WORK SAFE. FOR LIFE.
WORKERS' COMPENSATION BOARD OF NOVA SCOTIA

Rate Setting Policy Clarifications:

Final Program Policy Decision and Supporting Rationale

October 2017

I – Introduction:

In December 2016 the WCB Board of Directors added the topic of the clarification of two rate setting policies to the Revolving Program Policy Agenda. This topic emerged from the appeal system as a result of a WCAT decision dealing with Rate Group formation, monitoring, and adjustment that is done for the purpose of setting employer assessment rates. The WCAT decision was not consistent with the WCB's longstanding interpretation and application of the two policies. The WCB believes WCAT's interpretation could (without clarification) lead to significant annual fluctuations (up or down) of employer assessment rates.

From May 03 to June 30 2017 the WCB consulted on revisions to two rate setting policies. The document "*Program Policy Background Paper - Clarification of Rate Setting Policies: Policy 9.3.1R2 – Classification, Rate Setting and Experience Rating Process and Policy 9.3.3R1Data Used in Rate Setting at Rate Group Level"* was posted to the WCB website and e-mailed to stakeholders.

The policy background paper can be found on the WCB website at www.wcb.ns.ca.

The remainder of this report provides:

- key issues raised by stakeholders during consultation on the proposed revisions to the policies;
- the rational for why the WCB did or did not revise the draft program policies in response to stakeholder submissions received as a result of the consultation; and
- the WCB's final policy decision as reflected in the final version of the program policies – Appendix B.

II - Issues Raised During Consultation:

The WCB received four stakeholder submissions in response to the consultation. An injured worker association made a submission and three employers made submissions.

For a detailed overview of feedback from stakeholders, please see Appendix A.

The WCB appreciates feedback from all stakeholders. Some of the feedback received was beyond the scope of the consultation or the proposed policy revisions and therefore is not explicitly addressed in this document. These topics included:

- The WCB Board of Director's decision to add the topic of clarification of rate setting policies to the policy agenda
- The need for a broad review of the current rate setting process and policies
- Changes to specific elements of the rate setting process such as elimination merits for employers and inclusion of data other than payroll and claims cost in the definition of "accident experience"
- Issues that are before the Supreme Court of Nova Scotia
- Elimination of the unfunded liability
- WCAT decisions on claims related matters

As noted in the policy background paper the WCB Board of Directors believes the current rate setting process is appropriate for Nova Scotia and is not considering broader changes to the process at this time.

III – Summary of changes made to "draft" policy language based on consultation:

After considering the feedback received, the Board of Directors has decided that some changes to the draft policy are required to increase clarity of intent and language. Specifically, four changes have been made to the draft polices in response to the feedback from the consultation. The changes are as follows:

- Removal of the term "generally" in the definition of "cost ratio" and in Step 3 - Rate Group Formation, Monitoring, and Adjustment in *Policy 9.3.1R2*. It has also been removed from *Policy 9.3.3R1*.
- The addition of an example to Step 3 of *Policy 9.3.1R2* to clarify the number of years of data that is considered during Rate Group formation and adjustment.
- The addition of the phrase "on average" to Step 3 of Policy 9.3.1R2 to clarify that the WCB considers the overall trend when forming and adjusting Industry Groups.
- The addition of wording to the definition of "accident experience" in Policy 9.3.1R2 to clarify that weighting factors are applied to the data.

These changes are discussed in more detail in the following section.

IV – Stakeholder Feedback, Analysis, and Response:

#1: The use of the term "generally" in *Policy 9.3.1R2 – Classification, Rate Setting and Experience Rating Process* is confusing and does not clarify the policy.

Analysis and Response:

The WCB agrees the policy can be more precise and has removed the word "generally" in the following parts of the policy:

3. Definitions

"cost ratio" ~~generally,~~ is cash payments on new claims in a defined period divided by assessable payroll for the same period.

4. Policy Statement

Step 3 - Rate Group Formation, Monitoring, and Adjustment

Formation

To ensure credibility, Rate Groups are formed by combining Industry Groups with similar accident experience. ~~Generally,~~ A Rate Group is considered to be made up of Industry Groups with similar accident experience when there is no more than a 20% difference, **on average**, between the annual cost ratio for each Industry Group and the Rate Group's annual cost ratio over the previous 5 consecutive years.

Monitoring and Adjustment

~~Generally~~, An Industry Group no longer has accident experience similar to its current Rate Group when there is more than a 20% difference, **on average**, between the Industry Group's annual cost ratio and the Rate Group's annual cost ratio calculated over the previous 5 consecutive years.

The WCB has added the phrase "on average" to clarify that the WCB considers the overall trend for an Industry Group as compared to the others in the Rate Group in the 5 year period when forming, monitoring, and adjusting Rate Groups.

#2: Notwithstanding the WCAT Decision, the WCB seeks to continue using claims experience data from a period longer than 5 years.

Analysis and Response:

In its decision, WCAT stated the WCB is not permitted to use data "outside the relevant 5-year window permitted in *Policy 9.3.3R1* in establishing the Rate Group." The WCB believes the lack of detail in the foundational rate-setting and experience rating process policy (*Policy 9.3.1R2*) may have resulted in WCAT's application of *Policy 9.3.3R1* to the formation and adjustment of Rate Groups (Step 3 in *Policy 9.3.1R2*). As discussed in the policy background paper, *Policy 9.3.3R1* is applied in Step 4 of the process when calculating the baseline rate, **not** Step 3 – formation and adjustment of Rate Groups. If the WCB were limited to only the data specified in *Policy 9.3.3R1* when forming Rate Groups, it would be nearly impossible to form Rate Groups that are credible and produce stable assessment rates.

Since the inception of the current rate setting process approximately 20 years ago, the WCB has considered at least 5 consecutive annual cost ratios (each containing 5 years of data) when forming and adjusting Rate Groups. Using data from a short time period (like the 5 years specified in *Policy 9.3.3R1* also known as 1 annual cost ratio) would result in rate instability year over year for employers. This could be considered desirable in years when claims experience has improved (resulting in lower rates), but undesirable when claims experience is poor (higher rates). By using claims experience data from a longer time period, the WCB is able to obtain a more accurate picture of an Industry's claims experience and achieve rate stability for Industries and employers.

The revisions to policies *9.3.1R2* and *9.3.3R1* codify the WCB's existing practice related to the formation and adjustment of Rate Groups and ensure the continued credibility and stability of assessment rates.

#3: The current policy proposal is misleading because it gives the impression that only 5 years of data are used. However, each annual cost experience ratio uses data from the previous 5 years of claims experience. This means that a total 10 years of data are considered in forming Rate Groups and is inconsistent with the WCB's goal of being responsive to improved safety. This is compounded by

the use of the term "appropriately" when referring to the responsiveness of the rate setting process.

Analysis and Response:

The WCB agrees the policy should be clarified to indicate the total number of years of claims experience data that is considered when forming and adjusting Rate Groups. The following wording has been added to Step 3 - Rate Group Formation, Monitoring, and Adjustment in *Policy 9.3.1R2 – Classification, Rate Setting and Experience Rating Process*:

> Example: When setting rates for 2017 (carried out in 2016), Industry Group annual cost ratios for 2011 to 2015 inclusive are considered when forming and adjusting Rate Groups. Given that each annual ratio is calculated using the previous 5 years of payroll and cost data – a total of 9 years (2007 to 2015) of data are ultimately considered.

The term "appropriately" is not used in the policy. It is used in the policy background paper for the policy revisions. In reference to responsiveness, the policy states:

> 2. Goals of Rate Setting and Experience Rating Process
>
> The goals of the WCB Rate Setting and Experience Rating Process are:
>
> - Achieve a balance between rate stability and rate responsiveness. The use of a collective liability model, statistical analysis, and actuarial advice prevents extreme rate variations (increases or decreases) year over year. The WCB's annual monitoring of the process and employers' ability to affect their rate through injury prevention and return to work ensures rates respond to changes in accident experience.

In the background paper, the word "appropriately" is used to describe the type of responsiveness that is desirable for the rate setting process. As noted in the policy language above (and discussed previously), the goal is to prevent extreme rate variations year over year while at the same time recognizing changes (positive and negative) in accident experience in a timely manner. This is why the process considers accident experience trends over time instead of reacting to changes in accident experience over the short-term. This is balanced by the use the weighting factors (discussed in more detail later in this paper) that enable industry rates to be responsive to claims experience. If an industry's recent experience is good, the rate will come down faster than without the weighting factors; if the recent experience is poor, the rate will go up faster than without the weighting.

Individual employers have an opportunity to positively impact their rates. This is accomplished through the WCB's experience rating program (Step 6 – Experience Rating in *Policy 9.3.3R1).* The program adjusts employer rates on the basis of the comparison of their accident experience to the average accident experience of the rate group over a period of three years. Employers with better than average accident experience may receive merits (rate decreases), while employers with worse than average accident experience receive demerits (rate increases). Section 9.4 of Chapter 9 of the Policy Manual contains a series of policy that set out the WCB's experience rating program.

#4: Current/more recent claims experience data should be given more weight instead of every year being given equal weighting.

In the rate setting process, the accident experience of Industry and/or Rate Groups are compared to one another to arrive at assessment rates that reflect industry risk. Accident experience is historical WCB claims cost data on workplace injuries. To make accident experience data comparable across industries, it is expressed as an annual cost ratio by dividing costs for claims with accident dates in the previous consecutive 5 year period by payroll from the same 5 year period. Weights are applied to the cost data so that the most recent years of costs have a higher weight and the most distant years have a lower weight.

The same weighted accident experience data noted above is used in both Step 3 – Rate Group Formation, Monitoring, **and** Adjustment **and** Step 4 – Calculating the Baseline Assessment Rate for Rate Groups. The difference is that the baseline assessment rate calculation uses 5 years' worth of data (data in 1 annual cost ratio) while Rate Group formation and adjustment uses 9 years of data (data in 5 annual cost ratios). While *Policy 9.3.3R1* specifies that weighting factors are applied to claims experience data, the rate setting process foundational policy - *Policy 9.3.1R2* - does not mention the use of weighting factors. Therefore, the following wording has been added (**<u>bolded and underlined</u>**) to the definition of "accident experience" in *Policy 9.3.1R2*:

> "accident experience" means historical WCB claims cost data on workplace injuries. The data may be reported at the employer, Industry Group, or Rate Group level. **<u>A greater weight will be applied to the most recent year of costs and a lower weight to the most distant year. The weighting factors used will be based on actuarial valuations as determined by the WCB</u>**. Accident experience is expressed as a cost ratio for rate setting and experience rating purposes

This change makes it clear that weighted claims experience data is also used in the formation and adjustment of Rate Groups.

Appendix A

Rate Setting Policy Clarifications: Consultation Summary

Introduction

The WCB received four submissions of feedback regarding the *Program Policy Background Paper - Clarification of Rate Setting Policies: Policy 9.3.1R1 – Classification, Rate Setting and Experience Rating Process and Policy 9.3.3R1Data Used in Rate Setting at Rate Group Level*.

Overview of Stakeholder Submissions

Outlined below is a summary of general comments submitted by stakeholders.

Injured Worker Association

- The proper procedure for challenging a WCAT decision is to submit an appeal to the Nova Scotia Court of Appeal.
- The WCB is quick to change policy in response to WCAT decisions for employer related matters but does not act in response to WCAT on worker related issues. WCAT decisions which provide improved or additional benefits to injured workers are ignored by WCB but WCAT decisions which may positively or negatively impact employers are given immediate attention by the WCB.
- Overall, the proposed amendments appear to be consistent with information contained in various WCB publications relating to the formation and determination of when an Industry Group should be moved from its Rate Group.
- Further revisions and amendments are required to ensure the policies are consistent with the *Workers ' Compensation Act*, including:
    - Include factors other than the cost of new claims in the formula to ensure employers are charged a premium that accurately reflects their record and risk.
    - Elimination of merits in the experience rating process.
    - Amend policy to ensure all employers with poor safety records are appropriately penalized with surcharges.
- The WCB is more interested in addressing the needs and special interests of large employers at the expense of small to medium employers and injured workers.
- There should be no reduction in employer's rates as long as an Unfunded Liability is in existence and benefits to workers are the lowest. Section 121 states rate reduction is discretionary.
- The classification of employers in groups of like with like is appropriate for original rate setting purposes. However, each firm within the group should then be paying an additional assessment rate base upon their individual experience and not that of the group.

Employers

- There should be broader continuing discussion between the WCB and employers, with the goal of creating new policies which are transparent, predictable, sustainable and fair, and which fully support and encourage improved safety performance.
- The WCB should not use the term "generally" when setting out the criteria for determining whether or not industry groups have similar accident experience. Why can't WCBNS actually guarantee that all Industry Groups will be made up of Industry Groups within 20% of one another in terms of accident experience? Why should WCBNS

exercise a discretion which erroneously forces some employers into higher Rate Groups?

- Notwithstanding the binding WCAT Decision, WCBNS seeks to continue assessing risk based on a longer period of time longer than the 5 year period mentioned in the policy. Using WCBNS's methodology, 10 years of data are considered. This is inconsistent with the WCAT Decision and inconsistent with WCBNS's goal of being responsive to improved safety. It is also inconsistent with the policy directive of giving more weight to recent experience, as every year is given equal weighting. How can employers have confidence in a process which takes so long to recognize improved safety?
- Responsiveness is critical to a properly functioning assessment process. Employers must be confident that their investments in safety will be recognized. However, of the three key objectives described by WCBNS, "Responsiveness" is the only one which is qualified in a way which makes it arbitrary and unclear.
- WCBNS does not recognize deficiencies in the current rate setting process. Instead, WCBNS has repeatedly said it does not intend to change anything.
- Rate Groups do not create unfunded liabilities and investment shortfalls. Accordingly WCBNS should not fund these shortfalls using Rate Group methodologies. Unfunded liabilities and investment shortfalls are a collective responsibility which should be borne by all employers and a new formula found for more equitably funding the deficit.

Appendix B

Final Version of Policies

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POLICY

NUMBER:9.3.1R3

Effective Date:	November 23, 2017	**Topic:**	**Classification, Rate Setting and Experience Rating Process**
Date Issued:	December 19, 2017	Section:	Assessments and Collections
Date Approved by Board of Directors:	November 23, 2017	Subsection:	Rate Setting

1. Preamble

The WCB uses a rate-setting and experience rating process that incorporates both collective, and individual, employer liability to set assessment rates for employers.

Collective liability is a risk sharing arrangement where the cost of compensation is spread among a pool of employers who are jointly responsible for the costs of the compensation system. Alternatively, under a system of individual employer liability (e.g. self-insured employers), an employer would pay the full amount of the costs it incurs and therefore be exposed to financial costs that might impact its ability to stay in business.

The purpose of this policy is to provide an overview and outline the steps in the rate-setting and experience rating process.

2. Goals of Rate Setting and Experience Rating Process

The goals of the WCB Rate Setting and Experience Rating Process are:

- Financial sustainability. This process produces, as required by Section 115 of the *Workers' Compensation Act* of Nova Scotia, enough funds to cover the estimated total revenue requirements for the upcoming year.
- Balance collective liability with individual employer accountability. While all registered employers in an industry are jointly responsible for the costs of claims, the process provides financial incentives and disincentives to individual employers for their injury prevention and

return-to-work performance through experience rating.

- Achieve a balance between rate stability and rate responsiveness. The use of a collective liability model, statistical analysis, and actuarial advice prevents extreme rate variations (increases or decreases) year over year. The WCB's annual monitoring of the process and employers' ability to affect their rate through injury prevention and return to work ensures rates respond to changes in accident experience.

3. DEFINITIONS

"accident experience" means historical WCB claims cost data on workplace injuries. The data may be reported at the employer, Industry Group, or Rate Group level. A greater weight will be applied to the most recent year of costs and a lower weight to the most distant year. The weighting factors used will be based on actuarial valuations as determined by the WCB. Accident experience is expressed as a cost ratio for rate setting and experience rating purposes.

"annual cost ratio" is calculated:

- for the purposes of Industry Group or Rate Group formation, by dividing costs for claims with accident dates in the previous consecutive 5 year period by payroll from the same 5 year period.
- for experience rating purposes, the annual cost ratio is calculated by dividing the costs for claims with accident dates in the previous consecutive 3 year period by payroll from the same 3 year period.

"cost ratio" is cash payments on new claims in a defined period divided by assessable payroll for the same period.

"credible" in relation to an Industry or Rate Group, means the group has a sufficient volume of claims accident experience data to allow for confidence in the prediction of future claims experience.

"year" means calendar year.

4. POLICY STATEMENT

Introduction

The WCB Rate-setting and Experience Rating process has 7 Steps. Steps 1 through 5 reflect the principle of collective liability. In these steps assessed employers are classified and grouped to enable the WCB to assign baseline assessment rates that are statistically valid. Steps 6 and 7 provide individual employers the ability to directly impact their assessment rates through injury prevention and return-to-work.

<u>Step 1 - Classifying Employers by Standard Industrial Classification (SIC)</u>

Each employer is classified based on the principal activity of the business. The framework used to classify employers is the SIC system published by Statistics Canada.

Some firms may qualify for multiple classifications. See policies *9.2.1 - Multiple Classification – Eligibility* and *9.2.2R - Classification of Firms not Eligible for Multiple Classification*.

Step 2 - Industry Group Formation

Industry groups are determined by combining SIC's which have similar business activities.

Step 3 - Rate Group Formation, Monitoring, and Adjustment

Formation

The objective of Rate Group formation is to enable the WCB to calculate assessment rates (carried out in Step 4) that are an appropriate reflection of the underlying risk characteristics of a Rate Group when compared to other Rate Groups.

To ensure credibility, Rate Groups are formed by combining Industry Groups with similar accident experience. A Rate Group is considered to be made up of Industry Groups with similar accident experience when there is no more than a 20% difference, on average, between the annual cost ratio for each Industry Group and the Rate Group's annual cost ratio over the previous 5 consecutive years.

A Rate Group may consist of a single Industry Group if the group, on its own, has a sufficient volume of claims accident experience data to form a credible Rate Group.

Monitoring and Adjustment

As part of the annual review of Rate Groups the WCB will identify Industry Groups that no longer have accident experience similar to their current Rate Group. Those identified may be moved to another Rate Group.

An Industry Group no longer has accident experience similar to its current Rate Group when there is more than a 20% difference, on average, between the Industry Group's annual cost ratio and the Rate Group's annual cost ratio calculated over the previous 5 consecutive years.

Example: When setting rates for 2017 (carried out in 2016), Industry Group annual cost ratios for 2011 to 2015 inclusive are considered when forming and adjusting Rate Groups. Given that each cost annual ratio is calculated using the previous 5 years of payroll and cost data – a total of 9 years of data (2007 – 2015) are ultimately considered.

The WCB may move an Industry Group from its current Rate Group based on a period of less than 5 consecutive years. In making this decision, the WCB will consider (among other factors) the:

- amount of difference between the Industry Group and the Rate Group's annual cost ratios in the period; and
- the Industry Group's relative impact on the cost experience of the Rate Group.

Changes to Rate Groups may also be made if they are no longer credible.

Step 4 – Calculating the Baseline Assessment Rate for Rate Groups

Baseline assessment rates are calculated for each Rate Group based on the Rate Group's five-year accident experience. *Policy 9.3.3R2–Data Used in Calculating the Baseline Assessment Rate for Rate Groups* is applied when calculating the baseline assessment rate for a Rate Group.

For greater certainty, baseline assessment rates are not calculated for individual employers. They are calculated at the Rate Group level.

Step 5 - Calculating Basic Assessment Rates by Employer

Each employer's basic assessment rate (prior to experience rating) is determined by moving the current rate toward the Rate Group baseline rate over a transition period. The WCB applies policy *9.3.2R1 Transition* when moving the employer's basic assessment rate toward the Rate Group baseline rate.

Step 6 - Experience Rating

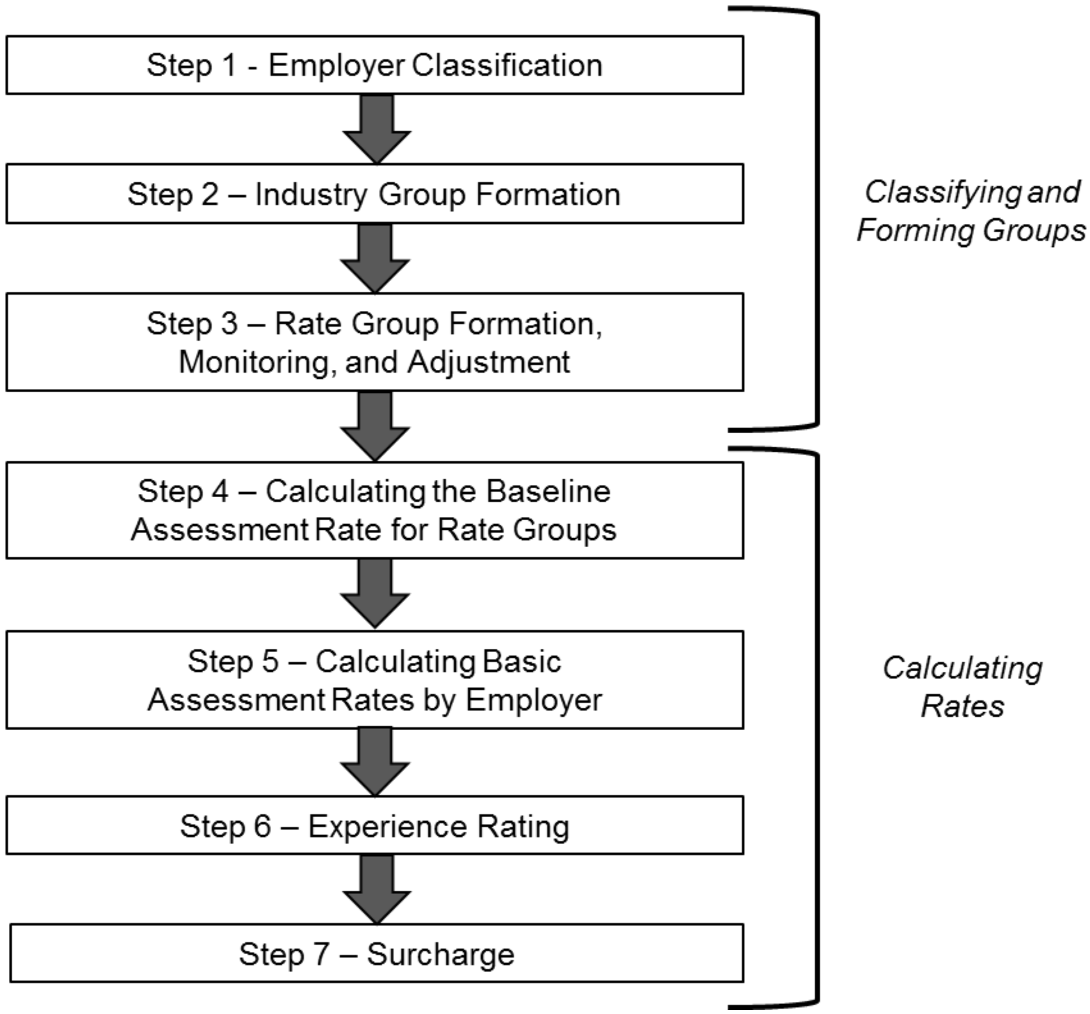
Experience Rating is a program, designed to be revenue neutral, which adjusts employer rates on the basis of the comparison of their accident experience (cost ratio) to the average accident experience of the Rate Group over a period of three years. Employers with better than average accident experience may receive merits (rate decreases), while employers with worse than average accident experience receive demerits (rate increases). (See *Policy 9.4.2R4*, re: Maximum Merit/Demerit and Surcharge). In the calculation of the average accident experience, the WCB excludes claim costs for any employers at the maximum demerit which are beyond the level required to put them at this maximum, as they form a portion of the collective liability of the Rate Group. However, the average cost ratio used cannot be less than half (50%) of the cost ratio for the Rate Group including these collective liability costs.

Step 7 – Surcharge

A surcharge will be applied to an employer's basic rate if the criteria outlined in *Policy 9.4.2R4 Experience Rating – Maximum Merit or Demerit Surcharge* are satisfied.

5. GUIDELINES

Classification, Rate Setting and Experience Rating Process



APPLICATION

This Policy applies to all decisions made on or after February 1, 1996, but does not apply to any decision where as of November 23, 2017 there exists an active appeal, in that case Policy 9.3.1R2 will continue to apply.

REFERENCES

Workers' Compensation Act (Chapter 10, Acts of 1994-95), (as amended), Sections 120(1), 121(1) (2) (3) (7), 125(1).

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POLICY

NUMBER:9.3.3R2

Effective Date:	November 23, 2017	**Topic:**	Data Used in Calculating the Baseline Assessment Rate for Rate Groups
Date Issued:	December 19, 2017	Section:	Assessments and Collections
Date Approved by Board of Directors:	November 23, 2017	Subsection:	Rate Setting

1. PREAMBLE

This policy is applied during Step 4 – Calculating the Baseline Assessment Rate for Rate Groups in *Policy 9.3.1R3 – Rate Setting and Experience Rating Process Policy*, after Rate Groups have been formed.

2. DEFINITIONS

"annual cost ratio" is calculated:

- for the purposes of Industry Group or Rate Group formation, by dividing costs for claims with accident dates in the previous consecutive 5 year period by payroll from the same 5 year period.
- for experience rating purposes, the annual cost ratio is calculated by dividing the costs for claims with accident dates in the previous consecutive 3 year period by payroll from the same 3 year period.

"cost ratio" is cash payments on new claims in a defined period divided by assessable payroll for the same period.

"year" means calendar year.

3. POLICY STATEMENT

1. The data used to calculate the baseline rate for a Rate Group for a particular year consists of the claims costs and assessable payroll for the Rate Group over a period of five consecutive years for all claims with accident dates during that period. The costs that are included and excluded from rate setting are outlined in policies *9.3.4R Costs Used for Fatal Claims for Rate Setting*, and *9.3.5R Claims Costs Which are Excluded From Rate Setting*.

2. Where the benefit is a commuted Permanent Impairment Benefit, the claims costs used will be equivalent to three and one-half annual Permanent Impairment Benefit payments that would have been made had the benefit not been commuted.

3. The payroll used in the calculation will be the total assessable payroll on which the assessments are based for the same five years.

4. The WCB will calculate the cost ratio for the Rate Group by assigning a weighting to each of the five years. A greater weight will be applied to the most recent year of costs and a lower weight to the most distant year. The weighting factors used will be based on actuarial valuations as determined by the WCB. The WCB compares the Rate Group's annual cost ratio to the annual cost ratio for the province in calculating the baseline rate.

EXAMPLE
To calculate the 2006 baseline rate for a Rate Group the cost and payroll data used will be for the years 2000, 2001, 2002, 2003 and 2004.

APPLICATION

This Policy applies to all decisions made on or after February 1, 1996, but does not apply to any decision where as of November 23, 2017 there exists an active appeal, in that case Policy 9.3.3R1 will continue to apply.

REFERENCES

Workers' Compensation Act (Chapter 10, Acts of 1994-95), Section 121(1).