Discussion Paper – Excess Surplus Distribution
May, 2016

Background

The Workers' Compensation Board (WCB), by legislation, is required, annually, to collect premiums from employers sufficient enough to cover all costs of injury claims that occur in the respective year. For example, the 2015 premiums charged are intended to cover all of the costs, present and future, associated with the injuries that occur in 2015. The underlying principle is that today's employers fund the cost of today's injuries.

The legislation also requires that the WCB be fully funded at all times; i.e., sufficient funds are always on hand to fund all obligations related to all injury claims that are in the system such that current and future benefits are not in jeopardy. The legislation goes on to require the WCB to maintain a reserve fund to prevent employers in future years from being unduly or unfairly burdened with costs in those years relating to injuries that had previously occurred. The amount of these reserves is left to the discretion of the WCB Board of Directors (the Board).

Accordingly, annually a premium rate is set by the Board for the following year based on forecasted claim counts, cost of claims, and payroll. The premium rate is therefore a reflection of the revenue requirements to fund the next year's claims, expressed as a percentage of assessable payroll. For example, in December of 2015, the Board set the average premium rate for the 2016 year at $1.34 per $100 of payroll, intended to fund all of the costs of all of the injuries that are forecasted to occur in 2016. Each industry is assigned its own premium rate based on the expected claims and payroll activity in that industry.

These premiums are collected up front each year, with payments due in April and September of each year. However, the costs associated with the injury claims for that year will not all be paid out in that year. They would be spread out over the life of the claim. The premiums therefore are invested in various investments that are expected to earn a return sufficient to pay for the ongoing costs of the claims. This rate of return, or discount rate, is used in the calculation of the premium rates to determine the net present value of the future claim costs. The assumed discount rate set by our actuaries is 5.5%. In other words, the premiums must be invested such that they earn a minimum of 5.5% per year, over the long term.

In keeping with the legislated funding requirements, the Board has established a funding policy wherein it defines acceptable surplus and reserve levels. Surpluses are accumulated in the Injury Fund (IF). The policy requires that the IF maintain a balance of between 5% and 20% of the benefits liabilities and that reserves for Disaster and Second Injury be held at 3% of the benefits liabilities. The policy also states that where the IF exceeds 122%, the Board, at its discretion, will return this excess to the employers over a period not exceeding 5 years. If the IF falls below 103% the Board will add amounts into the premium rate such that the IF returns to the 105% over a period not exceeding 5 years.

The WCB has only two sources of revenue: the premiums it charges employers and the returns it earns on the investments it holds. When investment returns exceed the required rate of return of 5.5% excess investment earnings are generated which get added into the WCB's surplus. In addition, investment earnings on the surplus and reserves that the WCB holds also add to the excess investment earnings.

Investment income comes in two forms: realized and unrealized investment income. Realized investment income includes interest and dividends received on investments and gains on the sale of investment assets sold. Unrealized income is gains and losses in our investment portfolio caused by market value fluctuations on investment assets that have yet to be sold. The WCB funding policy only considers realized investment income in determining its funded position.

Current Condition

The WCB has released its 2015 Annual Report for the year ended December 31, 2015. The WCB reported a comprehensive loss of $7.5 million and a funded position of 144.7 percent. The 2015 funded position exceeds the WCB's funding policy by 24.7 percent which equates to a $281.5 million in excess surplus.

Substantially all of the excess surplus for 2015 is directly related to investment earnings in 2015. The following is a breakdown of the factors that resulted in the 2015 surplus:

- Investment activity caused 22.3 percent of the 24.7 percent excess funded position.
- During 2015, the WCB realized investment income of $252.8 from interest, dividends and investment assets sold during the year, which were reinvested in the investment portfolios.
- A small portion of the $281 million 2015 excess funded position, $25.8 million, was caused by the underwriting profit, premium revenue minus costs, as a result of lower than anticipated claims costs and higher reported payroll.

Under Consideration

Among other things, the Board is considering the approval of a $56.3 million excess surplus distribution for 2015 to be paid to qualifying employers by July 31, 2016. This amount, 20 percent of the excess surplus amount, represents one fifth of the excess surplus as provided for in the funding policy. The Board is considering this based on the following considerations:

- **Funding policy review** - The WCB is in the process of reviewing its current funding policy subsequent to the Asset Liability Study completed in 2015. The recommendations from the Asset Liability Study may affect the funding range and future surplus distributions. It is anticipated that this review and subsequent changes, if any, will be completed by the fall of 2016, after consultation with stakeholders.

- The Asset Liability Study recommended the board consider its risk tolerance for excess surplus distributions following the review of the rate setting model. An element of the rate model review will be consideration of the reactivity of the model to improved injury rates and related costs for setting required premium rates. The rate model review is anticipated to be complete by June 1, 2016 in order to be implemented for the setting of 2017 premium rates.
- The Asset Liability Study recommended that distribution of excess surplus be shorter than a period of 5 years. The funding policy review will consider this recommendation including updated risk analysis of the board becoming under-funded considering changes to the rate setting model. The study recommended the funding policy state a fixed percentage of the excess surplus to be distributed when the upper range of the funding target is exceeded.

- **Market uncertainties and investment return volatility**

  Total investment income decreased by $53.2 million in 2015. To the end of April, 2016 the market value of our investments has declined $21 million from December 31, 2015 as compared to the decline at the end of February 2016 of $75 million. It is uncertain of the performance and volatility of investment markets for the remainder of 2016 and beyond.

- **The Board is also determining cash flow requirements**

  It will be necessary to dispose of investments to fund the distribution of excess surplus in 2016. The board is financially responsible to minimize realized losses on investments disposed in 2016 to fund the excess surplus distribution.

- **Economic uncertainty**

  Activity in the resource sector continues to be slow. This is having residual effects on other industries like construction. An agricultural slow down on top of the challenges in the resource sector, could further hamper other sectors of the economy. The combined effects could result in lower than forecast payrolls which would lead to lower than expected premiums, without a corresponding decrease in claims costs.

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- **Changes in accounting and actuarial standards**

  Changes in accounting and actuarial standards will be applicable to the benefits liability in 2020 and are anticipated to increase our benefit liability in the range of $186 million to $224 million per consultant actuaries. This will have a material and significant impact on our funded position in the range of 16 to 19 percent. The Board is considering the establishment of a reserve in 2016 to spread the impact of these changes over the next four years and lessen the impact in 2020. If no reserves are established, there will be a significant impact on 2020 employer premium rates. Given current estimates, the impact on rates could be an increase of 62 to 75 percent if the funding deficit caused by the change in accounting and actuarial standards are funded in one year.

- **2016 Committee of Review recommendations** - The Board will be receiving the Committee of Review recommendations in 2016 which may include recommendations with financial implications.

In light of these considerations, the Board is inviting input from you, your organization, and your members with respect to the 2015 excess surplus distribution to be paid in 2016.

Please submit your comments to Nancy Anderson by email at nanderson@wcbsask.com by May 31, 2016.

We look forward to receiving your feedback.

Sincerely,

Gord Dobrowolsky
Chairman