundation of the NAICS sectors allows the WSIB to establish the number and range of risk bands that reflect the reality of the range of risk in that sector. For example, the performance of employers in the “Utilities” sector is much more homogenous than the performance of employers in any one of the three manufacturing sectors. This would support the need to consider more risk bands in the manufacturing sector, reflecting the diversity of performance in that sector. This is an area that requires more analysis by WSIB in the development of this model.

Whereas the existing system makes an assumption that employers with the same SIC code will have similar risks and begins by grouping SIC codes together into statistically credible rate groups, in this new system a risk band is made up of a statistically credible group of employers who have a similar risk profile. It is possible to measure an employer’s risk profile with a degree of credibility that roughly coincides with the size of their payroll relative to their accident costs. You can then assign a rate for the employers in that risk band in the same way as you formerly set a rate for employers sharing a classification code or rate group. The advantage of this new approach is that you are not making an assumption of homogeneity of risk; you know the group is homogenous. Further, the system responds to an individual employer’s changing risk profile. An employer is not stuck in a risk band that no longer reflects their risk profile. Rules can be established to ensure changes in an employer’s risk profile are credible and to provide a proper balance of stability and responsiveness.

In addition to being much more transparent, this new integrated process for risk adjusted premium rate-setting removes a great deal of complexity from the system, making it more efficient and easier to administer for employers and for the WSIB.

I recommend that in the development of this system, stability is preferred over responsiveness. I make that recommendation for two reasons: first, employers overwhelmingly said that “rate stability” was always preferred and second, a less responsive system is less likely to incent unintended and undesirable outcomes.

RECOMMENDATION 4.2:

A sectoral premium rate should be developed for each of the 20-25 sectoral groups, based on the collective claims experience all employers.

Risk bands should be developed in each of the two-digit NAICS levels considering appropriate expansions and collapsing of the two-digit level, and ALL employers placed into those risk bands based on the risk that they present to the system, considering their level of actuarial credibility. If the costs increase the employer’s rate would go up and if their costs decrease, their rate would go down.

There should be a drive to maximize the participation of employers of all sizes, considering their actuarial credibility. This element of rate adjustment must be revenue neutral and factored into the rate setting formula.

In the design of this system, stability is preferred over responsiveness and appropriate measures for stability ought to be considered.

FINANCIAL INCENTIVES FUNDING AND SUPPORT FOR PREVENTION

In my Discussion Paper, I drew a fairly sharp distinction between experience rating designed to ensure fair and equitable premiums and experience rating designed to drive particular employer behaviour, often simply referred to as an “incentive program”. In part, I drew this clear distinction to differentiate the areas of focus of the WSIB from those of the new Chief Prevention Officer (CPO). I also drew the distinction because stakeholders in Ontario tend to think of experience rating exclusively in terms of the existing financial incentive programs.

In the discussion with stakeholders, some took exception to such a clear distinction, pointing out that even with the establishment of the Prevention Office as a separate entity, the promotion of occupational health and safety was still a statutory obligation of the WSIB. That is true, and in reality, the distinction is simply one of degree. Any system designed and intended to moderate the premium rate of an employer whose risk to the system (their statistically predictable costs of accidents) is less than their peers will influence that employer’s behaviour. If not actually encouraging good performance, at least removing any incentive to maintain poor performance by eliminating the subsidization of the poor performers by the good performers. The essential point I wanted to make is that, when considering financial incentives and experience factors, like cost and frequency, there is a spectrum of objectives from premium assessment fairness to pure behaviour incentives. From a reading of the literature on experience rating programs, I believe that when the objective is fair assessment, in a system designed to provide rates that are stable yet responsive in the long term, you should avoid any incentive leading to unintended and undesirable outcomes.

The WSIB’s goals and objectives in rate setting are to raise the money it needs in accordance with the Funding Policy and to fairly assess employers for those costs. That raises the question then about “prevention”. Although it is outside the scope of this Report, clearly it is an issue that must be addressed given WSIB’s funding of existing prevention programs.

In 2011, Bill 160 transferred significant responsibilities for Occupational Health and Safety (Prevention) oversight and delivery from the WSIB to the Ministry of Labour (MOL). The Bill amended the *Occupational Health and Safety Act* (OHSA) and made clear that the Minister was given the responsibility to, among other things:

- Promote occupational health and safety and to promote the prevention of workplace injuries and occupational diseases
- Promote public awareness of occupational health and safety
- Educate employers, workers and other persons about occupational health and safety
- Foster a commitment to occupational health and safety among employers, workers and others
- Make grants, in such amounts and on such terms as the Minister considers advisable, to support occupational health and safety

A new position was created, a Chief Prevention Officer (CPO), and was specifically given responsibility for, amongst other duties:

- Developing a provincial occupational health and safety strategy

- Providing advice to the Minister on the prevention of workplace injuries and occupational diseases
- Providing advice to the Minister on any proposed changes to the funding and delivery of services for the prevention of workplace injuries and occupational diseases
- Providing advice to the Minister on the establishment of standards for designated entities (Safe Workplace Associations) under section 22.5

However, at the same time the *Workplace Safety and Insurance Act (WSIA)* still maintained a “purpose” for the WSIB to “promote health and safety in workplaces” although that purpose is not followed up by the granting of any specific responsibilities to the WSIB.

To make a more general point, even though accident prevention has now been given a new institutional focus with the creation of the CPO, it does not follow that all other contributors to the promotion of workplace health and safety should abandon their efforts. On the contrary, because the CPO’s mandate and resources are inevitably limited, the CPO will have to find ways to engage with, stimulate and coordinate initiatives undertaken by other players in the field, including the WSIB. From a public policy perspective the advancement of occupational health and safety must remain an important objective of the WSIB.

Prevention activities and enforcement through the MOL are currently funded through the WSIB premium assessments on employers covered by the WSIA. Arthurs recommended that the government review the WSIB’s obligation to fund educational, prevention and enforcement programs through a charge on Schedule 1 employers and this issue was raised by employer stakeholders in several submissions to me. However, it would seem that the current arrangement is expected to continue in some form, and for some purposes it may be a legitimate funding mechanism.

It should be clear, however, that the funding of these activities is an added cost to employers. The funding cannot come out of the premium rates set for the purposes of recovering 100% of accident costs. Security of benefits for injured workers is guaranteed by the collection of those premiums. You cannot collect premiums to secure benefits and then spend that money on some other program, no matter how worthy that expenditure may be. Similarly, you cannot set a premium rate based on the expected accident costs in any year and then collect less than 100% of that premium as some incentive to behaviour that is not guaranteed to reduce those accident costs.

If the WSIB premium assessment system is going to be used to raise money to fund these programs and activities, there has to be a serious discussion about who benefits and who should pay. The discussion must be grounded on an understanding that, in a rate setting system driven by strategic objectives that is transparent, intelligible and conducted with integrity and determination you cannot drain off premium revenue assessed to achieve your primary objective of funding benefits to 100%.

An example of this can be seen in Manitoba that has a system of Safety Associations and Certificate of Recognition (COR) discounts in the construction industry for firms meeting certain audited safety standards. These programs are paid for by a levy on participating sectors that is clearly identified in the employers’ premium calculations. Similarly New Brunswick imposes a levy on certain industry sectors for the support of industry specific safety associations.

Industry Specific Programs

The issue of the responsibilities of the CPO and the distinction between the objectives of experience rating programs for insurance equity versus encouraging positive health and safety outcomes are related in a very important way to the argument I heard from the construction industry about the necessity of construction-industry-specific WSIB programs. The framework I recommend for rate setting, in a very simple and transparent way, assesses the “risk” that an employer presents to the system based on the cost they present to the system. It bases premiums on those levels of risk. For the purposes of this simple exercise of calculating risk based on cost, there is nothing that distinguishes an employer in any industry from any other employer. However, it is very true to say that there are aspects of certain industries, such as construction and the employment relationship in that industry, that do make them unique and should have an impact on the design of a variety of safety association, safety education, accident prevention and return to work programs and activities. These kinds of industry specific programs are very successful in other jurisdictions and there is a history of safety associations in Ontario. The funding of these programs however should be a separate consideration from the rate setting exercise designed to raise sufficient revenue for the accident fund.

THE PROBLEM OF THE UNFUNDED LIABILITY

The Unfunded Liability (UFL) represents the shortfall between the money needed to pay the future benefits to workers for all established claims, and the money that is in the accident fund. I have made the observation already that the UFL is also a measure of “security of benefits”. If you are 60% funded, then benefits are only 60% secure. The Harry Arthurs Report concluded that any funding level less than 60% represented a “tipping point” that is, likely scenarios might arise in which the fund would not be able to meet its obligations. As of Q1 2013, WSIB was 57.5% funded²¹. The government has legislated a three-stage plan for reaching 100% funding. The WSIB must reach at least a 60% funding level by 2017; 80% funding level by 2022; and 100% funding by 2027.

In the design of a model for the fair assessment of the system’s costs, legacy costs present a unique problem. Arthurs has commented on the inequity of the intergenerational subsidy that results from the UFL. This inequity increases, and the problem of paying it down will compound in any future environment where new claims costs (NCC) are declining and the average premium rate is not allowed to go down. The problem then becomes less an analytical accounting exercise and more a practical one as it becomes increasingly difficult to justify an increasing UFL charge to today’s employers at any time when the new claims experience might be improving. Those employers would argue that their generation is unreasonably burdened with addressing this long-standing problem over too short a period of time. Nevertheless the WSIB, in its role as administrator of the system, has to recognize that it is the legislative obligation of those employers to fund the system, including any UFL that may arise from time to time.

Recognizing that these legacy costs are the financial responsibility of today’s employers, any system for apportioning premiums must account for how the legacy costs are to be apportioned. However, the retirement of the UFL is not a permanent feature of a rate setting system. In theory, a rate setting system starts with the proposition that every year is going to be properly funded. As I noted in the previous section, there should be a disciplined process for getting up to full funding when the system periodically slips below that point or getting down to a safe funding target above full funding if excesses develop beyond that target. The retirement of the UFL would not be as big an issue in the design of a system, if it were a small part of the cost that the system had to recover. If it is a big part of the annual cost to be assessed to employers, then it is very noticeable and may appear to be disproportionate relative to today’s employers’ own claims cost experience.

The premium that an employer pays to the WSIB covers administration, NCC and a contribution towards the UFL. The size of the UFL charge, in relation to the NCC, presents certain challenges to the WSIB. I said earlier that employers were willing to pay their fair share of the system going forward, and it is possible to show them what that fair share is. What their fair share is of the legacy costs is an entirely different matter. Because of that difficulty and because the legacy costs are significant in relation to the NCC, it is those costs on which some employer stakeholders focused a great deal of their attention in my discussions.

If the cost of new injuries is falling and the average rate is maintained, the contribution towards the UFL will be larger than what employers were expected to make. The current generation of employers is denied a rate reduction they could claim they are entitled to based on the reduction in NCC. In effect, they would

21 The WSIB’s funding ratio (WSIB, Q1 Financial Statement).

be asking for recognition of today's experience which they contributed to and they may legitimately complain that failure to do so puts an unreasonable level of UFL charge on them. It should be noted that the opposite is also true and if NCC are increasing, increases in rates are necessary to maintain the funding of the UFL at its current level.

In his report, Arthurs recommended a formula that avoided having the UFL portion of the premium creep upwards as the NCC decreased. He recommended that the contribution to the UFL be fixed and would only increase or decrease if the average premium rate moved outside of a "funding corridor". This also had the advantage of providing some rate stability.

Arthurs' recommendation on a timetable for reaching full funding was not followed. The difficulty in managing around the existing legislated requirement is that it is a fixed target in a dynamic environment, where some of the market factors (such as investment returns) are outside of the WSIB's control. Allowing the UFL portion of the premium to creep would maximize the chances of reaching or exceeding the legislated funding goals. Similarly, allowing rising NCC, if that were the case, to use up funds intended to address the UFL would present a greater risk of failure to meet the legislated funding goals. It is not necessarily fair to today's employers to deny them the benefit of declining claims costs in favor of an accelerated UFL payment. Similarly, it would not be fair to injured workers to further delay UFL funding because of rising NCC.

Arthurs' recommended "funding corridor" approach was an attempt to strike the balance between giving the WSIB a reasonable chance of success for reaching these funding requirements, while also providing a mechanism to adjust rates along the way if the WSIB was ahead of (or behind) schedule. A word of caution is necessary here. In rate setting for workers' compensation, a material portion of the NCC is based on a current liability estimate of future payments. It may take a few years before there is sufficient information to support that estimate with greater confidence. Therefore, it would be preferable for any observed reduction in the NCC to be supported by sufficient claims experience data and be expected to be sustainable before adjustments are made to rates.

In my discussion paper, I asked stakeholders to comment on the manner in which the UFL ought to be recovered from today's employers in future rate setting. The response from one employer association was that, in the absence of knowing which classes were "responsible" for the creation of the UFL, it was difficult to comment on a "fair" system of recovery.

Attribution of the UFL to classes cannot be an exact science but we were able to take several different approaches to the historical data to test the assumption that attributing the UFL on the basis of the NCC was "fair". These three different approaches to painting a picture of the UFL suggested the same result and tended to confirm the suspicion, that if the UFL is apportioned on the basis of their own NCC, some industries might be paying more than their share. On the other hand, it has also been suggested that the construction industry was given a break in 1998 when the UFL was moved from the class level to the system level. In any event, it would be a mistake to attempt to apply any "precise" analysis of the past in the UFL attribution calculation.

What a "fair" attribution of the UFL might be, given these results, and how that is reflected in future rate setting is problematic and distracting, because sectors and industries do not pay premiums. Employers pay premiums and there is simply no getting away from the essential unfairness to those employers, which is the intergenerational transfer of costs to today's employers. That has nothing to do with the sector or classification they are in.

In deciding how the UFL charge should be determined, you can mitigate the problems I discuss above but you cannot eliminate them. I recommend that the contribution be made up of two fixed and one variable charge. First, a modest general fixed charge on all employers in the system recognizing their responsibility. Second, a fixed sector amount based on the sector an employer is in and third an amount based on the employer's NCC. In applying this approach, the WSIB will need to determine the amount of money that needs to be recovered on an annual basis.

This approach would be a fairer attribution than the current system, where the UFL charge is determined for Schedule 1 employers as a collective whole and employers pay their appropriate share based on their rate group in proportion to their NCC.

Unlike classification and rate setting, this part of the exercise does not have to be written in stone. As I said earlier it is not intended to be a permanent feature of the system. I recommend that the WSIB revisit this issue every five years.

Managing Annual Gains and Losses

Rate setting is not an exact science and there will be inevitable annual gains and losses that result from operating in a variable environment. These will result in premium revenue being above or below the funding target at the end of any year. The Funding Policy includes rules for how these fluctuations are accounted for and how the system responds to return to that funding target.

I note that Alberta is the only jurisdiction that has a policy of returning annual surpluses directly to employers through a cheque. However, in order to do this, and not face the problem of sending a bill to employers to recover a deficit, they maintain a level of 120% funding. This 120% funding level assures them that there will almost always be a surplus, but employers are paying for that policy through a higher funding level. I would not recommend that policy for Ontario.

RECOMMENDATION 5.1:

I recommend that the contribution to the UFL be made up of two fixed and one variable charge.

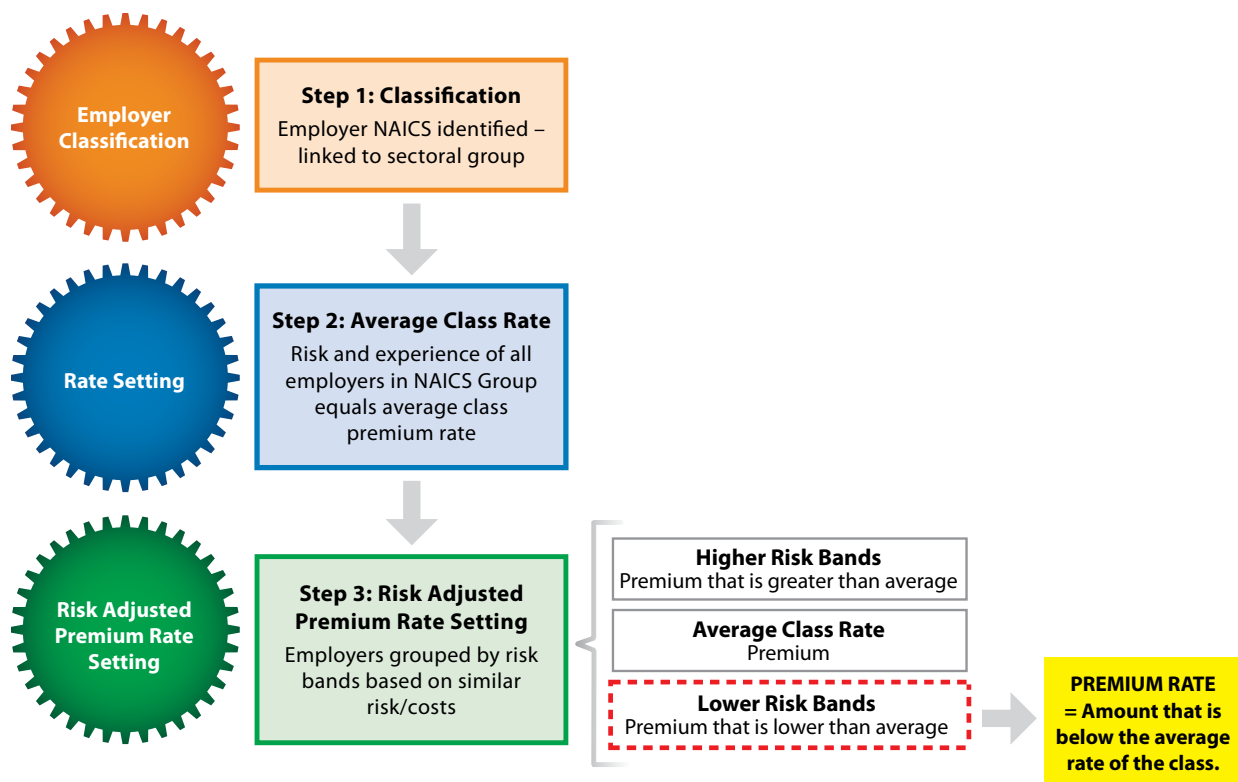
- ***A modest general fixed charge on all employers in the system recognizing their responsibility,***
- ***A fixed sector amount based on the sector an employer is in, and***
- ***An amount based on the employer's New Claims Cost (NCC).***

SIX | SUMMARY OF RECOMMENDATIONS AND NEXT STEPS

I have provided what I refer to as a “conceptual framework” for a new integrated system of classification, rate-setting and experience-rating. In the actual design of a working model, there is a tremendous amount of work that has to be done by the WSIB. That work will involve technical analysis and modeling of design features, to ensure objectives are met and that undesirable outcomes do not also result. The transition to a new system will be a technical and administrative challenge for the WSIB. There will have to be extensive consultation with stakeholders who have a right to be assured that this is a secure and efficient system for raising the necessary funds.

I’ve provided an illustrative example below to show how an employer’s premium rate would be determined under the Rate Framework that I’m proposing:

Figure 15: Illustrative Example (Schedule 1 employers)



I opened the Report by revisiting the question of the need for change because some stakeholders were concerned that taking on this challenge of developing a whole new system would sidetrack the achievement of the real goal of getting to full funding. That is a legitimate concern and I agree full funding is the ultimate objective. However, in my discussions with stakeholders, reviewing the excellent reports that have been done and examining the systems of other jurisdictions I have concluded that a new rate setting framework will not detract from the goal of full funding. Rather, a new framework, that is transparent, fair and understandable will build confidence in the system, allocate costs appropriately, and support the WSIB as it fulfill each of its strategic transformation objectives.

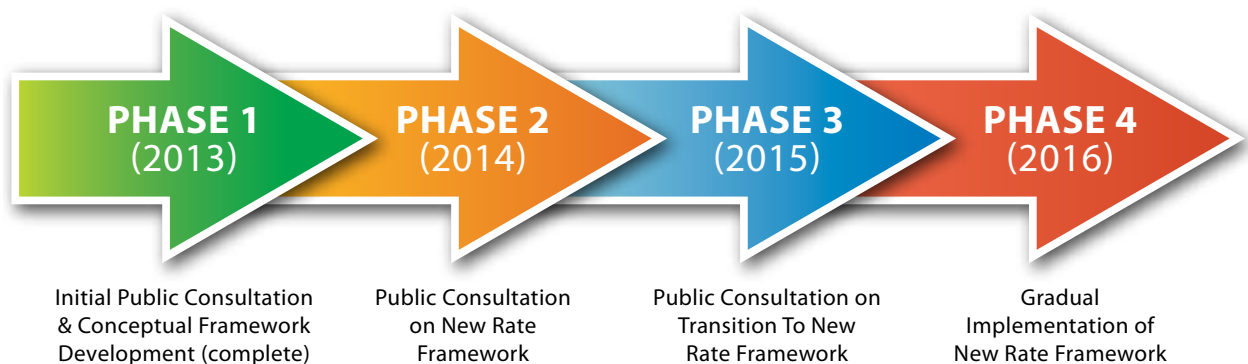
I have also found that there is considerable stakeholder support for a fresh look at these issues, considerable frustration with the existing system and a genuine interest in making the system work. The WSIB can build on some of that stakeholder enthusiasm. The framework I recommend is very different from the existing one. It is simple and transparent and once in place should be easier to administer. In developing a working model of the framework, the WSIB should provide stakeholders with examples of how it will apply them. There will be employers/sectors whose rates will go up and employers/sectors where rates will go down. However, it should be clear that, whatever those outcomes are, they are a reflection of the real costs those employer/sectors are generating.

I am cognizant of the legislative framework under which the WSIB operates. I have tried to limit my recommendations to changes that are within the mandate of the organization and do not require legislative change, though changes to regulations and to policies may be anticipated. However, others will make that determination.

I have highlighted recommendations throughout the body of the Report. In addition there are suggestions made in the text that should assist in putting together a working model from the conceptual framework. I share the sense of urgency expressed by some stakeholders. I would hope that these are recommendations that the WSIB is able to act on in a thoughtful but expeditious manner.

As outlined in the introduction, prior to moving towards implementation of a new Rate Framework, the WSIB will need to develop an approach and seek input from stakeholders for the phasing-in of a new system to ensure an orderly transition for Schedule 1 employers.

Figure 16: Conceptual Transition Plan



I recommend the WSIB introduce a transition process so that changes in premium rates are spread over a number of years to ensure a smoother process for employers. However, it is important to ensure that a balance is maintained between rate increases and decreases for this transition period. Otherwise, the WSIB will affect its revenue objectives and lead to further unfunded liability and deterioration of its funding position.

The WSIB could consider establishing a set of rules whereby premium rates would increase or decrease no more than a set percentage for each year of the transition period. This could provide a fair and equitable distribution of costs without disruption to a great degree to the current Schedule 1 employers. Before establishing this set of transitional rules, the WSIB has to have some sense of the extent of individual employer rate changes that will result from the new model.

As part of the transition phase, the WSIB would also need to determine the best approach and timing when abandoning the current experience rating programs and how it would coincide with the implementation of a new Rate Framework. This element of the transition would require a great deal of consideration and analysis to move from primarily retrospective programs to a prospective risk adjusted premium setting process in a fair and equitable manner.

SEVEN | IMPORTANT OUT-OF-SCOPE ISSUES

In the written submissions and oral presentations from stakeholders a number of issues beyond the scope of this exercise were raised. Some of these out of scope issues, like the fatal claims policy and prevention issues are related in a significant way to the matters I was asked to comment on. Some like WSIB claims administration are unrelated but none the less important for me to comment on.

ADMINISTRATION OF CLAIMS

It is not surprising that in any open consultation concerning workers' compensation, injured worker advocates, representatives and injured workers themselves will come forward. Their presence is a reminder of how important workers' compensation is to workers and their families.

Given the focus of my discussion paper on "fairness for employers" I was asked at my meetings about "fairness for injured workers". In carrying out my assigned task of inquiring into the fairness of the system of employer classification, rate setting and experience rating, I do not want to be taken in any way as diminishing the importance of fairness for injured workers. In the hearings I held, I heard from injured workers and their representatives about issues around claims administration and employer treatment of injured workers. Though it is outside my terms of reference, I committed to responding to this issue. The WSIB registered over 195,000 claims in 2012 . Currently, 92% of those claims are relatively simple to administer and decisions are made within two weeks. Only a small percentage of difficult, off-track claims shape the perception of the administration of workers' compensation. I have advised the WSIB that the reputation of any workers' compensation agency rests on how they administer those claims and how they do so in an expeditious, fair and respectful manner.

I believe the WSIB understands that it has a moral responsibility in the administration of the system:

- To ensure the rules in place foster respect for the rights of injured workers and their entitlement to the benefits described in the legislation
- To ensure that those benefits are securely funded by ensuring that all employers are paying the premiums they are obliged to pay under the legislation

RESTRICTIONS ON WORKER ADVISORS

In the public sessions I had in Thunder Bay one of those "off track" claims with tragic consequences was brought to my attention. From the subsequent discussion it was clear that the problem could probably have been averted if the injured worker had access to adequate representation from the start of her claim. The restriction on the Worker Advisor's Office representing injured workers who are members of a union, contained in both the *Workplace Safety and Insurance Act, 1997* (s.176.(1)) and the *Occupational Health and Safety Act, 1990* (s.50.1(1)), may be a short sighted policy and may result in those workers not having access to adequate representation.

FATAL CLAIMS POLICY

Several stakeholders referred to the inequity of the WSIB's Fatal Claims Premium Adjustment Policy. One described it as "an arbitrary prosecutorial style weapon" and "an affront to the basic tenets of administrative justice".

The fatal claims policy was put into place with the aim of ensuring that no employer who experiences a workplace fatality should receive an experience rating program refund in the year in which the fatality occurred. There is no doubt that the Fatal Claims Policy introduces a subjective performance element to what should be an objective determination of whether someone is entitled to a premium rebate under NEER or CAD-7. Workers' compensation is intended to be a no-fault system and the policy undermines that concept. The source of the "problem" that the policy tries to address, is reconciling premium rebates with what appears to be seriously deficient health and safety performance.

The system I am recommending does not include retrospective premium rebates and it does not involve a subjective assessment of performance in setting an employer's premium rate. When rebates are not a part of the system, the fatal claims policy becomes redundant and I recommend that it be rescinded.

Associated with the stakeholder input on this issue, was the suggestion that the remedy to the real problem of reflecting the seriousness of fatalities was to set a uniform, high proxy cost to a fatality. One of the ironies of workers' compensation is that the financial/accounting cost of a fatal claim is small relative to most long-term disability claims. This leads to an unfortunate element of chance and unfairness in the calculation of employers' claim costs. To counter this, most systems that ascribe cost of claims to employers for rate setting, use a high number for the cost of a fatal claim. I recommend that the WSIB follow that practice and considers how this applies to employers of all sizes. I also suggest that the WSIB consider this path immediately with its current experience rating programs.

The impact of assigning a proxy cost to a fatality should not adversely impact small employers. To the extent that the system is designed to protect small employers from the impact on rates of one catastrophic claim it still protects against a fatal claim. The point is that the fatality will have the same impacts as a claim where the injured worker becomes totally disabled, yet lives.

COVERAGE

Many stakeholders raised the issue of the scope of coverage under the WSIA. Some with the superficial observation that the cost of the system might be lower if more employers were contributing. Clearly this logic is flawed. If the system is going to be free of cross subsidization, there should be no expectation that new employer entrants are going to lower the rate for employers already in the system. The exception could be that new entrants might bring down the average administrative cost portion of the premium, assuming there are always some economies of scale in administration. Similarly, it is not realistic to assume new entrants would come into the system and contribute to the UFL.

There are two very real and legitimate public policy concerns around the issue of coverage. First, there is the public policy concern about coverage with respect to workers in the province, and whether it is fair that a substantial number are denied the protection of workers' compensation. Some may have equal protection through alternate plans but there is no requirement that an employer provide that protection. In the absence of any plan, an injured employee is faced with the tort law remedies and process that workers'

compensation was intended to replace. Second, the fact that the premium assessment mechanism is being used to raise funds for purposes not restricted to employers covered by the WSIA (e.g. Legislative Obligations under the *Occupational Health and Safety Act*, which applies to Ontario's entire workforce). Arthurs drew specific attention to this matter and some stakeholders raised the issue in their submissions. Clearly this is not fair.

There is a related issue that Arthurs drew attention to – Ontario is one of only two provinces (Nova Scotia, the other) where the legislation tries to describe the employers who are covered as opposed to describing those who are excluded. This is the source of real practical problems as noted earlier. The regulation describes the specific industries covered by the WSIB. While covered industries change over time, the Regulation has not. This should be considered by the WSIB and its partners going forward.

PROVINCE	% WORKFORCE COVERED*	INCLUSIONARY / EXCLUSIONARY
Alberta	87%	Exclusionary
British Columbia	94.8%	Exclusionary
Manitoba	74.7%	Exclusionary
New Brunswick	92.3%	Exclusionary
Newfoundland	97.6%	Exclusionary
Nova Scotia	73.3%	Inclusionary
Ontario	71.7%	Inclusionary
Prince Edward Island	95.9%	Exclusionary
Quebec	93.1%	Exclusionary
Saskatchewan	78.7%	Exclusionary

* All figures based on 2013 AWCBC data.

EMPLOYER HEALTH CARE TAXATION

Several stakeholders raised the issue of whether employers in Ontario are being “double taxed” for health care since they pay health care premiums and also the costs of medical care for injured workers. This is a legitimate issue of concern and is related in a way to the issue of coverage.

Workers’ compensation established the system for employer’s financial responsibility for medical care arising out of workplace injuries long before the existence of a general system of publicly funded health care. When the national public health care system was developed, policy makers decided that employers should continue to be financially responsible for injured workers’ medical costs and the Canada Health Act contains a specific exemption for this purpose.

Provinces raise money for health care through taxation. Ontario and some other provinces have a specific health care tax on employers and other provinces raise the money through general taxation. In those provinces where employers are taxed, they have a legitimate claim that they seem to be “paying twice”.

For those who perceive this as an “inequity”, it is compounded by the relatively low level of workers’ compensation coverage in Ontario. In Ontario it is only the employers of just over 70% of the workforce who can claim to be “paying twice”. The employers of the other 30% are not caught by this anomaly. They pay health care taxes, but if one of their employees is injured at work, their medical expenses are covered by the public system.

Pricing Fairness: A Deliverable
Framework for Fairly Allocating
WSIB Insurance Costs

Douglas Stanley
Special Advisor

February 2014
