Chapter 3
Section
3.14

Unfunded Liability of the Workplace Safety and Insurance Board

Background

The Workplace Safety and Insurance Board (WSIB) is a statutory corporation created by the *Workplace Safety and Insurance Act, 1997* (Act). Its primary purposes are to provide income support and fund medical assistance to workers injured on the job. The WSIB also funds programs to help prevent workplace injuries, illnesses, and fatalities. The WSIB endeavours to apply an integrated approach to workplace health and safety that promotes co-operation and collaboration among its stakeholders, including the government.

The workplace safety and insurance system is financed through premiums charged on the insurable payrolls of employers; the WSIB receives no funding from the government. Under the Act, the government has the sole responsibility for setting benefits and coverage through legislation, while the WSIB has direct responsibility for setting premium rates, within the following guideline:

> The Board has a duty to maintain the insurance fund so as not to burden unduly or unfairly any class of Schedule 1 employers [generally all private-sector employers] in future years with payments under the insurance plan in respect of accidents in previous years.

Notwithstanding this legislative guideline, the assets in the WSIB insurance fund are substantially less than what is needed to satisfy the estimated lifetime costs of all claims currently in the system—thus producing what is known as an "unfunded liability."

In our *2005 Annual Report*, we noted that the WSIB's unfunded liability had reached $6.4 billion at that time, and commented on the importance of the WSIB having a credible plan to reduce it. We noted that failure to effectively control and eliminate the unfunded liability could result in the WSIB being unable to meet its existing and future financial commitments to provide worker benefits.

We decided to revisit our previous comments on the unfunded liability with a view to providing a more detailed commentary on the issue given the recent turmoil in the global financial markets and the impact this has had on the viability of pension plans and other worker benefit plans, such as workers' compensation insurance.

Workplace safety and insurance systems operate in a complex business environment because they serve a number of stakeholders with competing interests and views pertaining to the key areas of insurance benefits, coverage, and premium rates. For instance, employers want low premium levels while workers want high benefit-payment levels. These competing interests influence benefits, coverage, and premium rates, which can have a negative impact on the size and growth of the unfunded liability. It is incumbent on the WSIB and the government to try to balance such views against the need to maintain financial stability.

Review Objective and Scope

Our work focused on providing information on the changes in the unfunded liability, the factors contributing to these changes, and the initiatives being undertaken by the WSIB to control the growth of the unfunded liability. We did not audit the WSIB's finances or controls because these aspects are examined annually by other auditors.

We caution the reader that references are made throughout our report to future unfunded liability estimates, which are based on assumptions regarding future events. Actual results may of course vary significantly from these estimates. As well, the degree of uncertainty will generally increase the further into the future the estimates extend. We have not audited the data the WSIB provided to us and do not express an opinion on the actuarial assumptions it has made or the methods used.

As well as conducting work at the WSIB, we approached four of the larger workers' compensation boards in other provinces to discuss the practices and actions that these jurisdictions have put in place to allow them to achieve and/or maintain over the last 10 years their fully funded position (that is, their assets are sufficient to cover their liabilities). Two boards responded to our requests; we visited these boards to discuss with their officials some of the common issues and their approaches to managing them. Our observations on some of the practices implemented by the other provincial boards to support the financial sustainability of their systems are also presented in this report.

We also met with the WSIB's Chair, its President and CEO, members of its senior management team, and current and former members of its Board of Directors to discuss their perspectives on the unfunded liability. We would like to acknowledge their assistance during our review.

Summary

The WSIB's funding ratio represents the percentage of assets it has available to meet its financial obligations. As of December 31, 2008, its funding ratio was 53.5%—significantly lower than any of the four large provincial boards with which we compared Ontario (British Columbia, Alberta, Manitoba, and Quebec), which averaged 102%. In each of these four provinces, legislative and policy differences are key factors that contribute to their higher funding ratios. A Board's funding ratio is largely determined by the size of its unfunded liability, which is the amount by which the Board's financial obligations exceed its assets. As of December 31, 2008, the WSIB's unfunded liability was $11.5 billion—an increase of $3.4 billion from December 31, 2007. One factor that had a significant negative impact on the unfunded liability in 2008 was the global economic downturn. However, there are also a number of other systemic issues that have affected the size of the unfunded liability.

The main observations arising from our review are as follows:

- Eliminating or reducing the unfunded liability requires the interaction of four key levers—legislated benefits, coverage, premium rates, and investments—to work effectively in tandem. The inability to eliminate the WSIB's unfunded liability over the last two decades has been owing in part to the desire to satisfy all the stakeholders. Both the WSIB and the government may have to commit to a different strategy with respect to the setting of premium rates and benefits if the WSIB is to be able to eliminate the unfunded liability within a reasonable period.
- The WSIB advised us that its 2008–12 strategic plan, *The Road to Zero*, contains a number

of initiatives that target and support the financial sustainability of the system. Key initiatives include the prevention strategy, which provides for a collaborative prevention partnership model; social marketing, which supports the organization's prevention mandate; development of a new case-management approach to service delivery; and other initiatives in the areas of return-to-work programs, health-care solutions, and occupational-disease services. However, despite these initiatives, the WSIB advised us that, because of the significant financial losses resulting from the global financial market downturn, its target of full funding by 2014, which was originally established in 1984, will not be achieved. The WSIB has not set a new target date. On the basis of February 2009 projected estimates, the unfunded liability may not be eliminated until 2022—eight years past the 2014 date targeted by the WSIB and successive governments since 1984.

- The WSIB's actions to eliminate the unfunded liability have been limited by recent economic circumstances and by the four key levers that are to some degree beyond the control of the WSIB. These include the government's responsibility and authority over legislation, including benefit changes and the extent of business sectors and industries that are covered by the system. As of 2007, the percentage of the workforce covered by the system in Ontario was 72.6%, as compared to Alberta at 89.7%, B.C. at 93.1%, and Quebec at 93.4%. The WSIB has the direct responsibility for setting premium rates. The WSIB and the government face the least resistance from stakeholders when they keep premiums low (which satisfies employers) and benefits high (which satisfies workers). Over time, this can result in a large unfunded liability. To mitigate against this risk, the provincial boards we visited cited examples of legislated requirements or formalized funding models that required their systems to be fully funded. We recognize, however, that this is a policy issue specific to each jurisdiction and that neither the WSIB's legislation nor its Memorandum of Understanding with the Ministry of Labour requires that the plan be fully funded.
- Premiums have a significant impact on the size of the unfunded liability. However, annual premium revenues in recent years have not been sufficient to cover benefit costs. The WSIB has not reported an annual surplus since 2001, and since that date the annual deficits have ranged from a low of $142 million in 2006 to a high of $2.4 billion in 2008. Although investment losses in 2007 and 2008 have increased the unfunded liability, we believe that even if these losses had been netted against previous unrealized investment gains, the unfunded liability would still have been in excess of $7 billion. In the seven years since 2001, while the WSIB has experienced annual deficits averaging over $900 million, premium rates were only increased in 2003 and 2006, resulting in an overall 7.5% increase or 1% per year on average. Since 2006, premium rates have not changed to reflect the impact of higher benefit costs—such as the $750-million benefit enhancements the government enacted in 2007, which did not have matching premium or investment revenues to offset the increased costs.
- Benefit and health-care costs have been rising over the last 10 years. These cost increases—in particular, benefit cost increases arising from increases in the amount of time that workers are staying on benefits and increases in benefits arising from legislative changes—have contributed to the unfunded liability. Key factors identified by the WSIB for the increasing duration of claims include some unintended consequences of Bill 99, *The Workers' Compensation Reform Act* (which was the last major legislative reform to the system), along with an ineffective employer-incentive program. As

well, an increased use of prescription pain killers has added to the costs of the system.

In the current economic climate, the WSIB and the government face significant challenges in eliminating the unfunded liability. Increasing premium rates would be challenging because Ontario already has one of the highest average premium rates of any province. The WSIB's 15-year average rate of return on its investments from 1994 to 2008 was 6.6%, slightly less than the WSIB's 7% target. Given that future benefit costs are expected to rise at 7% annually, investments must earn more than 7% before any reduction of the unfunded liability can be realized solely from investment returns. On the benefit cost side, the WSIB has undertaken a number of internal initiatives to reduce claims duration, including the implementation of a new service delivery model and the introduction of new technology initiatives to reduce health-care costs. However, in addition to improved investment returns and further cost-reduction measures, more significant structural changes, including legislative reforms, may be needed to ensure that the Board continues to have the ability to meet its future financial obligations.

The WSIB acknowledges that significant actions will need to be taken to get its financial affairs in order. In spring 2009, the WSIB's Chair initiated province-wide stakeholder consultations on solutions to the financial challenges facing the WSIB. According to the WSIB's March 2009 newsletter, this process was to be "aimed at achieving a broad consensus among stakeholders on how best to deliver a sustainable future for Ontario's Workplace and Safety Insurance Board" and was to "include open and frank communication about the financial and legislative framework in which the WSIB operates."

OVERALL WSIB RESPONSE

As the Auditor General's review notes, the growth in the unfunded liability to $11.5 billion as of December 31, 2008, is of concern to the WSIB. The WSIB faced a key challenge in 2008 because financial results were significantly affected by the global economic downturn. This major decline in equity markets led to a significant decrease in investment returns in 2008, which in turn resulted in a $3.4 billion increase in the unfunded liability in 2008. The ongoing market volatility and uncertainty in 2009 continues to have an impact, but, to address this issue, an enhanced investment strategy was implemented in late 2008 to reduce the impact of potential market volatility and to better align investment assets to long-term funding obligations.

The WSIB's vision is the elimination of all workplace fatalities, injuries, and illness. In 2007, the WSIB implemented *The Road to Zero*, which is the five-year corporate strategy for 2008–12. Financial sustainability is one of four key fundamentals of *The Road to Zero*, and, in that regard, the WSIB has implemented a funding framework and regularly reviews funding scenarios and financial results through a process of funding outlooks. The WSIB's prevention efforts are already showing positive results: as the lost-time injury rate (the lost-time injury count per 100 covered workers) has decreased from 2.37 in 2000 to 1.51 in 2008, which represents an annual rate of change of -4.9% over 2000–08.

The WSIB is taking a measured, fiscally prudent approach in setting premium rates to avoid placing undue financial burdens on employers. For 2010, premium rates will closely reflect the performance of rate groups with poorer health and safety performance and other factors, while addressing the financial pressure facing the WSIB. Only those rate groups with poorer performance will experience rate increases; otherwise, premium rates will remain at 2009 levels. Unlike previous years, there will be no premium rate reductions for any rate groups, including those with improving safety records.

The WSIB is committed to the goal of long-term financial sustainability and expects to establish the new target date to eliminate the unfunded liability shortly. The WSIB agrees with the Auditor General's observation that a comprehensive, balanced approach is required to ensure that the four key levers of legislated benefits, coverage, premium rates, and investments work in tandem to effectively support the elimination of the unfunded liability.

Detailed Review Observations

ONTARIO'S WORKPLACE SAFETY AND INSURANCE SYSTEM

Workers' compensation boards exist in each of Canada's provinces and territories. These organizations provide assistance to workers who have been injured on the job or have job-related illnesses, and also to promote safety awareness with a view to preventing workplace injuries. Each organization was created under provincial or territorial law. The workers' compensation systems are generally similar in structure and mandate, but they are not identical in all respects. The provincial organizations may differ from each other in size, policies concerning the employers, injuries, and illnesses they cover, and the benefits they offer.

One of the key principles adopted when Ontario's workers' compensation system was established—a principle that still guides the system—is that in exchange for guaranteed protection, injured workers give up the right to sue employers over work-related injuries or illnesses, regardless of fault. The legislation created a compulsory no-fault insurance and collective liability system administered by a workplace safety/workers' compensation organization—an independent public agency that adjudicates the claims of injured workers or their survivors and provides compensation where the agency considers it appropriate. To help fund the benefits and the administration costs, premiums are levied on most employers and paid into a fund held by the agency.

The Workplace Safety and Insurance Board (WSIB) is a statutory corporation under the *Workplace Safety and Insurance Act, 1997*. Its mandate is to promote the prevention of injuries, illnesses, and fatalities in Ontario workplaces. The Board also provides insurance benefits to the survivors of workers who die from a workplace injury or from an occupational illness and provides loss-of-earnings assistance to injured workers receiving benefits.

The WSIB is the largest workplace safety and insurance/workers' compensation organization in Canada. According to the Association of Workers' Compensation Boards of Canada's *2007 Annual Report*, the WSIB is ranked first in Canada in 2007 by number of claims (about 329,000 compared to second-place Alberta with about 175,000 claims), and by premium revenue ($3.5 billion compared to second-place Quebec with $2.3 billion).

The WSIB administers the Act for two groups of employers:

- Schedule 1 employers, which, under a "collective liability" system, are required to contribute to the WSIB's insurance plan. They include, among others, any firms involved in the automotive, construction, manufacturing, and transportation sectors.
- Schedule 2 employers, which are self-insured, are individually liable for the full costs of any claims made by workers. They include, among others, the provincial government, Crown agencies, and some municipalities and school boards. The WSIB pays the benefits of Schedule 2 workers but is reimbursed by the employers for the cost of the claims, for administrative costs, and for a portion of the cost of the WSIB's prevention activities.

The Act requires that the WSIB maintain an insurance fund to "pay for the benefits under the insurance plan to workers…and to survivors of deceased workers" and to pay the WSIB's operating expenses (that is, the cost of administering the Act). Under the Act, funding of the system is the responsibility of employers, including government and government agencies as employers in Ontario. As in other provinces, Ontario's system is financed through insurance premiums charged on the insurable payrolls of employers. The insurance premiums paid by the employers vary depending on the degree of safety risk of the employer's type of business. The WSIB receives no direct funding from the provincial government.

The WSIB has two sources of revenue: employer premiums and investment income. Similar to pension plans and other insurance companies, investment returns on the fund's assets are a key revenue source for the fund to make future benefit payments.

On the expense side, the WSIB provides benefits for loss of earnings, benefits for permanent impairment, payments for health-care expenses, assistance to facilitate an injured or ill worker's return to work, and survivor benefits in the case of work-related fatalities. Annual benefit costs for accounting purposes consist of two components: benefit costs paid (the amount paid to injured and ill workers during the year) and changes in benefit liabilities (the adjustment to the actuarially determined estimates for future claim payments for current and prior-year claims). The benefit liabilities are calculated based on actuarial assumptions. Changes in some assumptions can cause significant changes in the benefit liabilities. Key actuarial assumptions include the discount rate (that is, the interest rate used in "discounting"—or determining the present value of—future cash flows), mortality rates, lost-time injury rates, and inflation factors.

If premiums collected from employers and returns on the WSIB's investments are insufficient to cover the total expected future benefit costs, the shortfall will result in an unfunded liability. Put simply, the unfunded liability is merely a measure of the difference between the value of the WSIB's assets and its estimated financial obligations at a point in time.

The Act does not require the insurance plan to be fully funded. The legislative provisions that relate to the plan's funding status stipulate only that funds must be "sufficient to make the required payments under the insurance plan as they become due". However, the Act does state that employers in future years are not to be burdened with "payments…in respect of accidents [that occurred] in previous years."

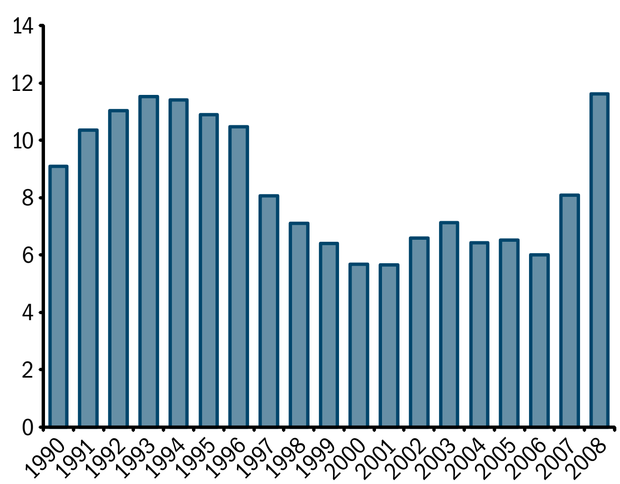
GROWTH OF THE UNFUNDED LIABILITY

The WSIB's unfunded liability was $9.1 billion in 1990 and stood at $11.5 billion as of December 31, 2008. As Figure 1 shows, there was a significant decline in 1997, resulting from legislative reforms to the system that arose from the passage of Bill 99, *The Workers' Compensation Reform Act*, which revised inflation protection to partially disabled workers. During the last three years, from 2006 to 2008, the unfunded liability almost doubled in size, growing from $5.9 billion on December 31, 2006, to $11.5 billion—one of the highest levels in the WSIB's history—on December 31, 2008.

The funding ratio (the ratio of assets to liabilities) is a useful measure of the adequacy of a workers' compensation system to pay future claims. A ratio above 100% indicates that the workers' compensation organization has more than sufficient assets to meet its estimated future liabilities.

Figure 1: WSIB Unfunded Liability, 1990–2008 ($ billion)

Source of data: Ontario Workplace Safety and Insurance Board



Conversely, a low ratio indicates that the organization currently has insufficient assets to meet its estimated future liabilities. As of December 31, 2008, Ontario's funding ratio stood at 53.5%. By comparison, the funding ratio of the other four large provincial boards included in our review ranged from 70% to 116% and averaged 102%.

Figure 2, which breaks out the unfunded liability by its asset and liability components, shows that, since 2001, the WSIB's liabilities (consisting mainly of workers' claims for benefits) have increased at an average rate of 2.5%, which is close to the 2.7% average growth rate in the fund's assets over that same period. Because the WSIB's liabilities are so much larger than the fund's assets, the generally consistent average growth rate in both the liabilities and the fund's assets means the liabilities are increasing much faster in size than are the fund's assets, and therefore the unfunded liability has gotten larger. On a year-over-year basis, the other key variable has been that the yearly rates of return on the fund's assets have varied significantly since 2001.

Figure 3 shows that Ontario's unfunded liability dwarfs those of the several other larger provinces we compared it to.

HISTORICAL PERSPECTIVE AND PROJECTIONS

In 1984, the WSIB adopted what it called a "full-funding" strategy to retire the unfunded liability over a 30-year period. The full-funding strategy aimed to have the WSIB's assets match its liabilities by 2014. From 1984 onward, achieving the goal of eliminating the unfunded liability by 2014 was the primary objective of the WSIB's funding approach.

By 1994, the unfunded liability stood at $11.4 billion. In response to the growing unfunded liability, the government reduced benefits in 1995. In 1996, the government of the day undertook a comprehensive review of the system. That review determined that legislative intervention was necessary because the existence of such a large unfunded liability threatened the viability of Ontario's system.

Figure 2: WSIB Liabilities, Assets, and Unfunded Liability, 1996–2008 ($ billion)

Source of data: Ontario Workplace Safety and Insurance Board

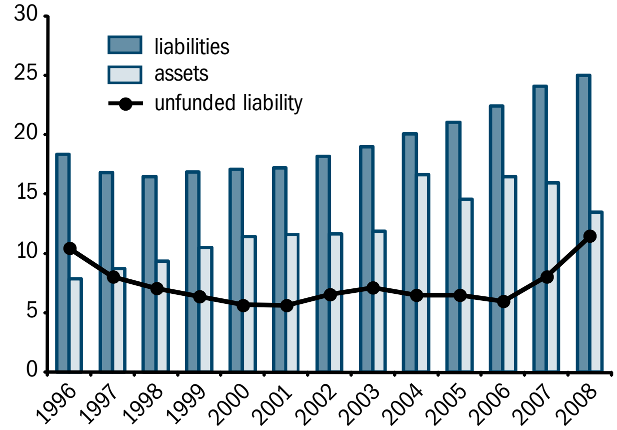
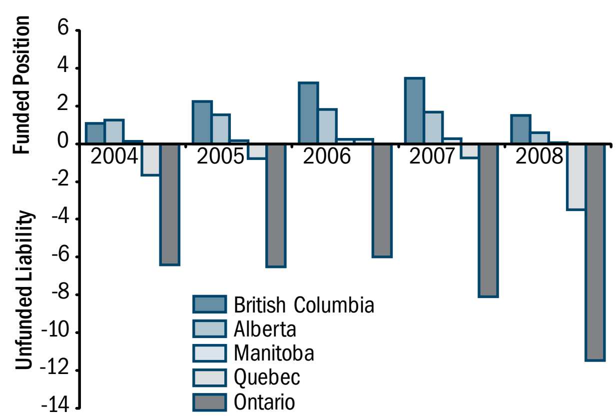


Figure 3: Funded Position and Unfunded Liability for Major Provincial Boards in Canada, 2004–2008 ($ billion)

Source of data: Various Provincial Workplace Safety and Insurance Boards and Workers' Compensation Boards



The government believed that the unfunded liability not only put at risk the system's ability "to provide fair and secure compensation to injured [and ill] workers both now and in the future" but also had resulted in premium rates that were among the highest in North America—a situation that adversely affected Ontario's competitive position.

The 1996 review of Ontario's workplace safety and insurance system led to the passage of the new *Workplace Safety and Insurance Act, 1997* (Act). The Act made fundamental reforms to Ontario's workplace safety and insurance system by refocusing the system on the need for preventing injuries and encouraging early return to work. The Act contained new provisions that were intended to restore the system's financial viability by reducing benefits to a level consistent with those in other provinces and by tightening eligibility requirements for workers seeking compensation. These legislative reforms resulted in a net reduction of $1.8 billion in future benefit costs and expected benefit liabilities.

Subsequent to the passage of the Act, the WSIB has consistently maintained its commitment to deal with the size and growth of the unfunded liability and have the plan fully funded by 2014. For instance:

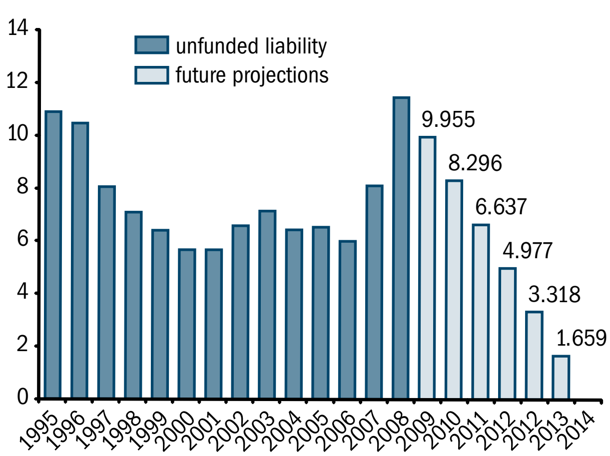
- The 2005 funding framework reconfirmed the WSIB's commitment to avoid passing the unfunded liability on to future generation of employers.
- In 2006, the WSIB released its 2006–10 five-year strategic plan entitled *The Road Ahead*. This plan noted that, in the interests of financial sustainability, the WSIB was "building a strong financial framework to address the elimination of the unfunded liability." This five-year strategic plan was updated in September 2007 as *The Road to Zero,* which covers the period 2008–12. The document notes that "the Board [remains]committed to a planned and disciplined approach to eliminating the Unfunded Liability and achieving full funding by 2014."
- The 2008 funding framework updated the 2005 framework and formalized it for the next three years. In detailing how the WSIB would meet its full-funding target by 2014, the 2008 funding framework relied heavily on the targets set in *The Road to Zero* with respect to the WSIB's commitment to eliminating all workplace injuries, illnesses, and fatalities and to reducing the amount of time it takes for injured or ill workers to recover and return safely to work.

In our opinion, the WSIB's publicly stated goal of achieving full funding status of the plan by 2014 in the 2008 funding framework was ambitious. This expectation was premised on having all employers and their workers meet all the objectives and targets set out in *The Road to Zero*. Specifically, the Board would have to reduce costs, increase premium revenues, and/or record investment gains that, when combined, would produce an average surplus of approximately $1 billion in each of the remaining eight years in order to eliminate by 2014 the $8.1 billion unfunded liability that existed at December 31, 2007. However, given the $11.5 billion unfunded liability reported at December 31, 2008, the WSIB's operating results would have to go from annual operating deficits averaging over $900 million in recent years to operating surpluses averaging $1.6 billion in each of the remaining seven years in order to eliminate the unfunded liability by 2014, as shown in Figure 4.

The Board of Directors was advised, in presentations on the 2009 corporate budget in November 2008 and in a preliminary 2009 funding outlook presentation in December 2008, that the 2014 target was no longer achievable. The Board was advised that the impact of the significant downturn in the global financial markets was the key driver for the re-assessment of the 2014 target.

Figure 4: WSIB Unfunded Liability 1995–2008 and Future Projections (Annual Decline Required to Achieve Full Funding by 2014) ($ billion)

Source of data: Office of the Auditor General of Ontario



In February 2009, largely as a result of the impact of the global financial crisis on the value of the WSIB's investments, the WSIB prepared new estimates of the unfunded liability based on three scenarios:

- Base Case, 2009 Preliminary Funding Estimate—Under this scenario, the 2014 unfunded liability would be $6.7 billion and its elimination was projected to occur in 2018.
- Plausible Adverse Scenario—Factoring economic uncertainties and cost pressures into the Base Case, this scenario estimated the 2014 unfunded liability to be $11.4 billion and projected its elimination in 2021.
- Plausible Adverse with Indexation Scenario Base Case—This scenario factored the economic uncertainties and cost pressures into the Base Case, but also assumed continued full indexation for certain workers' benefits, as required under Bill 187, which was an act respecting Budget measures and interim appropriations. It estimated the unfunded liability in 2014 to be $14.1 billion and projected it would be eliminated no earlier than 2022.

SHOULD WE BE CONCERNED ABOUT THE UNFUNDED LIABILITY?

The risk that a large unfunded liability poses to the system's financial viability was recognized over a decade ago. In the 1996 review that led to the legislative changes contained in Bill 99, it was noted that the problems associated with the unfunded liability could eventually come to a head when the WSIB was forced to liquidate investments in order to fund current operations and benefit payments. The 1996 review noted that between 1985 and 1995, the WSIB had "transferred some $1.65 billion from the investment portfolio to general operations to pay for benefit payments." A 1998 Statistics Canada research paper, *Government Finances and Generational Equity*, noted that "[i]t is compounded returns on these assets that the [WSIB] relies upon in order to pay future benefits. Removing the base of assets upon which investment revenues must be earned presages the descent into a vortex that will require strong action to reverse."

Withdrawals from the Investment Fund are still occurring: in the past seven years, the WSIB has transferred approximately $3.4 billion from investments in order to fund payments in workers' benefits. In addition, the WSIB had to sell $550 million more in investments than it has purchased in order to cover cash shortfalls from operations. The seriousness of this practice was conveyed in 2003 by a member of the Board of Directors who, as noted in the Board of Directors' meeting minutes, indicated that there was a strong sentiment among members of the Investment Committee that the WSIB should avoid drawing funds from the Investment Fund and that one member of the committee indicated he or she might resign as a result of this issue.

We acknowledge the argument that because the worker's compensation system is a perpetually ongoing operation, the unfunded liability is meaningless. From this point of view, this liability is merely an amount that will become due only in the highly unlikely event that the WSIB was to wind down its operations today. For example, the WSIB told us that, from an injured worker's perspective, there are currently sufficient funds to pay benefits for up to three years even if ongoing premium revenue was eliminated completely and the WSIB was wound down.

We do not agree with this argument and are concerned that the trend of selling off the WSIB's investments to fund current operations and benefit payments is not financially sustainable.

The more pertinent issue is whether a large unfunded liability poses significant risk to the financial viability of the system. To assess this concern, one needs to examine the major drivers that increase (or decrease) the unfunded liability—that is, the factors that drive either decreases in assets or increases in liabilities.

Of the several drivers that either decrease assets or increase liabilities, the most notable for 2007 and 2008 were actual investment returns in comparison to the 7% expected return; increased costs resulting from legislated changes that increased benefits liabilities; and the cost to carry the unfunded liability itself (at 7% per annum). Over the last two years, $4.2 billion has been lost owing to investment losses; almost $900 million owing to additional injured-worker benefits; $1.3 billion owing to changes in actuarial estimates and assumptions; and $1 billion to carry the liability. Conversely, over these two years, only $2 billion has been collected from employers to offset this, with the end result that the unfunded liability has increased by almost $6 billion.

Although the WSIB has suffered significant investment losses for 2007 and 2008, it does not expect these to continue in the long term. On the basis of average long-term returns in the equities markets, this is not an unreasonable assumption. If this turns out to be the case, the risk to financial viability arising from the size of the unfunded liability will therefore rest primarily with the other two components: whether premium rates are sufficient to cover current benefit payments and the cost to carry the unfunded liability and pay it down over a reasonable period of time; and whether legislated changes add additional unfunded costs to the system. For instance, under Bill 187, partially disabled workers were granted a 2.5% increase in each of 2007, 2008, and 2009. There is added pressure from certain stakeholders to restore full inflation protection for 2010 and beyond.

ELIMINATING THE UNFUNDED LIABILITY

The WSIB has only three levers at its disposal to reduce the unfunded liability:

- increasing premium revenues;
- reducing benefit costs (by reducing the number and duration of benefit claims and health-care costs and/or by reducing or eliminating benefits); and
- increasing investment income.

This section discusses each of these tools and makes reference to some of the practices we found in the other provincial jurisdictions we visited. But it is important first to supply some perspective on some of the pressures and challenges the WSIB faces in its operating and political environment.

Balancing Stakeholder Interests

The Road to Zero communicates the WSIB's five-year (2008–12) corporate strategy, which supports the WSIB's vision of eliminating all workplace fatalities, injuries, and illnesses. The WSIB advised us that it uses an integrated approach to workplace health and safety that promotes collaboration among system partners and stakeholders through initiatives such as a prevention partnership model, rewarding superior workplace behaviour, and facilitating a cultural shift through social marketing campaigns. The WSIB indicated that key initiatives in *The Road to Zero* include reducing injured workers' time off work, bringing a more integrated approach to case management, facilitating early and safe return to work, purchasing cost-effective and evidence-based health-care services, managing occupational-disease services more effectively, and a new service delivery model, which is expected to help reduce benefit costs and optimize premium revenue while improving overall service.

As *The Road to Zero* communicates, the WSIB's efforts to improve its funding position have focused primarily on reducing the number of new claims and reducing claims duration. Increasing premiums or reducing benefits has proven difficult—many years of experience have shown the inherent political, social, and economic sensitivity of implementing changes to either. But the last two years have also demonstrated how unpredictable and inconsistent the results can be when the third option of overly relying on increased investment returns is chosen.

Governments and workplace safety/workers' compensation organizations face significant pressures in trying to manage the system. The problem faced by the government and the WSIB when trying to eliminate the unfunded liability is that there is little agreement among labour groups and employers as to whether the unfunded liability is even a problem, let alone how it should be addressed if it is a problem. The positions generally taken by labour groups and employers differ in ways that reflect a concern that they will be required to bear the entire cost of eliminating the unfunded liability.

Labour is concerned that the unfunded liability will be eliminated by reducing benefits to workers and by restricting the eligibility of certain types of injuries and occupational diseases for compensation. Many employers believe that the unfunded liability exists only because benefit levels are too high and because the scope of injuries and occupational diseases being compensated is too broad. In addition, they believe that increasing premium rates to eliminate the unfunded liability would hurt both their competitive position and job creation. Employers therefore tend to believe that premiums should not be increased and that, instead, benefit reductions represent the only acceptable approach to reducing the unfunded liability. Both the government and the WSIB must balance the concerns of labour and employer stakeholders. This balancing act between changing employer premiums and/or changing worker benefits is where the WSIB is most susceptible to the influence of the government of the day.

Authority of the Board to Address the Unfunded Liability

The Ontario Financial Review Commission's (OFRC's) 1995 report on the province's accounting, reporting, and financial-management practices commented on the government's apparent influence over benefits, premiums, and coverage, which the OFRC believed undermined the WSIB's ability to govern itself in an accountable fashion. The OFRC stated that "while the government has the responsibility for setting the Board's mandate, the Board must have the sole power to carry it out." Our observation is that the OFRC's comments continue to be relevant.

For example, in 2002, one WSIB director commented (as recorded in the Board of Directors' meeting minutes) that "some government representatives are of the view that the Board should reduce premium rates [for 2003, which was a provincial general election year] below the level required to meet claims costs."

We noted that the funding models of the two other provincial boards we visited require that their plans be fully funded—and that the officials at one board even consider this full-funding requirement to be enshrined in their governing legislation. Although Ontario's legislation does not require a fully funded plan, the government and the WSIB may wish to consider whether there is lack of clarity around the role of the WSIB and of the government in ensuring that the system is managed in a financially accountable manner and that the plan remains financially viable. For example, we noted that one of the guiding principles in the Memorandum of Understanding (MOU) between the WSIB and the government is that the "Minister and the Board are committed to a workplace safety and insurance system predicated on sound insurance and business principles, including…a commitment to achieving and maintaining a financially sustainable workplace insurance plan." Missing from the MOU's described elements of sound insurance and business principles is a specific statement that the system must be based on sound financial management practices that will facilitate a fully funded plan. In the insurance business, sound financial management practices include ensuring the system's financial stability and sustainability for the beneficiaries not only by making the plan fully funded but also by setting aside reserves to address any major financial shocks that may affect the system.

Premium Revenues

In 1996, the average premium rate was $3 per $100 of payroll—a decrease from the 1991 average premium of $3.20. Despite the WSIB's apparent authority to set premium rates, the government's May 7, 1996, Budget Speech announced a planned 5% reduction in the average premium rate (to $2.85) effective January 1, 1997. Since then, notwithstanding the unfunded liability's upward trend, the average premium rate has been reduced multiple times, levelling out in 2006 at $2.26, where it has remained through 2009. Figure 5 presents the WSIB's average premium rates from 1991 through 2009.

In the first quarter of 2009, the WSIB concluded that, had the 1996 average premium of $3.00 been maintained from 1997 until the end of 2008, the unfunded liability would have been $3.7 billion instead of $11.5 billion. This analysis clearly illustrates the sensitivity of the unfunded liability to premium rates.

Clearly, premium revenues have not increased enough to offset the costs of the benefits that are mandated under the Act. We noted that:

- Benefit expenses increased by about 7% annually from 1999 through 2008, but premium revenues increased by an average of only 3% during the same period.
- Premium revenues, which include a surcharge intended to help pay down the unfunded liability, are not sufficient to cover the WSIB's annual expenses. In fact, they just barely cover the actual cash amounts of benefits paid, with none of the surcharge actually going toward paying down the WSIB's unfunded liability. Figure 6 illustrates this point.
- Premium revenues in Ontario cover a lower percentage of the WSIB's expenses than premium revenues cover in the four other large provincial boards we considered. As Figure 7 shows, premium revenues from 2004 to 2008 have covered on average only 70% of the WSIB's total expenses. For each of the other provincial boards, premium revenues covered a higher percentage of total expenses over this same period—between 80% and 103%, with an average of 86%.

Figure 5: WSIB Average Premium Rates, 1991–2009 ($ per $100 of Insurable Payroll)

Source of data: Ontario Workplace Safety and Insurance Board

	Rate
1991	3.20
1992	3.16
1993	2.95
1994	3.01
1995	3.00
1996	3.00
1997	2.85
1998	2.59
1999	2.42
2000	2.29
2001	2.13
2002	2.13
2003	2.19
2004	2.19
2005	2.19
2006	2.26
2007	2.26
2008	2.26
2009	2.26

Figure 6: WSIB, Comparison of Benefit Expenses, Benefit Costs Paid, and Premium Revenues, 1998–2008 ($ billion)

Source of data: Ontario Workplace Safety and Insurance Board

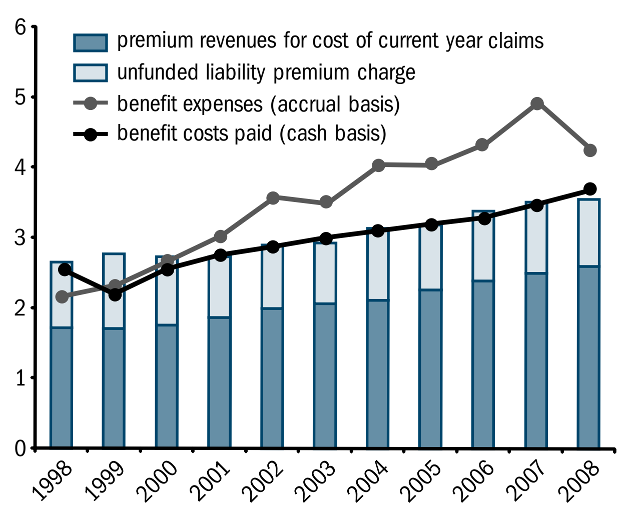
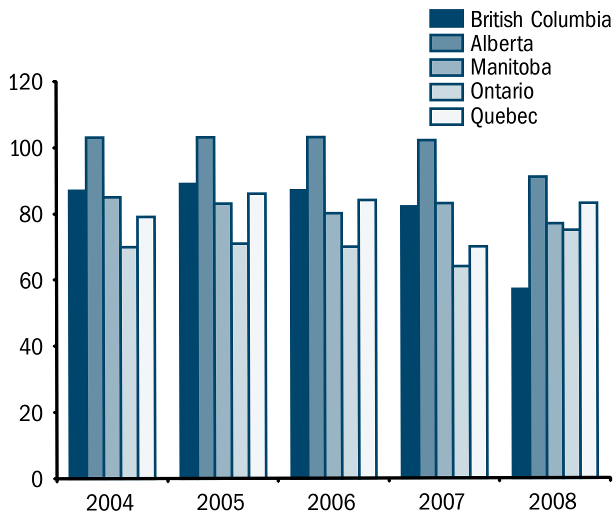


Figure 7: Major Provincial Boards, Total Gross Premium Revenues as a Percentage of Total Expenses, 2003–2008 (%)

Source of data: Ontario Workplace Safety and Insurance Board and Provincial Workers' Compensation Boards



- In reviewing the WSIB's Statement of Operations over the last 10 years, we noted that the WSIB has not reported an annual surplus since 2001, and since that date, the annual deficits (that is, losses on operations) have ranged from a low of $142 million in 2006 to a high of $2.4 billion in 2008, with the annual deficit averaging over $900 million since 2002. Admittedly, investment losses in 2008 have been significant owing to the global economic downturn and have contributed over $3 billion to the increase in the unfunded liability in 2008. However, the WSIB's lack of success in eliminating the unfunded liability has been more directly the result of benefit expenses not being adequately funded by the premium-revenue and investment-revenue streams. More specifically, if previously recorded unrealized gains on the WSIB's investments are netted against the investment losses in 2008, the unfunded liability would likely still have been in excess of $7 billion.

Premium Setting in Other Jurisdictions

In each of the other two provincial jurisdictions we visited, there was no ambiguity regarding how they establish their premium rates: each sets rates based on the principle that its plan must be fully funded at all times. For example:

- One provincial board's Act imposes a statutory obligation on the board to ensure that its plan is fully funded: "The Board must ensure that there is sufficient money available in the Accident Fund for the payment of present compensation and future compensation as estimated by the Board's actuary." The board's rate-setting policy rests on a philosophy that includes eliminating the use of investment returns to subsidize average premium rates. According to the board's funding policy, its plan is considered to be sufficiently funded only when the plan's total assets equal or exceed its total liabilities, and its plan is not considered to be fully funded unless its funded ratio is within the target range of 114% to 128%. If the funded ratio falls below that target range, that provincial board's funding policy requires that special levies be included in the premium rates to recover the shortfall.
- Officials from the second provincial board indicated that, although its governing legislation includes no specific provision requiring full funding, they have adopted an external benchmark for determining a suitable funding level for their plan. The benchmark chosen—that used in the insurance sector as legally required by that sector's regulator (the Office of the Superintendent of Financial Institutions)—requires insurers to hold prescribed levels of capital to help mitigate against possible adverse circumstances and to be able to continue operating. The minimum capital reserve requirements therefore depend on the risk inherent in the assets (for example, equities require relatively more capital reserves than bonds) and in the liabilities (for example,

liability estimates that have greater uncertainty require more capital reserves). The provincial board officials told us that adopting these capital adequacy guidelines has had the additional benefit of providing clarity to their stakeholders, with the result that stakeholders had no expectation of receiving large-scale refunds of the surplus that had built up during the four years before the 2008 declines in the investment markets. Stakeholders understood that capital reserves could be used to dampen the impact on employer premiums during difficult economic periods.

In reviewing the process for setting premium rates in the two provincial jurisdictions we visited, we also noted that the underlying funding model obliges them to ensure that annual premiums charged to employers during a given year cover the cost of all new claims, the future costs of these claims, and related operating costs incurred during the year so that future employers do not bear the costs of prior-year worker injuries:

- Officials from one provincial board noted that they ensure that premium revenues meet or exceed all claim costs plus all overhead incurred during the year. They set a rate for each rate group based on that rate group's injury experience. Rates within that rate group are then adjusted for safety association levies, claims administration, appeals commission, medical panels, and occupational disease reserve funding. They noted that charging employers with the full cost of workplace injuries through premium rates "is imperative to securing workers' benefits for the lifetime of the claim and not passing costs on to future employers."
- Officials from the second provincial board noted that they ensure that current premium rates reflect the system's current costs: their target rate is the rate required to ensure that the system remains fully funded. They indicated they ensure that premium levels and corresponding benefit costs are evaluated by industry. In summary, they stated that their funding strategy's overall objective is "full funding at the rate group level (and consequently for the system as a whole) with additional appropriated reserves" provided "as deemed necessary."
- The officials from the second provincial board also noted that their organization has had a longstanding "unique practice of maintaining separate segregated industry rate group results and funding levels that are transparent to employers." That is, their board tracks each rate group's results by business activity (for example, premium revenues, claims costs, and unfunded liability/funded asset position) and by injury risk (for example, number of claims, accident types, nature of illnesses, injury rates, and claims duration). In their view, this "open-book policy" of tracking and reporting the performance of a particular industry rate group or industry sector on the types of injuries and illnesses taking place in that industry rate group, as well as on the costs of the workplace injuries and illnesses of that sector, has had a very positive effect of "garnering employer support for [premium] rate increases when necessary in order to recover from deficits or to lower accident rates and injury costs." They commented that their funding policy of requiring premium assessment rates to cover the costs incurred during the year, supported by this segregated industry rate group data, has the additional benefit of making it very difficult for the government of this province to influence premium rates.

Ontario's Approach to Setting Premiums

Setting premium rates that reflect the "full target level"—that is, the level required to cover the anticipated full costs of new claims, including administrative charges and unfunded liability charges—ensures that firms and industries pay for their costs relating to injuries or deaths incurred in their workplaces. The WSIB has stated that it follows a similar approach. As the 1996 review noted, Ontario employers are classified in nine industry classes, which are divided into rate groups.

The WSIB advised us that in 2008 there were 154 employer rate groups based on similar business activities and workplace health and safety risks. Premium rates are set each year on the basis of projecting a rate group's health and safety performance from the previous five years to the premium-rate year. Premium rates comprise four components:

- costs of new claims;
- a charge to repay the unfunded liability;
- gain or loss component; and
- administration expenses covering the expected costs to run the WSIB and administer the *Workplace Safety and Insurance Act*, the costs of the Ministry of Labour to administer the *Occupational Health and Safety Act*, funding for the health and safety associations, research, and the costs of the Offices of the Worker and Employer Advisers.

Under this methodology, premium rates can go up or down depending upon a rate group's workplace health and safety performance. When the average premium rate remains unchanged, about one-third of the rate groups have a rate increase, one-third stay the same, and one-third have a rate decrease.

In using this approach, the WSIB faces a challenge when unanticipated events, such as the recent economic downturn, result in either higher costs or lower revenues than planned. Ideally, such unanticipated shortfalls would be recovered by increasing subsequent years' premiums. However, as Figure 5 illustrates, average premium rates are 12.7% lower now than 10 years ago. Notwithstanding this, we recognize that increasing premium rates, and thereby increasing the cost of doing business in this province, would not be a popular option for either the WSIB or the government in the midst of a severe economic downturn. This problem is compounded by the fact that Ontario's average premium rate is among the highest in Canada (see Figure 8). Ontario will eventually need to increase its premium rates if it hopes to make any progress toward eliminating its unfunded liability—unless downward revisions are made to the current benefits structure or investment returns recover dramatically.

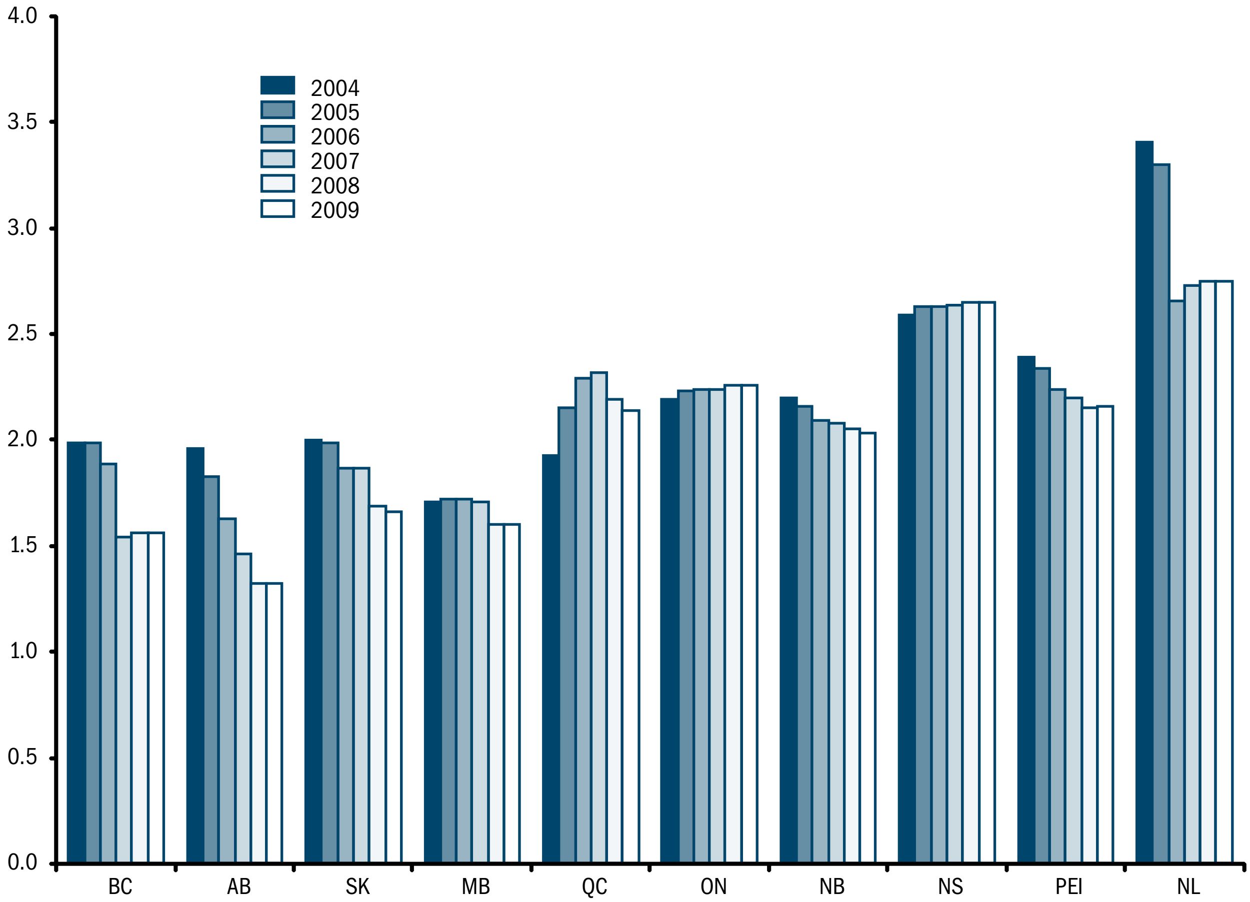
Premium revenues are also affected by the number of workers covered by the workers' compensation system. As the 1996 review pointed out, coverage of Ontario's workforce was significantly lower than in many other provinces. The 1996 review suggested that covering more workers might create additional revenues for the WSIB. Ontario's coverage rate remains among the lowest in the country.

In April 2009, the WSIB analyzed the additional revenues it would earn if coverage were expanded to include the entire Ontario workforce. Estimated additional revenues would be approximately $280 million. Included in this is $72 million that will be earned beginning in 2012 resulting from Bill 119, *The Workplace Safety Amendment Act*,which will make insurance coverage mandatory for a number of construction workers who had not previously been covered. The incremental revenues from expanding coverage would not come close to solving the unfunded liability problem. But one advantage of increasing coverage to all workers is that it would stabilize and improve the WSIB's financial position as the economy restructures. Many industries that are not currently covered are in sectors, such as financial institutions, that are experiencing high employment growth, whereas, for example, 26% of the WSIB's premium revenues in 2008 came from the currently ailing automotive industry.

And finally, in a worst-case scenario, the Act does allow the government to provide loans to the WSIB if the WSIB is ever unable to pay workers the benefits that they are entitled to. We are not aware of this having occurred previously in any workers' compensation system in Canada. In Ontario, the government has provided financial assistance in the form of interest-free loans to the Pension Benefits Guarantee Fund (PBGF). The PBGF's mandate is to

Figure 8: Comparison of 2009 Average Premium Rates, 2009 ($ per $100 of Insurable Payroll)

Source of data: Association of Workers' Compensation Boards of Canada



supplement the pensions of workers whose pension plans are insolvent. Like the WSIB, the PBGF is classified as a trust because it is funded by employers that have private-sector pension plans and therefore not included in the province's financial results. The province had to step in and provide the PBGF with the interest-free loans because the PBGF's potential liabilities far exceeded the assets available to pay those liabilities.

Benefit Costs

In accordance with the Act, the WSIB provides benefits for loss of earnings, benefits for permanent injuries, payments for health care, assistance to facilitate return to work, and survivor benefits in the case of work-related fatalities. Collectively, these payments are termed "benefit costs".

From 1999 to 2008, the WSIB's benefit costs increased by about 7% annually—almost doubling—from $2.17 billion as of December 31, 1998, to $4.26 billion as of December 31, 2008. This is generally in line with the growth rates of benefit costs of the other provincial boards we compared Ontario against.

The WSIB has identified increasing claims duration, which is the average number of days an injured worker is on benefits, as the key contributor to the increase in benefit costs since 1998.

Legislative Changes Affecting Benefits Costs

The 1997 legislative changes under Bill 99 generally reduced worker benefits, but the 2007 changes increased them. Both changes undoubtedly reflected the policy agenda of the government of the day. Before Bill 99, the legislative framework was highly structured and prescriptive regarding both the process and the timelines for handling claims. This system had numerous mandatory reviews or checkpoints, extensive WSIB interventions between worker and employer, and a strong focus on vocational rehabilitation. Bill 99 changed these processes significantly: its legislative reforms were based on a "self-reliance model", which follows the philosophy that workplace parties—employers and workers—are in the best position to make practical decisions about the management of workplace injuries and that the workplace parties should therefore co-operate. For the WSIB, these reforms resulted in fewer and less-prescriptive policies and interventions, eliminated vocational rehabilitation, and refocused the WSIB's role from one of direct intervention to one of monitoring the workplace parties. The WSIB indicated that this may have had the unintended effect of increasing claims duration. The legislation also required the WSIB to increase its activities aimed at preventing workplace injuries. Bill 99 also reduced the inflation protection provided to partially disabled workers.

The 2007 legislated changes, announced in the 2007 Ontario Budget, introduced a temporary indexing factor that increased some workers' benefits for three years. The amendments became law when the Legislature passed the 2007 Budget Bill on May 17, 2007, and affected benefit payments beginning on July 1, 2007. The amendments, among other things, temporarily increased benefits for a number of workers by 2.5% on July 1, 2007, 2.5% on January 1, 2008, and a further 2.5% on January 1, 2009. The government decision to increase benefits added $750 million to expenses and to the unfunded liability reported by the WSIB in its December 31, 2007, financial statements.

If the government were to introduce further benefit increases after January 1, 2009, similar to those implemented in the previous three years, the WSIB estimates that such changes would increase its expenses by $1.6 billion and add $1.6 billion to the unfunded liability in 2010 (because, under generally accepted actuarial standards, the WSIB's actuary would likely need to assume that this indexing rate had at that point become permanently built into the system).

Our Office is not questioning the government's policy decision to increase workers' benefits—the government has the sole responsibility for setting benefits and coverage through legislation. However, we do want to highlight how a government's decision to increase benefits can impair the WSIB's ability to address the unfunded liability. The problems inherent in increasing benefits without adequate financial provision were highlighted in the 1996 review that led to the legislative changes contained in Bill 99:

> However, the costs of [the] improvements [introduced in 1989 and 1994] were not balanced by measures to guarantee adequate reserves to meet current and future obligations. Understandably, expansion and enrichments in the name of improved equity have proved popular. However, governments in the past have chosen not to address the critical but difficult problem of how to finance these benefit changes.

In 2007, concerns about the rising benefit costs prompted the WSIB to engage the Institute for Work and Health (Institute) to examine its claims-duration data. That study identified three primary drivers of increased claims duration:

- Legislation: There was a high correlation between longer duration outcomes and the changes made by Bill 99 to the legislation and the Board's service delivery model (for example, Bill 99's elimination of mandatory reviews and checkpoints, along with the Board's vocational rehabilitation programs).
- Health Care: There was a high correlation between duration and health-care services being received, especially with prescriptions for narcotic medication.

- Workplace Behaviour: There was a high correlation between duration and changes in workplace behaviour that are affected primarily by the WSIB's workplace-safety employer-incentive programs.

The study concluded that only systemic change would make it possible for the WSIB to reverse the longstanding upward trend in claims duration.

The Institute's study showed that before Bill 99, claims duration was decreasing. Although Bill 99 was intended to decrease claims duration, it actually contributed to some significant unanticipated increases in claims duration. For example, the percentage of locked-in claims relative to long-term claims almost doubled from 1997 to 2001.

The Institute also examined why the self-reliance model had not achieved the intended result of decreasing claims duration, concluding that the primary reason was the ineffectiveness of the WSIB's return-to-work incentive programs. For the self-reliance model to succeed, the WSIB would need to have incentive programs that motivate employers to improve both prevention and return-to-work practices.

From an operational standpoint,the WSIB advised us that to reduce claims duration, it is introducing a new service delivery model that includes changes in how the WSIB manages claims both before and after accepting them. For example, changes are being made to the roles and function of the WSIB's claims adjudicator, and interventions will occur earlier than has been the practice in recent years. This revamped process will be supported by a new service delivery technology system that will provide the adjudicator with better information with which to make decisions. This new technology will be phased in, with complete implementation expected by mid-2010.

Although it is hoped that these initiatives will help reduce claims duration, fundamental legislative changes may also be needed before any significant progress can be made in reducing claims duration.

The following sections discuss the previously mentioned health-care and workplace behaviour issues in more detail.

Health-care Costs

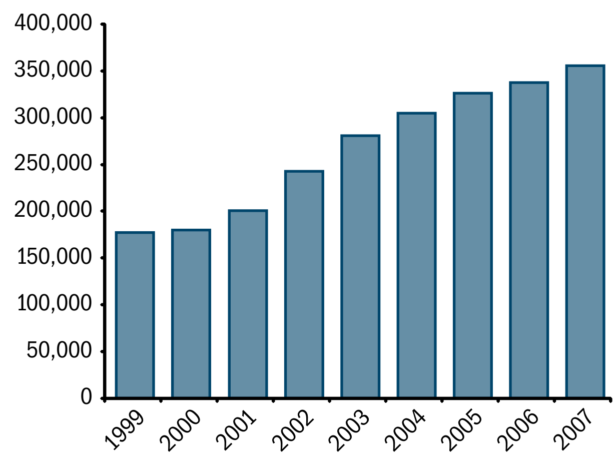
Health-care costs are those medical costs incurred by the injured worker that are paid by the WSIB. Health-care costs paid by the WSIB on behalf of workers receiving benefits averaged 16% of total benefit costs over the 1999–2008 period. But in that same period, these health-care costs more than doubled—rising from $238 million in 1998 to $619 million in 2008.

One of the primary drivers of increased health-care costs is the increased number of narcotic prescriptions for analgesia (pain relief). The Institute for Work and Health's study reported that in the nine-year period from 1999 to 2007 the number of such prescriptions included in the WSIB's health-care costs more than doubled (see Figure 9). Prescription costs grew from 20% to over 44% of the total health-care costs paid annually by the WSIB.

The increased use of these drugs concerns the WSIB from two standpoints: the drugs' direct costs

Figure 9: WSIB, Number of Narcotic Analgesic Prescriptions Included in Health-care Costs, 1999–2007

Source of data: Ontario Workplace Safety and Insurance Board



and the drugs' high potential for creating dependency. The Institute report noted that dependency on such drugs can often delay an individual's return to work and can increase the chances of an injury occurring when the individual does return to work. Studies have also shown that the addiction negatively affects the efforts of other return-to-work programs. Experience has shown that it is important to get the worker back to his or her workplace as soon as safely possible, because the longer the worker is away from the job the more difficult it is to return to work. Thus, any factor that tends to delay the return to work will increase claims duration (and therefore benefit costs) for both the short term and the longer term.

The WSIB, however, has minimal involvement in determining the need for these drugs, which is typically decided by the patient's doctor. This limitation restricts the WSIB's influence over the costs involved. Nevertheless, the WSIB is in the process of rolling out a narcotic drug program. This program includes the establishment of a narcotic drug advisory committee, and the WSIB will work with the Ontario Medical Association on ways to better inform treating physicians about the risks associated with these drugs. The WSIB hopes these collaborative efforts will succeed in reducing the use of such drugs. But if these efforts fail, the WSIB believes the only option would then be to consider the introduction of standards governing the situations under which it will and will not pay for prescribed analgesic narcotics.

Workplace Behaviour/Incentive Programs

The WSIB has a number of incentive programs of the type referred to as "experience-rating programs." Such programs reward employers (typically through rebates) for results that reflect good practices and penalize (typically through surcharges) employers for poor results. For example, employers whose injury rates are lower than the average for their rate group are rewarded; those whose injury rates are higher than their rate group's average are penalized. The Institute pointed out that if claims duration in general is increasing, rebates should decrease and/or surcharges should increase correspondingly. But the study noted that the opposite was occurring: employers were still being rewarded even as their injured-worker claims duration was increasing.

The WSIB recognized this issue and engaged an external consulting firm in June 2008 to review the programs. The report's key findings included the need for "better integration of the Board's experience rating programs with its legislative obligations," and "improved fairness and equity so that the programs enhance the focus on real improvements in prevention and return-to-work outcomes."

In response to the consultant's recommendations, the WSIB began obtaining input from stakeholders during 2009, with a view to revising the experience-rating programs to address those concerns.

Reducing New Claims

Reducing the amount of new claims entering the system is also critical to controlling the growth of benefit costs. Both the WSIB and the other major provincial boards focus on initiatives aimed at preventing work-related injuries and illnesses. In our discussions with the WSIB and the two other provincial boards we visited about lost-time injury rates, the consistent message we heard was that their injury-prevention initiatives have improved awareness of health and safety issues among employers and workers and have resulted in lower lost-time injury rates than those reported 10 years ago. But the other provincial boards also commented that, despite such efforts, their levels of new claims for lost-time injuries have remained relatively flat over the last few years.

In its 2008 funding framework, the WSIB set a goal of attaining a 7% reduction in new claims each year from 2008 through 2012, which is consistent with the 35% target for reduction of lost-time injury rates set out in the *The Road to Zero* strategy for that same period. The target assumes that the WSIB's prevention efforts will result in significant reductions. But the 2008 target was not met. According to the WSIB, the factors that prevented its achievement were that year's lower-than-anticipated employment—and therefore premium—growth and the worse-than-expected lost-time injury rates of two large industry sectors.

Investment Income

The WSIB relies on both premium revenues and investment income to fund its current and future obligations. The carrying value of the Insurance Fund's investments as of December 31, 2008, was $11.1 billion. This amount represented a decrease of $2.6 billion from the December 31, 2007, balance of $13.7 billion—a decrease caused primarily by the significant decreases in global financial markets. Investment results are reviewed by the WSIB's Investment Committee, which includes as advisors external investment and financial experts.

In most pension and insurance funds, investment returns constitute an important source of revenue to fund operating expenses, pay future benefits, and increase the net assets held that are needed to pay for increases in expected future benefit payments. Therefore, having too few investments relative to the WSIB's liabilities and liquidating investments to pay current operating expenses and benefit claims typically have a significant negative impact on the size of the unfunded liability and fiscal sustainability of the WSIB.

Our review of the WSIB's investments during the past two years shows that they were diversified among three primary asset classes: public equities, 59%; public fixed-income securities, 35%; and real estate, 6%.

When looking at investment performance as it relates to the unfunded liability, it is important to look at investments' long-term performance rather than their short-term performance, which can be very volatile. As Figure 10 shows, for 1994 through 2008, the WSIB's investments earned a 15-year average rate of return of 6.6%.

Most of the WSIB's long-term strategies for reducing the unfunded liability by 2014 have assumed a 7% average rate of return on its investments. Given that actual returns have been less than 7%, investment performance has not contributed to reducing the unfunded liability, which is now one of the largest in the WSIB's history. In an insurance operation such as the WSIB's, where future benefits payments are expected to rise by 7% annually, investments must earn more than 7% before any reduction in the unfunded liability can be realized from investment returns. In our view, this situation reinforces our observation that inadequate premium revenues in comparison to benefit levels—rather than inadequate long-term investment returns—are the main reason why benefit costs are not being fully funded.

It appears to us that, given the pressures to keep premium rates low, expectations were placed

Figure 10: WSIB, Average Rate of Return on Investments, 1994–2008

Source of data: Ontario Workplace Safety and Insurance Board

	Return (%)
1994	(1.7)
1995	18.4
1996	16.6
1997	16.3
1998	11.1
1999	12.8
2000	8.0
2001	(1.5)
2002	(6.2)
2003	12.8
2004	8.5
2005	10.5
2006	16.2
2007	(0.7)
2008	(15.5)
15-Year Avg. Return on Investments	**6.6**

on achieving very high investment returns as the vehicle for solving the unfunded liability issue. These pressures also may have contributed to the Board's adoption of an investment policy of having a relatively high exposure to equities—in the hope of generating high returns—than the more conservative investment policies pursued by the two other boards we visited. Figure 11 compares the WSIB's investment mix with those of the two provincial boards we visited. The WSIB's public-equity holdings have represented a much higher proportion of its total investments than has been the case with the other two organizations. Although having higher public-equity holdings can result in increased returns, it can also increase the risk, volatility, and losses in the WSIB's investment returns compared to the other organizations.

In 2006, at 16.2%, the WSIB had the best investment returns of any provincial board in Canada. But as Figure 12 shows, when the economy started to slow in 2007, the WSIB's investment returns dropped to negative 1%, causing the WSIB to rank 10th in Canada. In 2008, all provincial boards suffered significant losses.

It appears to us that one consequence of having good investment returns in any one year seems to have been a strong temptation for the government to assume that those gains can be used to finance enhancements to workers' benefits. We noted that the Bill 187 legislative reforms—which added

Figure 11: Comparison of Investment Mix in Provincial Jurisdictions Reviewed (%)

Source of data: Ontario Workplace Safety and Insurance Board and Provincial Workers' Compensation Boards

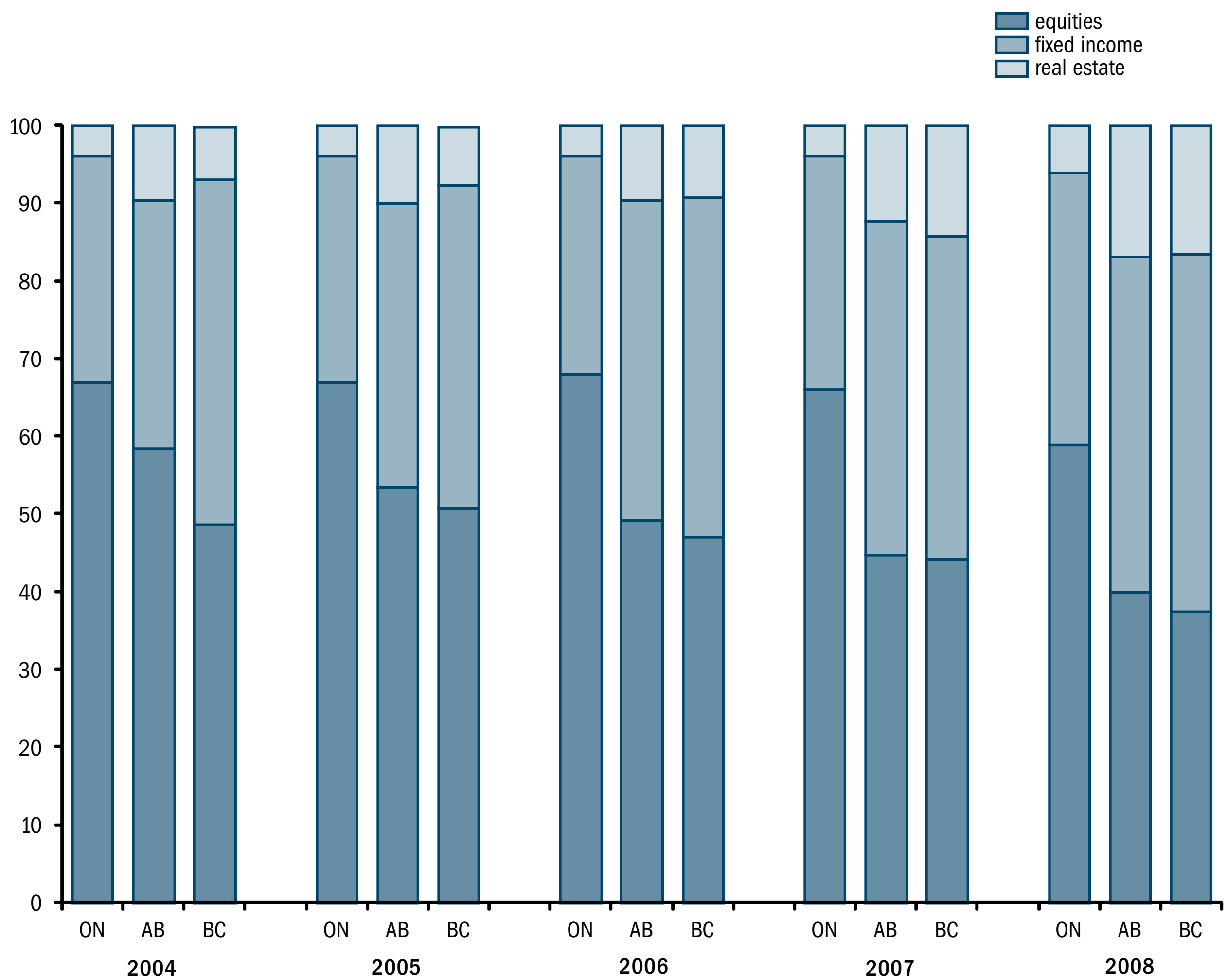


Figure 12: One-year Rates of Return on Investments, All Provincial Boards, 2004–2008
Source of data: Association of Workers' Compensation Boards of Canada, 2004–2007, and
Ontario Workplace Safety and Insurance Board and Provincial Worker's Compensation Boards, 2008

Year	Ontario Board Rate of Return on Investments (%)	Ontario Board Ranking	Rate of Return on Investments Range Low	Rate of Return on Investments Range High	Avg. Rate of Return (%)
2004	8.5	8	7.6	12.8	9.8
2005	10.5	7	9.5	15.7	11.9
2006	16.2	1	11.6	16.2	14.1
2007	(0.7)	10	(0.7)	6.5	2.7
2008	(15.5)	4	(26.9)	(8.2)	(16.5)

$750 million for 2007 by introducing a temporary increase in the indexation of workers' benefits for 2007 through 2009—followed shortly after the impressive 16.2% investment returns experienced in 2006.

To reduce the effects of market volatility and to better match its investments to its long-term funding obligations, the WSIB revised its investment policies as of January 1, 2009. Its new Statement of Investment Policies and Procedures continues to have a long-term investment return objective of 7%, but proposes a significant change in the asset mix. The new asset mix strategy emphasizes reducing risk by the public equity component to 25% from its current 59% level and includes private equity, infrastructure, and additional real estate investments. We were advised by the WSIB that this approach is supported by the Ministry of Finance and is expected to lower volatility while still achieving the target investment return of 7%.

TOMORROW'S EMPLOYERS PAYING FOR COSTS OF TODAY

Section 96 (2) of the *Workplace Safety and Insurance Act, 1997* states:

> The Board has a duty to maintain the insurance fund so as not to unduly or unfairly burden any claims of Schedule 1 employers in future years with payments under the insurance plan in respect of accidents of previous years.

Clearly, the very existence of the unfunded liability demonstrates that, over the years, the province's employers have not fully funded the costs of injuries and occupational diseases, so these liabilities will need to be funded by future employers.Thus, employers in currently declining industry sectors have transferred workplace-safety financial obligations to other current and future generations of employers.

Given the government's legislated role in determining benefit levels and employees to be covered by the system, addressing this section of the Act is not entirely within the Board's purview. However, we urge both the government and the WSIB to keep the intent of this section of the legislation in mind when making future premium and benefit decisions.