Rate Framework Consultation

PRICING FAIRNESS:
A Deliverable Framework for Fairly Allocated WSIB Insurance Costs

February 2014

Agenda

- Overview of the Consultations
- What Are We Trying to Build?
- A Conceptual Integrated Rate Framework
- The Unfunded Liability
- Summary and Next Steps
- Conceptual Transition Plan
- Closing

Overview of the Consultations

- In the Fall of 2012, the WSIB announced that I would be leading a comprehensive engagement with stakeholders on reforms to Employer Classification, Premium Rate Setting and Experience Rating.
- From my appointment as Special Advisor, in September through to the end of 2012, I was engaged in initial discussions with key stakeholders, as I immersed myself in Ontario's workers' compensation system.
- In January 2013, my Discussion Paper was released. 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.
- Public hearings were held in Toronto and Thunder Bay in April. Submissions I received:
  - 25 oral presentations (18 in Toronto & 7 in Thunder Bay)
  - 43 written submissions (including letters and emails)
- The feedback received demonstrates a growing sense of urgency and frustration amongst stakeholders and a genuine desire amongst many for the WSIB to get on with the task of developing a new classification/rate setting model.
- I've collected my research and have established my recommendations. 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.

What Are We Trying to Build?

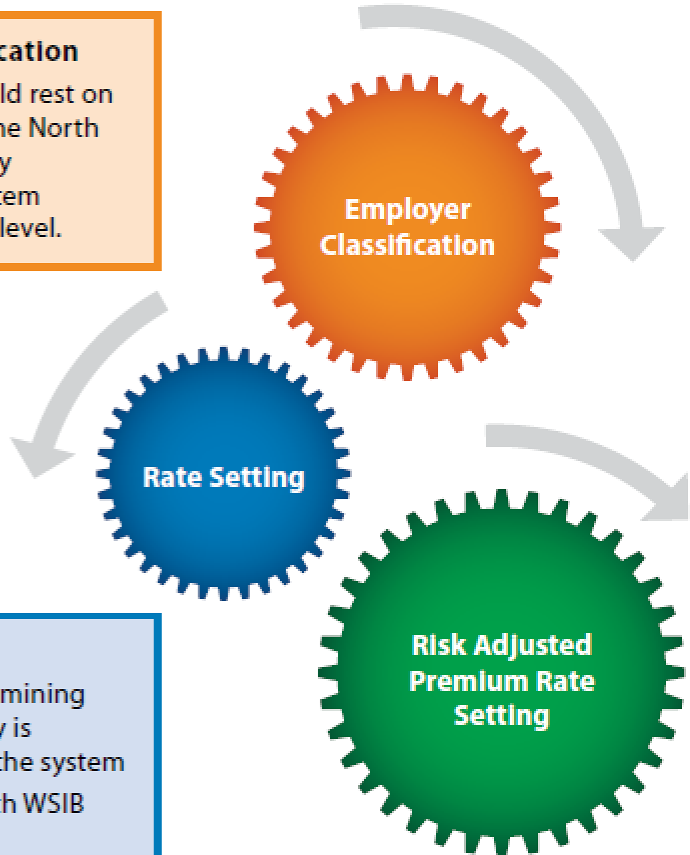
The conclusions I have drawn from my research, analysis and consultations with stakeholders are that the WSIB ought to design and implement a new and disciplined risk adjusted rate setting process:

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)**.

A Conceptual Integrated Rate Framework

Employer Classification

- Rate setting should rest on a foundation of the North American Industry Classification System (NAICS) at a high level.



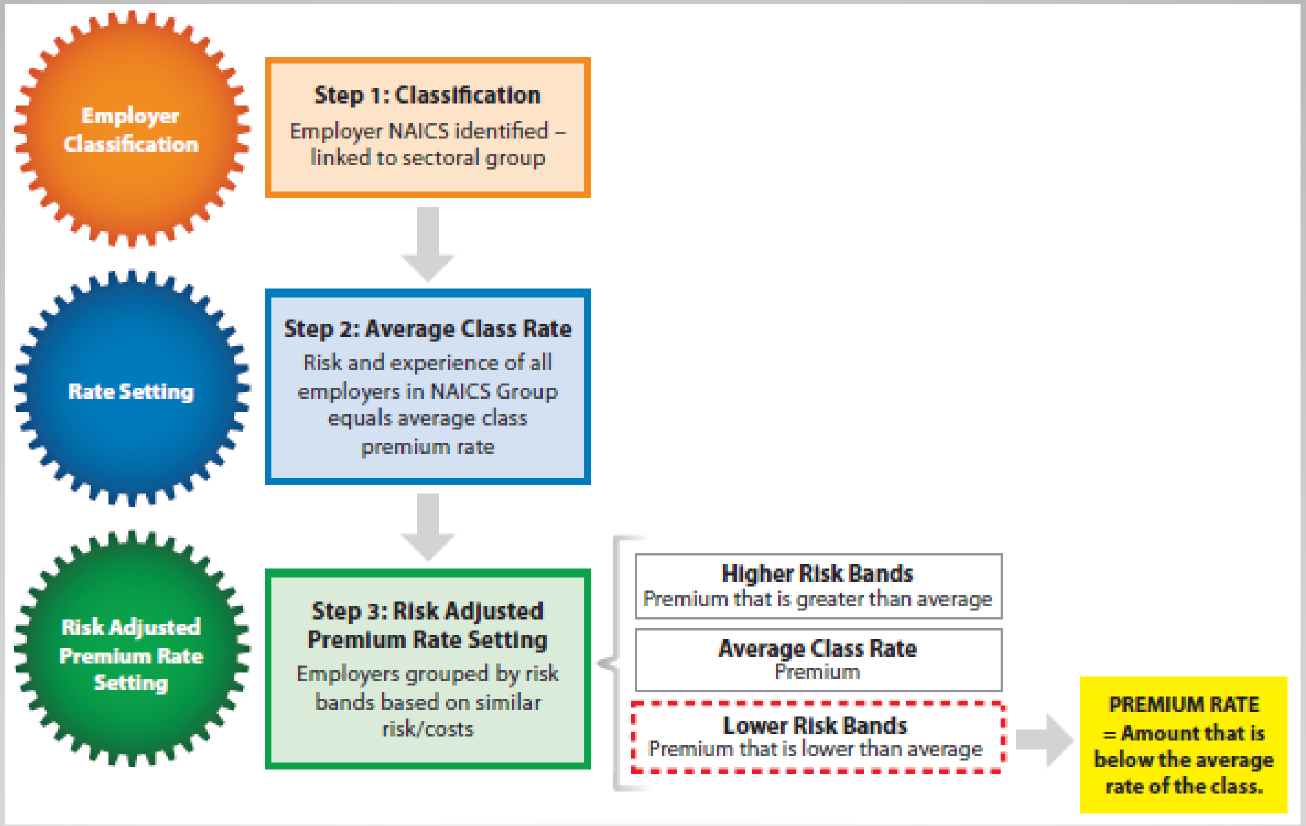
Rating Setting

- Formula for determining how much money is required to fund the system
- In accordance with WSIB Funding Policy

Risk Adjusted Premium Rate Setting

- Risk banding allows employers to "find their own level" on the basis of risk.
- Prospective "experience rating" adjusts rates within a risk band.

Stepped Approach to the Conceptual Rate Framework



Step 1: Classification

- Employers would be classified and aggregated on the basis of their NAICS sector for the purpose of rate setting. This is similar to the current premium rate process but at the class-level.

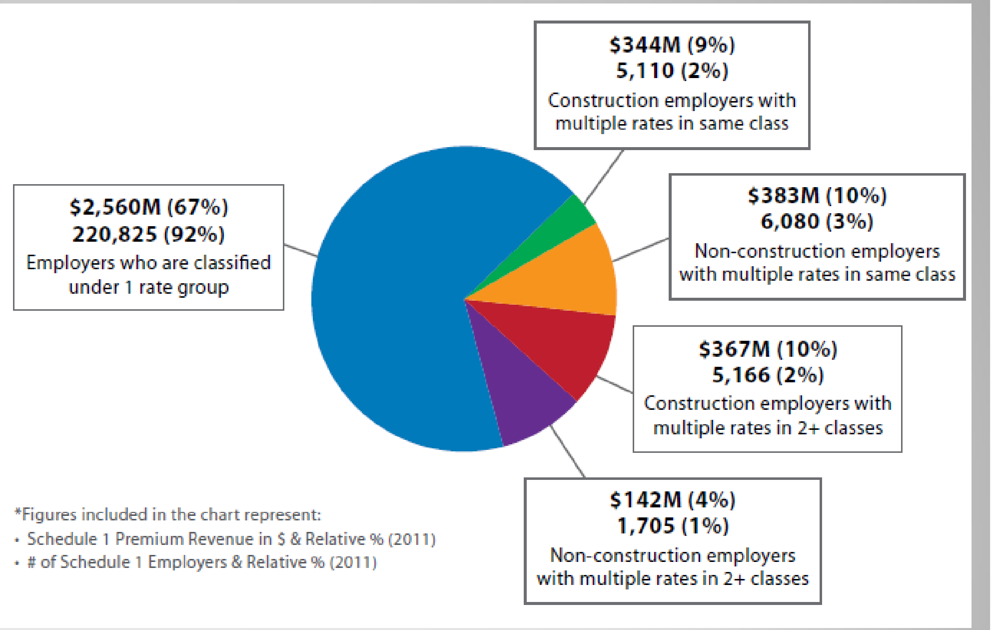
	CURRENT SYSTEM	INTEGRATED RATE FRAMEWORK
Classes	9	20-25
Rate Groups (RG)	155	20-25 (same as above)
Classification Units (CU)	800+	711*

* 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.

Step 1: Classification – 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 a system where an employer's overall risk profile determines their premium, multi-rating employers becomes an irrelevant issue.



Step 2: Average Class Rate

An average premium rate based on the collective claims experience and the required premium revenue for each sectoral group will be determined.

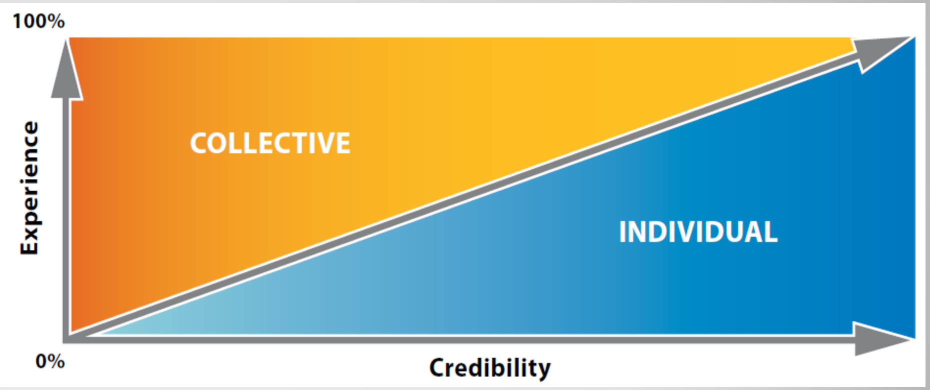
Step 3: Risk Adjusted Premium Rate Setting

A) Risk Profile

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.

B) Weighting Credibility

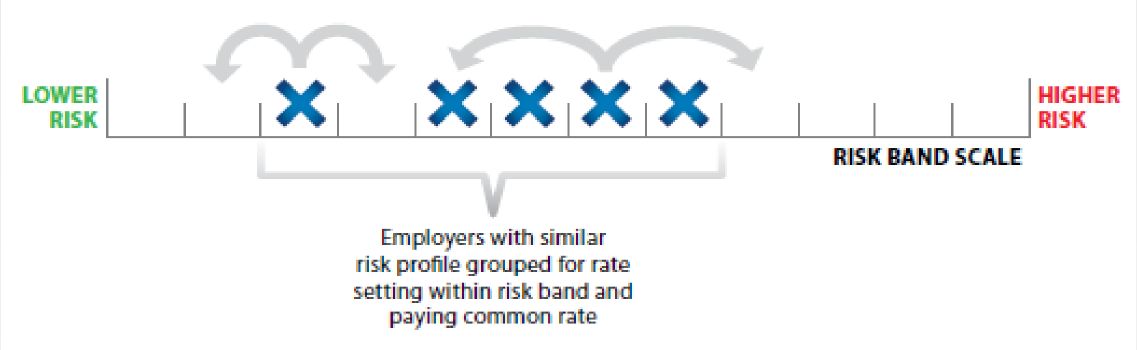
Based on an assessment of insurable earnings and claims information to ascertain their level of actuarial credibility, an employer would be attributed a percentage for their individual credibility, with the balance, consisting of the collective experience of their sectoral group.



Step 3: Risk Adjusted Premium Rate Setting

C) Risk Bands

- 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.



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.

- 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.
- The design of a model for a fair assessment of the system's costs and legacy costs present a unique problem.

The Current Approach

The Unfunded Liability charge is determined for Schedule 1 employers as a collective whole; employers pay their appropriate share based on their rate group in proportion to their new claims costs.

Class Description	2013 UFL Component of Premium Rate	Contribution to UFL 2013 Rates (in $'M)	% by Class
Class A - Forest Products	1.72	20	1.5%
Class B - Mining And Related Industries	2.38	47	3.6%
Class C - Other Primary Industries	0.68	12	0.9%
Class D - Manufacturing	0.91	362	27.4%
Class E - Transportation And Storage	1.49	117	8.9%
Class F - Retail And Wholesale Trades	0.53	169	12.8%
Class G - Construction	2.40	348	26.3%
Class H - Government & Related Services	0.30	101	7.7%
Class I - Other Services	0.43	145	11.0%
Schedule 1	0.79	1,322	100.0%

Premium Rate Implications

<u>It is essential to note that the methods reviewed in this analysis were not intended as specific solutions or recommendations</u>. They were identified merely to seek to answer the question as to the fairness and reasonableness of using NCC exclusively to apportion the UFL.

While the premium rate implications with each method has been noted below, they were never intended to be considered towards specific implementation.

2013 UFL Component of Premium Rate (per $100 of insurable earnings)	**Current Method**		**Method 1***		**Method 2***		**Method 3***	
Class A - Forest Products	$1.72	1.5%	$3.61	3.2%	$3.50	3.1%	$10.79	9.5%
Class B - Mining And Related Industries	$2.38	3.6%	$3.21	4.8%	$2.40	3.6%	$7.59	11.4%
Class C - Other Primary Industries	$0.68	0.9%	$0.09	0.1%	$1.31	1.8%	$1.53	2.1%
Class D - Manufacturing	$0.91	27.4%	$1.65	49.9%	$1.08	32.7%	$1.50	45.3%
Class E - Transportation And Storage	$1.49	8.9%	$1.25	7.4%	$1.23	7.3%	$0.35	2.1%
Class F - Retail And Wholesale Trades	$0.53	12.8%	$0.16	3.9%	$0.52	12.6%	$0.09	2.1%
Class G - Construction	$2.40	26.3%	$1.72	18.8%	$1.95	21.4%	$2.12	23.2%
Class H - Government & Related Services	$0.30	7.7%	$0.32	8.3%	$0.33	8.5%	$0.08	2.1%
Class I - Other Services	$0.43	11.0%	$0.14	3.5%	$0.36	9.0%	$0.08	2.1%
Schedule 1	$0.79	100%	$0.79	100%	$0.79	100.0%	$0.79	100%

*Further information available in appendix and on the on the WSIB website, UFL Apportionment presentation.

What Does This Tell Us?

- There is no one precise method for apportioning the UFL on an industry class basis.
- Using new claims costs to apportion the UFL might not be fair and reasonable for the UFL generated prior to 1998 and from 1998 to 2012.
- The general conclusion is that using new claims costs to apportion UFL recovery may lead to a certain level of subsidization, as demonstrated by the reasonable methods identified.

What Am I Recommending?

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 employer's sector; and
- ✓ An amount based on the employer's New Claims Cost.

Summary & Next Steps

- I have provided what I refer to as a "conceptual framework" for a new integrated framework of classification and risk adjusted premium rate setting.
- The system I recommended is very different from existing approach - it is simple and transparent and once in place should be easier to administer than the present one.
- In developing a working model of the system from the Conceptual Rate Framework, the WSIB should provide stakeholders with examples of how it will apply to 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 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.
- 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.

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 smother process for employers.
- 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.
- 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.

Discussion

Appendix

Description of UFL Methods Reviewed

Method 1

- Uses actual loss on new claims by injury year from 1998 – 2012, including net experience rating expense, as basis of allocation of UFL by class.

Class Description	Current Approach Based on NCC	Method 1 G/L on Claims Cost
Class A - Forest Products	1.5%	3.2%
Class B - Mining And Related Industries	3.6%	4.8%
Class C - Other Primary Industries	0.9%	0.1%
Class D - Manufacturing	27.4%	49.9%
Class E - Transportation And Storage	8.9%	7.4%
Class F - Retail And Wholesale Trades	12.8%	3.9%
Class G - Construction	26.3%	18.8%
Class H - Government & Related Services	7.7%	8.3%
Class I - Other Services	11.0%	3.5%
Schedule 1	100.0%	100.0%

1998-2012 Injury Years, at 2012 Year End
Methods #1 and #2 do not account for the UFL generated prior to 1998

Method 2

- Allocates UFL by class based on the relative distribution by class of the sum of 50% of the premiums paid (net of experience rating expense) and 50% of total calendar year paid claims from 1998 – 2012.

Class Description	Current Approach Based on NCC	Method 2 50% of Premium (net of ER) & 50% of Paid Claims
Class A - Forest Products	1.5%	3.1%
Class B - Mining And Related Industries	3.6%	3.6%
Class C - Other Primary Industries	0.9%	1.8%
Class D - Manufacturing	27.4%	32.7%
Class E - Transportation And Storage	8.9%	7.3%
Class F - Retail And Wholesale Trades	12.8%	12.6%
Class G - Construction	26.3%	21.4%
Class H - Government & Related Services	7.7%	8.5%
Class I - Other Services	11.0%	9.0%
Schedule 1	100.0%	100.0%

1998-2012 Financial Year
Methods #1 and #2 do not account for the UFL generated prior to 1998
Future Liabilities are not considered in Methods #2 and #3

Method 3

- Allocates UFL by class based on the 1998 UFL (adjusted for investment returns through 2012) plus notional loss (less notional gain) from 1999-2012
- Notional gain/loss for 1999-2012 defined as premium paid net of experience rating less paid claims (CPI-adjusted through 2012)

Class Description	Current Approach Based on NCC	Method 3 1998 UFL by Class plus Net Premium Less Paid Claims
Class A - Forest Products	1.5%	9.5%
Class B - Mining And Related Industries	3.6%	11.4%
Class C - Other Primary Industries	0.9%	2.1%
Class D - Manufacturing	27.4%	45.3%
Class E - Transportation And Storage	8.9%	2.1%
Class F - Retail And Wholesale Trades	12.8%	2.1%
Class G - Construction	26.3%	23.2%
Class H - Government & Related Services	7.7%	2.1%
Class I - Other Services	11.0%	2.1%
Schedule 1	100.0%	100.0%

1998 UFL adjusted by average investment returns, Claims adjusted with CPI to 2012
1999 to 2012 Financial Years
Methods #3 accounts for the UFL generated prior to 1998
Future Liabilities are not considered in Methods #2 and #3