INSTITUT C.D. HOWE INSTITUTE
Essential Policy Intelligence | Conseils indispensables sur les politiques

E-BRIEF

March 22, 2012

FISCAL AND TAX COMPETITIVENESS

The Hole in Ontario's Business Budget: WSIB's Unfunded Liability

by
Colin Busby and Finn Poschmann

- Ontario's Workplace Safety Insurance Board (WSIB), which levies employer premiums intended to fund benefits for employees injured in the workplace, has a growing unfunded liability problem. The WSIB's pace of revenue collection and asset accumulation has not matched growth in current and expected benefit entitlements.
- The WSIB reports an unfunded liability of $12.3 billion: to arrive at that number the Board discounts its current benefit liabilities at a 7.0 percent nominal interest rate. A fair-value accounting method would use a much lower discount rate, implying a much higher true liability.
- Were the WSIB to discount benefit liabilities at a rate that better reflected the cost of guaranteeing benefits, it would report an unfunded liability about $7.4 billion higher, at $19.7 billion, implying a shortfall of about $4,100 per insured worker in Ontario.

As Ontario gears up for its March 27 Budget, the financial state of the Workplace Safety Insurance Board (WSIB) merits a red flag. While the WSIB collects employer premiums to pay for injury and disability benefits for insured workers, over time the premiums charged to employers and returns to investments have not matched growing benefit entitlements.[1]

The authors would like to thank Charles Beach, Mike Campolieti, Gabriel Hayos, Rhys Kesselman, Alexandre Laurin, Les Liversidge, James Milway, Jean François Paquin, William Robson, Daniel Schwanen, Peter Wallace, Thomas Wilson and anonymous reviewers for comments on earlier drafts. Responsibility for errors and omissions in this paper lies with the authors.

1 The WSIB provides injury and disability benefits to workers covered under its plan. The Ontario government sets the level and duration of benefits for on-the-job injuries, in exchange for workers', under the *Workplace Safety and Insurance Act* (WSIA), giving up their right to sue their employers.

Figure 1: WSIB's Unfunded Liability and Average Premium Rates, 1974-2011

Sources: WSIB (2011b) and Authors' Calculations.

The WSIB estimates the present value of promised payments to injured and disabled workers at $24.0 billion, which in 2011 exceeded assets held in the insurance fund to pay for these benefits by $12.3 billion. This amount, the estimated costs of injury claims less the assets of the insurance fund, is commonly referred to as WSIB's unfunded liability.[2] This liability, which has been growing (Figure 1), reflects the inability of government, employers and workers to align benefits with revenues.

As we discuss below, the true liability is much higher than $12.3 billion, and this amount ultimately will fall on the shoulders of Ontario employers and employees, or taxpayers. Lack of full funding also raises generational fairness issues: partially funded plans imply that future generations of employees and employers will pay for part of today's claim costs (Gunderson and Hyatt 2000).

2 In other words, the WSIB's unfunded liability is the present value of the expected cost of paying current claims net of the market value of assets.

Protecting taxpayers from bearing the costs of unfunded benefits will require fixing the WSIB's financing problems, through increased employer contributions – implying lower wage growth for employees – benefit adjustments, or both. To facilitate these changes, more stringent financing rules are required.

What Caused the Unfunded Liability of the Plan?

The WSIB has not, over time, set premiums to match benefit costs. To compound matters, unexpected shocks to premium and investment revenues have increased the size of the unfunded liability. Premiums sometimes have been lowered, and benefit generosity increased. In the late 1990s, for example, temporarily high investment returns permitted the WSIB to lower premiums (Liversidge 2010a). With the same optimism, in 2007, the Ontario government unilaterally enhanced benefit protection. These moves did not foresee the pinched investment revenues in store post-2007.

Ontario's legislation requires the WSIB to raise "sufficient" revenues to pay for benefits obligations[3] – a mandate that leaves room for discretion. Most provinces' workplace compensation boards, in contrast, are required to be fully funded – to carry enough assets to pay liabilities.[4,5] In the absence of a full funding rule, the insurance fund has less protection than otherwise from political or stakeholder pressure to lower premiums or increase benefits.

How Big is The Gap?

The WSIB values its assets on a market basis under generally accepted accounting principles, and in accordance with international accounting standards. The agency's most recent financial report (WSIB 2011a) assigns its net investment assets a fair value of $14.4 billion.[6]

The expected future value of the WSIB's liabilities is a function of currently known liabilities and benefit entitlements. The WSIB discounts future benefits at a 7 percent nominal rate, on the reasoning that its investment returns over the past 15 years have averaged 7 percent.

However, a reasonable discount rate – one consistent with the WSIB's ability to fund its liabilities – is the Government of Ontario's medium-term bond rate: typical such bonds currently yield just over 3 percent.[7] For illustrative purposes, we assume in what follows that a nominal discount rate consistent with the WSIB's ability to fund its liabilities is 3 percent.

Lacking detailed knowledge of the expected distribution over time of WSIB liabilities, which comprise mainly long-term disability benefits, we may nonetheless estimate the impact of valuing liabilities at a reasonably conservative discount rate. The management discussion in the WSIB's 2010 annual report stated that if

3 WSIA section 96.1.

4 The funding policies of most provinces and territories can be found at http://www.awcbc.org/en/wcbcommissionfundingpolicies.asp (Date of Access: February 22, 2012). As we discuss below, the interest rate at which other provinces' plans discount their liabilities will affect the extent to which they can be said to be properly funded.

5 Nova Scotia, like Ontario, does not require its workplace insurance plan to be fully funded. Nova Scotia's experience is similar to Ontario's – it carries a large unfunded liability and charges premiums above the national average.

6 Less a non-controlling interest of $1.8 billion.

7 See Laurin and Robson (2009), Appendix A, which discusses conceptual issues surrounding discount rate choices. In this case, if Ontario employers or employees privately sought to self-insure against the possibility of injury and lost work time, using instruments of credit quality similar to that available to the Ontario government, they would need to buy Government of Ontario bonds.

the $24.4 billion in liabilities were discounted at 6 percent as opposed to 7 percent, the present value of the liabilities would have been $1.6 billion higher. This sensitivity to interest rates is consistent with the sensitivity of the present value of an ordinary constant payment annuity compounded semi-annually over a 15 year term. If such an annuity were discounted at a nominal 3 percent rate, as we suggest, benefit liabilities would amount to approximately $31.3 billion in present value terms.[8]

This implies, in turn, that fair value accounting would put the WSIB's current unfunded liability at $19.7 billion – about $4,100 per payroll employee insured for workplace injuries or $2,900 per tax-filer.

Why We Care

Future employers, employees, and potentially taxpayers, ultimately must repair this funding gap. The WSIB's liabilities, though not listed as liabilities of the government of Ontario, would likely be backstopped by taxpayers if the WSIB was unable to meet benefit obligations (OAG 2009).[9] To match these obligations with higher premiums would raise the cost of hiring workers, with some or all of the cost being passed to workers through lower wages and benefits. To the extent that costs are not passed to employees, high premiums will encourage businesses to locate or expand elsewhere.

Ontario currently assesses among the highest employer premiums among Canadian provinces (Table 1, row 1). The unfunded liability exacerbates matters: premiums in Ontario must remain high to pay for prior unfunded claims, even though the cost of new claims is below the national average (Table 1, row 3). Further, with an assets-to-liability ratio hovering near 55 percent, the risk of not meeting benefit obligations in the short- and medium-term is high – the fund's ability to withstand further revenue shocks is limited.

What to do?

The WSIB gradually increased premium rates by 2 percent in both 2011 and 2012, with an average rate set for $2.40 per $100 of payroll in 2012. Further increases are needed if the WSIB is to meet benefit obligations. Premiums would need to rise in the short term to protect taxpayers from immediate financial risks, and stabilize in the medium term, then fall once the fund achieved actuarial balance.[10]

Under the WSIB's assumptions, eliminating the unfunded liability over 10-to-15 years' time would require increasing average premiums until they reached roughly $2.80 per $100 of payroll, about 13 percent higher than today's level (Eckler 2011). However, under our more conservative assumptions, restoring full funding would require premiums to rise and remain high for longer: premiums would need to increase to around $3.10 per $100 of payroll for roughly 15 to 25 years, or benefit entitlements would need to be trimmed, or both.

8 This is an overestimate to the extent that plan liabilities are front-end loaded, and an underestimate to the extent that the opposite is true.

9 In response to the Auditor General's 2009 report on the WSIB, the government of Ontario has taken steps seeking to distance itself from the likelihood needing to backstop a shortfall. The government repealed section 100 of the WSIA, which would have backstopped the WSIB if it was unable to meet benefit obligations, and repealed the part of section 167 that referenced the government's ability to influence the day-to-day operations of the fund (Liversidge 2010b).

10 Given that only 70 percent of Ontario's workers are covered by workplace compensation insurance (Table 1, row 4), expanding the plan's coverage might seem a reasonable option (OAG 2009). But were newly covered employers to be assessed actuarially fair premiums, the WSIB would raise no net revenue relative to its expected liabilities.

Table 1: Financing and Generosity of Workplace Injury Benefits, by Province and Territory, 2010

	Jurisdiction												
	BC	AB	SK	MB	ON	QC	NB	NS	PE	NL	NT/NU	YT	Average (un-weighted)
Funding Costs													
Average Premium Rate, $ per $100 payroll[a]	1.60	1.30	1.60	1.60	**2.30**	2.20	2.10	2.70	2.20	2.80	1.80	3.00	**2.10**
Funding Ratio (Assets/Liabilities)	130.5	129.4	124.8	124.4	**54.5**	81.4	111.5	64.0	113.8	93.7	116.0	134.3	**106.5**
Premium Rates based on New Claim Costs, $ per $100 payroll	1.30	0.90	1.20	1.50	**1.10**	1.40	1.40	1.70	1.10	1.80	1.30	1.70	**1.40**
Generosity of Benefits													
Percentage of workforce covered	94.4	85.5	75.5	73.5	**71.3**	93.0	92.1	72.8	96.0	97.7	100.0	96.5	**87.4**
Maximum Accessible or Insurable Earnings ($)	71,700	82,800	55,000	96,000	**79,600**	64,000	56,700	82,720	47,800	51,595	52,000	77,920	**68,200**

[a]: Each Workers' Compensation Board calculates these average assessment rates differently taking into account the range of rates that apply to each industry and employer group.

Sources: Association of Workers' Compensation Boards of Canada; WSIB (2011b); Authors' calculations.

Continued success will require legislative and regulatory guidance. The WSIB could be obliged, by legislation or regulation, to establish full funding in the medium term, as is typical for such plans, and when doing so to estimate liabilities discounted at a fair value rate. Thereafter, the WSIB would be obliged to maintain full funding over a rolling five-year period, and the WSIB's board charged with setting premiums accordingly.[11]

Meanwhile, Ontario employers, employees and potentially taxpayers face a massive WSIB liability. Premiums must rise, or benefit generosity must fall, or both. In any event, change is due.

11 Alberta and British Columbia maintain asset buffers well in excess of liabilities (Table 1, row 2). Other provinces with asset buffers, such as Saskatchewan, also require mandatory reductions or increases in premiums when the funding ratio falls outside certain bounds. When Saskatchewan's funding ratio – its ratio of assets to liabilities – falls below 105 percent, the board replenishes the fund in less than 5 years by raising premiums; when the funding ratio exceeds 122 percent, the board refunds employers until the ratio falls below 120 percent (SWCB 2011).

References

Eckler Consultants and Actuaries. 2011. "Concept Design Paper for Funding of the Workplace Safety and Insurance Board." Submission to the Harry Arthurs Funding Review. http://www.wsibfundingreview.ca/consultation-details.php (Date of Access: October 25, 2011).

Gunderson, Morley, and Douglas Hyatt. 2000. "Unfunded Liabilities Under Workers' Compensation," In *Workers' Compensation: Foundations for Reform*. Ed. by M. Gunderson and D. Hyatt. Toronto: University of Toronto Press. pp. 162-187.

Laurin, Alexandre, and William B.P. Robson. 2009. "Supersized Superannuation: The Startling Fair-Value Cost of Federal Government Pensions." Backgrounder 122. Toronto: C.D. Howe Institute. December.

Liversidge, Les. 2010a. "The WSIB 2014 Funding Plan: Why it Failed." The Liversidge e-Letter. April. http://laliversidge.com.dnnmax.com/eLetters/2010/tabid/78/Default.aspx (Date of Access: January 15, 2012).

————————. 2010b. "Bill 135: An Act Respecting Financial and Budget Measures and Other Matters." November.

Workplace Safety Insurance Board (WSIB). 2010. *WSIB 2010 Annual Report: Building Trust Through Fairness and Integrity*. http://www.wsibontario.ca/PDF/OnlineAR_E_2010.pdf (Date of Access: January 10, 2012).

————————. 2011a. "Third Quarter 2011 Report to Stakeholders." Workplace Safety Insurance Board. November.

————————. 2011b. "Perspectives on the Unfunded Liability at WSIB." WSIB's submission to the Harry Arthurs Funding Review. http://www.wsibfundingreview.ca/consultation-details.php (Date of Access: October 25, 2011).

Office of the Auditor General of Ontario (OAG). 2009. *2009 Annual Report of the Office of the Auditor General of Ontario*.

Saskatchewan Workers Compensation Board (SWCB). 2012. *Policy Manual*. Saskatoon: Saskatchewan Workers Compensation Board. http://www.wcbsask.com/WCBPortalWeb/ShowProperty?nodePath=/WCBRepository/pdfs/PolicyManual (Date of Access: February 10, 2012).

This e-brief is a publication of the C.D. Howe Institute.
Colin Busby is a Senior Policy Analyst at the C.D. Howe Institute.
Finn Poschmann is Vice President, Research at the C.D. Howe Institute.
This e-brief is available at www.cdhowe.org.
Permission is granted to reprint this text if the content is not altered and proper attribution is provided.