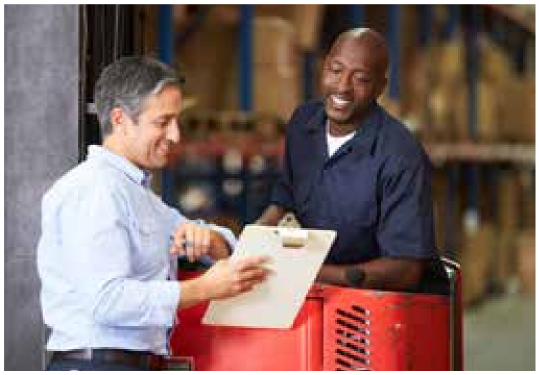




Rate Framework Reform

Paper 5:
A Path Forward

MARCH 2015

WORKPLACE SAFETY AND INSURANCE BOARD

MESSAGE FROM THE CHAIR AND PRESIDENT & CEO

In recent years, stakeholders, experts and the WSIB have identified a number of fundamental challenges to the WSIB's current classification and premium rate setting approach.

Following the recent engagement with stakeholders, Mr. Douglas Stanley released his final *Pricing Fairness* report, in which he recommends that the WSIB develop an Integrated Rate Framework that would change the way employers are classified and the way premium rates are set.

After a careful review of Stanley's recommendations, consideration of stakeholder perspectives and challenges, the WSIB's own analysis and advice from a team of actuarial experts from the firm Morneau Shepell, the WSIB committed to bring forward a proposed preliminary Rate Framework for discussion with stakeholders.

The WSIB's objectives are to consider reforms that ensure that everyone pays their fair share for workplace coverage, to ensure that there is a reasonable balance between premium rate stability and responsiveness, and to make it easier for stakeholders to understand and engage in the process.

The proposed preliminary Rate Framework described in these technical papers builds upon Stanley's recommendations and proposes a plausible working model – a way forward for the WSIB to distribute the costs of the system in a fair and transparent manner.

Its key features are:

- A simplified, transparent and modernized classification system, aligned to an accepted national standard;
- A fair process that prospectively sets premium rates, reflecting individual employers' claims experience relative to their industry; and
- Considerations for a reasonable transition path to ensure employers can gradually adjust to the new premium rate setting process.

Although the WSIB is proposing a plausible working model, there are a number of options and key questions for further consideration. The WSIB understands that it is only with stakeholders' varied and unique perspectives that it will be able to make informed decisions on the issues currently faced by the system.

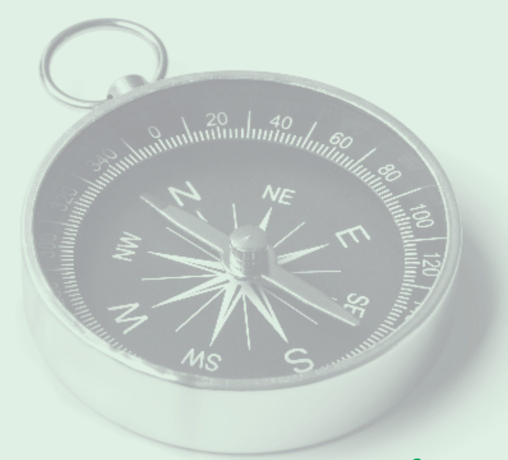
The WSIB is thankful for the support and thoughtful engagement of stakeholders in the Rate Framework Reform initiative and looks forward to further opportunities to hear the diverse perspectives as we consider potential reforms to the current approaches for employer classification and premium rate setting.

Yours truly,

Elizabeth Witmer
Chair

I. David Marshall
President & CEO

March 31, 2015



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PAPER 5 | A PATH FORWARD

This paper provides stakeholders with information to support a discussion regarding the development of a transition plan towards a new Rate Framework that strikes a balance between premium rate stability and responsiveness.

As described in detail in the preceding papers, the WSIB is proposing a prospective Risk Adjusted Premium Rate Setting process that would change the current method of calculating employer premiums. Changes could occur to Schedule 1 employers as a result of the following three components:

- Allowing class and employer experience to adjust premium rates;
- Implementing the proposed preliminary Rate Framework (as presented in Paper 3: The Proposed Preliminary Rate Framework); and
- Incorporating the proposed method for apportioning the UFL (addressed in Paper 4: The Unfunded Liability),

Because employers might not be paying the same premium rate under a new Rate Framework than they are today, the WSIB understands that change would need to be implemented in a gradual manner. With the valued input and perspectives of stakeholders, the WSIB is proposing to design a transition plan that would outline how employers would shift from their current premium rate to their Employer Target Premium Rate.

Key Considerations

The WSIB is responsible for administering one of the largest workers' compensation systems in Canada, covering over 280,000 employers and over 4 million workers. In order to provide workplace coverage and security of benefits, it collects billions in premium revenue each year. Given the number of employers and workers impacted, it is essential that the system be fair and efficient in the collection of those premiums.

Over the past few decades, the WSIB's system for premium rate setting has accumulated unfairness and inefficiency, and it is time to correct these issues and move forward with a more equitable and balanced process. Paper 3: The Proposed Preliminary Rate Framework presents a plausible model that addresses the issues with the current system. The WSIB is looking for stakeholder feedback on the approaches proposed and questions raised in Paper 3 in order to move towards meaningful change.

Revenue Neutrality as a Foundation

The adoption of a new classification structure and prospective Risk Adjusted Premium Rate process would not affect the total amount of premium dollars collected by the WSIB , thereby remaining revenue neutral. However, a new system would, in a reasonable and gradual manner, shift the distribution of premiums among individual employers based on their experience, while ensuring that employers are paying their fair share of workplace coverage. The transition period would be completed once all employers have reached their Employer Target Premium Rates.

Following the endorsement of any new Rate Framework, the WSIB would be seeking input from stakeholders specifically on the development of a transition plan towards the new Rate Framework.

The proposed preliminary Rate Framework would involve the introduction of a new employer classification structure and a prospective Risk Adjusted Premium Rate Setting process.

During the transition period, as employers move towards their Employer Target Premium Rate, an Employer's Actual Premium Rate would be determined based on the Risk Adjusted Premium Rate Setting process (as described in Paper 3: The Proposed Preliminary Rate Framework), their individual risk profile and their actuarial predictability.

The WSIB recognizes that it may be difficult to achieve general consensus on a transition plan owing to the diversity of its stakeholders and their particular circumstances. To support the discussion around an appropriate transition plan, the WSIB is proposing a set of key considerations for stakeholders' review and general acceptance. The WSIB is committed to engaging stakeholders in the future to consider the transitional features of any potential Rate Framework reforms.

The following considerations would form the basis for adopting an approach to transitioning employers to their Employer Target Premium Rate:

- Gradual, incremental movement towards Class Target Premium Rates;
- Utilizing the decreasing/eliminated UFL to support movement towards Employer Target Premium Rates;
- Balance between degree of premium rate increases and decreases;
- Gradual, incremental movement towards Employer Target Premium Rates; and
- Consideration for economic circumstances and potential legislative amendments.

One of the proposed key considerations to assess when transitioning from the current scheme to the proposed preliminary Rate Framework, is how it could be linked to the resolution of the UFL. The reduction of the UFL would provide significant maneuverability for employers who would find themselves particularly far from their Employer Target Premium Rate. For these employers, the gradual removal of roughly 40% of their premium rate due to the elimination of the UFL would provide the ability to maintain premium rates relatively stable, while making up significant ground towards arriving at their Employer Target Premium Rate.

One of the key outcomes of the Harry Arthur's Funding Review has been the implementation of Ontario Regulation 141/12 under the *Workplace Safety and Insurance Act, 1997*, which prescribes a set of funding sufficiency goals for the WSIB. The WSIB is committed to meeting its prescribed funding ratios of 60% by 2017, 80% by 2022, and 100% by 2027. According to the WSIB's 2014 Q3 Sufficiency Report, by December 31, 2013, the Sufficiency Ratio improved nine percentage points to 63.0%, which brings the WSIB ahead of its 2017 sufficiency goal.

The WSIB recognizes that employers may want to better understand what their premium rates could be under the proposed preliminary Rate Framework. In particular, employers may be interested in how the UFL would be addressed if a new Rate Framework were to be implemented, given that the UFL may be reduced from its current reported balance (as of December 2013) to a lesser amount in the coming years.

To support this discussion, it makes sense to provide employers with information that illustrates premium rate implications at a future point in time, considering a reduced UFL amount.

The next section provides an illustrative example, based on the approach suggested in Paper 3: The Proposed Preliminary Rate Framework, to demonstrate a solid foundation from which stakeholders can begin to consider the development of a sound and balanced transition.

QUESTION FOR CONSIDERATION

1. ***Are there any other key considerations that could be considered in the development of a transition plan from the current system to a new Rate Framework?***

Illustrative Example – Potential Transition Outcomes

The WSIB tested the premium rate outcomes of the proposed preliminary Rate Framework by using what employers are paying today as a starting point, and then projecting their Employer Target Premium Rates. In undertaking this work an estimated value for the UFL is required. While implementation timelines still need to be determined and the value of the UFL may fluctuate accordingly, for this illustrative example, a UFL balance of $5 billion was utilized to show premium rate implications. Alternate scenarios could be developed to test any UFL value, including a scenario where the UFL has been eliminated.

In order to complete this modeling of the proposed preliminary Rate Framework and project Employer Target Premium Rates, the WSIB needed to determine an appropriate starting point – what “best” represents what employers are paying today.

The WSIB evaluated different payment amounts (such as premiums paid in 2013, premiums net of experience rating charges for last year, last two years, last three years, etc.) to determine the right starting point, as this would change the outcome when transitioning employers from their current premium rate to the proposed preliminary Rate Framework.

The WSIB found the following:

- Using premiums paid in 2013 based on the employer’s rate group (RG) rate(s) may not incorporate the impact of experience rating surcharges or refunds (that are provided in the following year), and therefore may not reflect the employer’s actual claims experience – or net premiums;
- Using a shorter time period – such as last year’s net premium rate – may be easier for employers to understand, but may overly penalize an employer who had a poor accident year, when in prior years they had good accident records; and
- Using a longer time period – such as six preceding years – to assess an employer’s net premium rates may include claims costs that may not reflect an employers’ recent claims experience (e.g., an employer successfully, but only recently, adopted health and safety practices).

After considering a number of methods, the WSIB determined that the following approach provides a reasonable reflection of an employer's premium rate experience and helps address any potential anomalies that may have occurred in the prior year:

- For employers who are currently participating in WSIB experience rating programs: using the employer's average "net" premium rate (after considering experience rating refunds and surcharges) over the last three years; and
- For employers who are not experience rated (who are not eligible to participate in an experience rating program) using the premium rate of the RG from the prior year.

QUESTION FOR CONSIDERATION

1. ***Is using the average of the last 3 years net premium rate for experience rated employers and the premium rate of the RG for those employers who are not experience rated, a reasonable starting point for employers to transition to a new Rate Framework?***

For illustrative purposes, the premium rate outcomes shown in Figure 1, for the proposed preliminary Rate Framework, considering the various premium rate stability measures (e.g., limiting movement to three risk bands each year) indicates the percentage of employers increasing and decreasing.

For many employers, the premium rate changes from the current system to the proposed preliminary Rate Framework would become more manageable from a premium rate change perspective. For other employers, with relatively greater increases or decreases, the three risk band movement limitation from one year to the next would reduce major year-to-year shifts in premium rates.

Figure 1: Percentage of Employers Increasing and Decreasing

> 50% decrease	0.5	73.2
25-50% decrease	21.4	
10-25% decrease	38.1	
5-10% decrease	13.2	
0% change	0.3	0.3
5-10% increase	5.5	26.5
10-25% increase	10.8	
25-50% increase	9.9	
> 50% increase	0.3	

While employers who would see larger decreases would want more rate responsiveness, other employers, particularly those that would see large premium rate increases, may still see the three risk band movement limitation as too substantial a change. These employers may want to have more premium rate stability.

As part of any transition plan, a greater limitation on risk band movement (e.g., only one risk band or about 5% relative to their Class) would provide even more stability, but would also mean that it may take an employer a significantly longer time period to reach their Employer Target Premium Rate.

Employers who would not meet their Target Premium Rate after Six Years	
With increasing premium rates	5,060
With decreasing premium rates	8,753
Total	**13,813**
Percentage of total employers	**6.90**

The chart on the right provides employers with an idea of how many employers would not meet their Employer Target Premium Rate six years after introducing the proposed preliminary Rate Framework assuming the UFL would be eliminated by the end of the six year period.

In assessing the various options for transitioning employers to their Employer Target Premium Rates, the WSIB would be engaging with stakeholders on an approach that seeks to achieve a reasonable balance between premium rate stability and responsiveness for all Schedule 1 employers. This includes the consideration of transitional rules that could further limit premium rate implications (as identified on p. 4).

With potential reforms, the WSIB would propose to develop a transition plan with stakeholder input. One of the key reasons for incorporating transitional rules when moving to any new Rate Framework would be to provide employers with a greater level of stability, especially when contrasted with the current volatility of employer premium costs due to the effects of experience rating program rebates and surcharges. In order to address the issue of premium rate volatility, one consideration would be to incorporate limits to employers' year over year premium rate changes relative to their Class.

There are a number of other considerations that would also form part of a transition plan. For example, transition to a new Rate Framework would, as introduced in Paper 3: The proposed Preliminary Rate Framework, involve regulatory amendments. It would also mean changes to WSIB's internal accounting systems and processes. These significant items would require specific attention by the WSIB and its partners to ensure a smooth transition for all the stakeholders impacted.

Transition would impact employers in different ways: certain employers would reach their Employer Target Premium Rate when a new Rate Framework is introduced, while others may take a number of years to gradually move towards their Target Premium Rates. That being said, regardless of the difference between an employer's current net premium rate and their future Target Premium Rate, the WSIB believes that it is important to provide employers with enough time to adjust to any proposed changes, and to ensure that any movement towards Employers' Target Premium Rates is done gradually.

The WSIB's funding sufficiency projections highlighted in Paper 4: The Unfunded Liability shows that the WSIB is on the path to gradually eliminating the unfunded liability. The WSIB's comprehensive review of employer classification, premium rate setting and experience rating and the development of a proposed new model combined with the gradual elimination of the UFL, may never again occur at the same time. The elimination of the UFL provides a unique window of opportunity to get the WSIB's processes and systems set on the right path with the least burden and disruption to stakeholders. Ultimately, the workers' compensation system as a whole will be in a better situation once the UFL is eliminated.

Jurisdictional Comparison: WorkSafeBC's 3-Year Transition Plan

Similar to the transition plan the WSIB would develop, WorkSafeBC undertook a transition from its old assessment system to a new system from 1999 to 2002. WorkSafeBC's initiative is a useful point of reference due to the similarities in the objectives between WorkSafeBC's and the WSIB's current Rate Framework consultations.

WorkSafeBC's review focused on improvements to two main areas: classification and experience rating. WorkSafeBC was motivated to update its classification structure by changes in technology, work processes, and products in many industries occurring in the decades preceding the review of its assessment system. Additionally, the Board sought to introduce a new experience rating plan to enhance equity at the individual firm level. The new experience rating plan would result in more timely and appropriate experience rated adjustments than the old plan. Considering the significant undertaking moving to a new classification structure and experience rating plan would pose to the Board and its stakeholders, WorkSafeBC proposed to gradually move stakeholders from their current premium rate to their proposed Target Premium Rate.[i]

Under WorkSafeBC's new system, approximately 48% of base assessment rates were projected to decrease, and the remaining 52% would experience rate increases. Many of these increases were of a modest size, while 24% of those employers experienced increases of more than 40%.

As part of the transition plan, WorkSafeBC included a number of measures during the 3-year period. These included:

- No employer would see a rate increase of more than $2 over their 1999 net rate (base rate plus experience rating adjustment).
- A maximum of 40% increase in the first and second years and an appropriate percentage in the third year to achieve the Target Premium Rate.
- If an employer has a very significant increase, the rule allows for a transition of greater than 40% over each year, but in no case shall it exceed $2 over the 1999 net rate.

Under the proposed preliminary Rate Framework, approximately 74% of employers would be projected to see premium rate decreases and 26% would be projected to see premium rate increases, of which 10% would see a premium rate increase of greater than 25%.

Proactive Occupational Health and Safety Interventions – Return to Work and Prevention

Supporting employers and their workplaces in understanding the importance of proactive occupational health and safety is a critical component of any transition plan. The proposed preliminary Rate Framework would act as an early warning for employers by providing target premium rates allowing employers to; better identify the future projected path of their premium costs; and take proactive health and safety actions (e.g. prevention; and return to work (RTW) to address the risks).

Employers could see premium rate implications as a result of:

- A transition to a more responsive Rate Framework;
- A significant gap between their historical rates in the current system and their new Target Premium Rate;
- A sustained performance trend leading to a significant increase in their risk profile; and
- A risk profile that is disproportionate to their respective industry performance.

New and enhanced risk reduction support services (focusing on RTW and Prevention) are delivered by the WSIB's Workplace Health and Safety Services function and other Occupational Health and Safety partners (including the Ministry of Labour, the Chief Prevention Officer and Health and Safety Associations).

These services would be most helpful in assisting employers who have a particular interest in reducing their claims experience performance trends that have led to high premium rates.

The design of the proposed preliminary Rate Framework could accommodate other health and safety initiatives or programs (Ministry of Labour/Chief Prevention Office).

Conclusion

The WSIB is recommending replacing its current classification structure, premium rate setting process, and experience rating programs with the proposed preliminary Rate Framework. The new model aims to address some of the fundamental issues with the current framework and its associated business processes raised by stakeholders, partners and the WSIB itself. The WSIB has done extensive technical analysis and modeling of design features to ensure the proposed preliminary Rate Framework is aligned with the Rate Framework's Key Goals and is revenue neutral at the Schedule 1 level.

The proposed preliminary Rate Framework consisting of a modernized classification structure and Risk Adjusted Premium Rate Setting process would allow the WSIB to allocate the distribution of costs to the system appropriately. It is intended to help build stakeholder confidence in a more simplified and equitable system.

As outlined earlier in this paper, the WSIB is proposing key considerations that would be used in the development of a transition plan. This transition plan would consider a number of factors including the elimination of the UFL, the implementation of a new Rate Framework, and ensuring premium rates are responsive to employer claims experience.

The transition to a new Rate Framework would not burden employers with large fluctuations in premium rates. The WSIB would ensure that a gradual implementation would be possible with the introduction of premium rate thresholds, and incremental progress to Employer Target Premium Rates. This would provide a fair and equitable distribution of costs without major disruption to Schedule 1 employers.

Recommendations on the proposed preliminary Rate Framework have been highlighted throughout Papers 3, 4 and 5 with questions, and a summary of the WSIB's current approach. The WSIB is seeking feedback from stakeholders on each of the recommendations. Input from stakeholders on each of the recommendations and input can be provided at consultation meetings, and/or in writing to consultation_secretariat@wsib.on.ca.

The WSIB is committed to engaging stakeholders in the future to consider the transitional features of any potential Rate Framework reforms.

Endnotes

i. WorkSafeBC, *Net Rate Transition Discussion Paper*, November 1999, pp 2-5.

GLOSSARY

Actuarial Predictability is a process where the WSIB determines the degree to which past claims costs can be relied upon to predict future outcomes and therefore fairly and accurately set premium rates. Also referred to as actuarial credibility.

Class Actual Premium Rate is the premium rate that would be set by the WSIB, taking into consideration risk band limitations, previous year(s) premium rates, as well as the collective experience of all employers in that class.

Class Target Premium Rate is a premium rate based on the valuation of collective liabilities of new claim costs for the employers within a respective class, their allocation of administrative costs, and apportionment of the past claims costs for a particular class.

Employer Actual Premium Rate is an adjusted premium rate that represents how much each employer would pay taking into consideration risk band limitations, previous year(s) premium rates, minimum premium rate, as well as the collective experience of all employers in that class.

Employer Level Premium Rate Adjustment is a process where the Class Target Premium Rate is adjusted for an individual employer based on their risk relative to the Class Target Premium Rate, to arrive at their individual risk band position and corresponding Employer Target and Actual Premium Rates.

Employer Target Premium Rate is an adjusted premium rate that represents how much an employer needs to pay in order to fund their fair share of costs, as well as the collective costs of their class.

Net Premium Rate represents the premium rate, for a class, rate group or individual employer, comprised of the published premium rate combined with any premium adjustments resulting from the existing experience rating programs, as applicable.

Predominant Class is the class that represents the largest percentage of the employer's annual insurable earnings.

Risk Adjusted Premium Rate Setting is a two-step process that includes setting the Class Target Premium Rate and Employer Level Premium Rate Adjustments.

Risk Bands are hierarchical series of divisions within each class. Each division represents a different level of risk where employers would be placed relative to the Class Target Premium Rate. In each class, risk bands are subject to limitations, such as the premium rate of the minimum risk band ($0. 20), and the maximum risk band will not exceed about three times the Class Target Premium Rate. Each risk band represents approximately 5% increments in premium rate.

Risk Disparity is when claims experience or premium rates vary significantly from the average experience of the class.

Risk Profile is a step in determining the allocation of the costs to the system between the classes and/or individual employers, and is based on an employer's (or a class') claims costs relative to their insurable earnings.