

The Liversidge e-Letter

An Executive Briefing on Emerging Workplace Safety and Insurance Issues

September 19, 2007

An Electronic Letter for the Clients of L.A. Liversidge, LL.B.

2 pages

“Budget Reforms” & WSIB Premium Rates **WSIB says “starting to turn financial corner”** ***What has changed over the last year?***

Even prior to *Budget Reforms* WSIB described “daunting” financial challenges

Budget Reforms add at least \$700⁺ million (\$2.3 billion if indexing just keeps pace with inflation)

Yet, WSIB now more confident

Let’s find the “good news” story

As readers of *The Liversidge e-Letter* are aware, there was no WSIB premium increase for 2007. And none for 2008. On top of all that, the *Budget Reforms* immediately added between \$700 - \$750 million to workplace safety and insurance [“WSI”] system costs (the Board’s projections), and will increase costs by at least \$2.3 billion (on a fully funded basis) even if future so called *temporary indexing* increases just keep pace with inflation.

And, as I introduced in the September 14, 2007 issue of *The Liversidge e-Letter*, based on a government MPP’s commentary at a legislative committee last spring, increases beyond inflation may well be in the cards.

The Minister of Labour’s Audit, the Ontario Auditor General and the WSIB have all recently said funding is still a problem

As noted in the September 17th issue of *The Liversidge e-Letter*, “*Is the unfunded liability no longer a problem?*”, the Minister of Labour’s own 2004 audit said that eliminating the unfunded liability [“UFL”] by 2014 will require a “*combination of increased revenues (from investment income and / or premiums) and a reduction of costs over the long term*”.

The 2005 Auditor General’s Annual Report noted that the UFL was potentially a problem again (still) and lauded the Board’s 2005 Funding Framework which “*reconfirmed the Board’s commitment to fully fund the system by 2014*”. The Board’s own 2005 WSIB Annual Report noted that “*premiums have failed to keep up with rising costs such as benefit and health-care costs*” thus requiring a 3% premium hike for 2006.

All have agreed on one point – *the UFL and WSI funding is a continuing problem and priority.*

WSIB now says it can absorb the Budget Reforms and meet the UFL 2014 target without increasing premiums

With a few caveats, senior Board officials now inform that notwithstanding the dire scenarios sincerely advanced no more than two years ago, that given a few assumptions (lower accident levels; reduced time on claim; continued satisfactory investment performance), not only can the Board absorb the costs arising from the *Budget Reforms*, but it should be able to do it without the need for any increases in employer premiums, while still meeting the target to eliminate the UFL by 2014.

There must a good news story arising from the Board’s performance over the last year

So, there must be a “*good news story*” (actually, we need a very good news story) somewhere in the Board’s performance over the last year. So, let’s look. The best place to start (*the only place really*) is with the **WSIB’s 2006 Annual Report**, which indeed does relate *several* “good news” stories.

WSIB “starting to turn the financial corner”

The overall good news first. Right out of the gate, the Board announces that while the UFL “*remains high at slightly less than \$6 billion*” (as at the end of 2006), it was reduced by “*about half a billion dollars.*” The Board’s Chair notes, “*I am optimistic this result indicates we are starting to turn the financial corner*”. [2006 Annual Report, p. 5]

WSIB touts success in controlling administrative costs as one factor that helped reduce the UFL

It is noted that “*one thing that helped to achieve the reduction in the unfunded liability was the success of our efforts to control administrative costs . . .*” [also at p. 5]. ***But, wait a minute.*** Didn’t the Minister of Labour’s [“MOL”] 2004 Audit say that “*Achieving cost efficiencies at the corporate and administration level should be a priority . . . however, this alone will not generate sufficient savings to significantly reduce the unfunded liability*” [MOL 2004 Audit, at page 3].

But, I won’t nit-pick. A reduction in administrative costs may not have *significantly* reduced the UFL, but no doubt administrative efficiency gains *helped*. **Good news then.**

Hold on a moment. WSIB administrative costs actually went up, they didn't go down. Let's take a little closer look.

From 2005 to 2006 (from WSIB 2006 Annual Report, p. 54):

- salaries went up modestly \$1 million (from \$287 to \$288 million);
- equipment costs up \$2 million (from \$34 to \$36 million);
- occupancy costs up \$3 million (from \$37 to \$40 million);
- communication costs down a million (from \$16 to \$15 million);
- supplies down a million (from \$8 to \$7 million);
- travel down a million (from \$5 to \$4 million);
- new systems development, no change (\$7 million)
- "other" down a million (from \$19 to \$18 million).
- amortization expense (down \$5 million to \$13 million)
- staff benefit plans (up \$31 million to \$94 million)

WSIB administration expenses went up, not down

All in all, administrative expenses for 2006 came in at \$522 million which is up \$28 million (5.7%) from 2005's \$494 million (which the Board acknowledges at p. 29).

Controllable vs. non-controllable administration costs

The WSIB has distinguished administrative costs as being "controllable" or "non-controllable," which means exactly what it says. In a business context, things like WSIB premiums would, for the most part, be a "non-uncontrollable cost" (for which of course a business is still accountable). The Board says it has held "*administrative costs within its control to the same funding levels allocated in 2004*" and they have "*remained relatively stable*" (p. 28). Increases are attributed to the group of "non-controllable" costs (p. 28).

The leadership is in the right direction – control costs

The leadership goal of controlling costs is certainly in the right direction, and not at all inconsistent with the 2004 MOL Audit. And, *I have no doubt that there has been a strong internal effort to control administrative costs within the WSIB. No doubt these efforts have borne some fruit* (the Board describes a few such gains at p. 29). And realistically, there is just so much "wobble room" when it comes to administrative costs. While administrative costs are likely less than what they would have been absent these corporate initiatives – ***they are not down.***

At best the "controllable costs" are stable and the "non-controllable costs" are up. *How this impacted the UFL one way or the other baffles me. I don't get it.*

The MOL Audit was right – even if administration costs declined the impact on the UFL would be negligible

To put this in perspective, even if the Board's administrative costs were reduced by say, \$100 million (and that *would* be something to crow about!), that would lower the UFL by about a point and a half. Significant, but just a ripple in the large UFL pond. More realistically, if for argument's sake 25% of the Board's administrative budget (about \$125 million) is truly within the Board's discretionary control, and the Board cut those costs by say 10%, the \$12.5 million in savings is a grain of sand on the UFL beach.

The 2004 MOL Audit was clear – "*eliminating the unfunded liability by 2014 will require a combination of increased revenues . . . and a reduction in costs over the long term*" [MOL 2004 Audit, p. 3]. That means benefit costs. And, that was before the *Budget Reforms*.

Admin cost factor was neutral to the UFL

So, while the administrative cost issue is not a "bad news story" it is not a good news story either. Certainly there is not much there to get too excited about in the context of the future funding of the WSI system.

WSIB lauds the Funding Framework

So, what else? The Board is eager to "*build on the gains that have been made*" [WSIB 2006 Annual Report, p. 5] and the Board lauds the continued implementation of the *Funding Framework* [at p. 10].

Expenses still outpace revenues by \$142 million

The real story comes out in "*Management's Discussion and Analysis of 2006 Financial Statements and Operating Results*" of the WSIB 2006 Annual Report (pp. 18-31). For 2006, the Board still recorded an excess of expenses over revenues of \$142 million.

Shortfall is down from last year, but it is still a shortfall

While down from 2005's \$494 million shortfall, and down even more from 2004's \$843 million shortfall, ***it is still a shortfall.*** Recent trends are in the right direction, and no doubt the Board is banking on that trend continuing. But, improvement must be extreme to absorb the immediate \$750 million *Budget Reforms*, let alone *de facto* full indexing.

Investment gains contributed to the reduction in the excess of expenses over revenue

According to the Board, the reduction of the excess of expenses over revenues for 2006 was realized from investment gains (p. 19). ***In fact, it was strong investment performance which in spite of the excess of expenses over revenues of \$142 million, allowed the UFL to drop \$513 million to just under \$6 billion*** (p. 19).

Benefit expenses are up significantly

But expenses increased \$322 million, with most of that attributable to increases in benefit costs (\$293 million), and much of that caused by increases in long-term (12 month⁺) cases (at p. 19).

Long term case durations are increasing and the Budget Reforms will increase them even further

Recall that several elements of the *Budget Reforms* will lead to even further increases in long-term cases, making the problem of persistency increases an even tougher nut to crack. While the Board commits that it will "*continue to strive for innovative solutions in prevention, return to work, and health care*" and that the "*full savings to be achieved by these initiatives will be realized over a period of several years*" there is no hint that as tough as the job was, it is going to become ***even more challenging because of the Budget Reforms.***

All in all, the Board's phenomenal investment performance is the one good news story from 2006. The Board posted an investment income of \$1.3 billion, up from 2005's \$819 million. But, other than the investment story, there aren't many other real good news stories. ***So, what changed? Actually, not all that much.***

On Monday: "Is the Board playing a long-shot?"