

DISCUSSION PAPER

1. TITLE

Experience Rating System Enhancement – Excess Cost Surcharge

2. ISSUE

WorkSafeBC ("WCB") has identified that the current Experience Rating ("ER") system does not have the capability to adequately rate certain firms. Since the adoption of a new ER system in 2000, these firms have had significantly higher claim costs than their peers over several years.

At issue is whether adjustments should be made to the ER system to incorporate an Excess Cost Surcharge ("ECS") to provide that firms with consistently high claim costs pay an appropriate share of their costs. This would limit the subsidization of these firms' costs by their competitors and provide motivation for the firms to improve workplace health and safety and return to work practices.

3. BACKGROUND

3.1 Law and Policy

The *Workers Compensation Act* ("Act") provides the WCB with the authority to adopt an experience rating system. The Act sets out that where an "industry or plant is shown to be so circumstanced or conducted that the hazard or cost of compensation differs from the average of the class or subclass to which the industry or plant is assigned," the WCB may adopt an experience rating program.¹ Further, the purpose of the ER system is to charge rates that "correspond with the relative hazard or cost of compensation" of each firm.

Policy in the *Assessment Manual* describes key features of the ER system.² These features include:

- The ER system uses past cost and payroll information to calculate the rate at which a firm pays premiums.
- The ER system uses a weighted three-year window of claims costs. The most recent year is weighted at 50 percent, the prior year at 33.3 percent, and the most distant year at 16.7 percent.
- The firm's cost to payroll ratio in the three-year window is compared with the ratio of the rate group in which the firm's classification is placed; firms

¹ See section 42 of the Act.

² See section (a) of Item AP1-42-1 Experience Rating, attached as Appendix A.

with costs that are lower than average may receive a discount, and firms with costs higher than average may receive a surcharge.

- Discounts are limited to 50 percent of the base rate, and surcharges are limited to 100 percent of the base rate.

3.2 The ER System and Firms with Excess Costs

In 2006, the WCB reviewed the ER system and found that the system is generally providing adequate incentives for most firms to adopt health and safety and return to work programs, to minimize their claim costs. However, there are a small number of firms that consistently sustain much higher costs than other firms in their rate groups. The ER system provides surcharges in excess of 90 percent of base rate for many of these firms, but their costs have not generally decreased. The following table summarizes the financial performance of five firms being evaluated as part of the analysis and development for the ECS program.

From 2001 to 2005						
Firm	# Years counted ER costs at least 3x worse than rate group	Five-year Net Loss Premiums collected - claim costs from same period (Rounded to nearest '000)	Five-year Loss Ratio Claim costs/ premiums collected from same period	Rate WCB would have had to charge to cover losses	2007 Net rate charged	2007 ER System Surcharge
A	5	-\$2,392,000	394%	\$6.60	\$1.72	98.1%
B	4	-\$987,000	198%	\$3.96	\$2.80	91.6%
C	5	-\$783,000	116%	\$6.61	\$3.50	99.9%
D	5	-\$531,000	220%	\$1.14	\$0.53	90.5%
E	5	-\$424,000	125%	\$8.53	\$5.89	97.8%

There could be several reasons why a firm would sustain a significantly high cost trend over a long period.

The first possible reason is that the firm is misclassified. A review was performed to ensure that the firms showing this trend were correctly classified, and it is the the WCB's practice to review the classification of any firm that is showing such a performance trend. None of the firms that are under consideration for the program set out in this paper are misclassified under current law and policy.

The next reason could be that the firm is correctly classified, and has the same risk profile as its peers, but does not attend to its occupational health and safety and return to work responsibilities. Such a firm would consistently perform worse than its peers in terms of claim costs.

The last reason could be that the firm is correctly classified, but its operations nonetheless have a different risk profile than that of its peers. An example of this would be a winery that manufactures its own bottles. As most wineries source

their bottles from third party firms, the firm manufacturing its own bottles would have a different risk than other wineries. Firms in this situation may have acceptable health and safety and return to work compliance, but still sustain higher costs over a long period, despite being correctly classified. Consequently, the rates the WCB charges these firms do not reflect their risk.

Regardless of the reason for these firms' high costs, the fact remains that their competitors subsidize their costs over the long term, as their premiums do not reflect the significant burden they place on their rate groups. As an example, of the firms under consideration for the ECS program, one makes up under two percent of the payroll for its rate group, but is responsible for over 11 percent of its rate group's costs.

The ER system does not provide adequate incentives to this group of firms, as their costs may be so high that investment in better health and safety or return to work practices may not actually impact their rates under the ER system.³ These firms clearly fit the language of the *Act* concerning firms that are "so circumstanced" that their hazard or cost of compensation differs from the average of their class, but the structure of the ER system prevents the WCB from charging these firms rates that "correspond with the relative hazard or cost of compensation."

4. DISCUSSION

4.1 Overview of the Proposed Program

The proposed ECS program would significantly increase a small number of employers' rates, reflecting the costs they contribute to the system and reducing the subsidization of these firms' costs by their peers. For firms with a different risk profile than their peers, the rates charged by the WCB would more closely reflect the risk the WCB insures, and reinforce the importance of good workplace safety and return to work practices as a means to reduce costs.

The WCB has developed a proposed rate adjustment process that would step these consistently high-cost performers into higher rates over time. The key features of the proposed program are described below.

4.1.1 Criteria qualifying firms for an ECS adjustment

There is a potential that using simple criteria (e.g. only claim costs) would capture many firms whose data are not statistically credible, who may have one or two years of poor performance over an extended period. As a result, it is

³ This is because the ER system does not count costs higher than three times the rate group average, to prevent a single year of poor performance from significantly altering a firm's rate. However this means that if a firm with costs that are five times worse than average on an ongoing basis improves to four times worse than average, the ER system will not reflect this.

proposed that multiple criteria be used to identify potential candidates for the added surcharge. The proposed criteria to be captured within the ECS program include:

- the firm is active;
- the firm's claim cost to payroll ratio, as calculated under the ER program, has exceeded that of its rate group by three times or more for three consecutive years;
- the firm has a calculated ER surcharge adjustment of 90 percent or more; and,
- the firm has had 50 or more non-health care only claims in five years.

Using these criteria would allow the WCB to select firms that the ER system cannot properly rate, due to their significantly high costs over time. The use of the 90 percent surcharge criterion would only qualify firms with sustained high costs over an extended period, as it generally takes several years to reach such a high surcharge. Estimates provide that fewer than ten firms would qualify under these criteria for entry into the ECS program in the 2008 rate year.

4.1.2 The ECS surcharge calculation

Once a firm is captured within the ECS program, each year the WCB would calculate the firm's "required rate". The required rate would be used to calculate the amount of a firm's surcharge under the program. The key features of the required rate are as follows:

- As with costs used under the ER program, the required rate would not include costs of occupational diseases with latency periods of two or more years.
- Unlike the ER program, the required rate (and the resulting charged rate) would not be subject to mid-year recalculations; any cost relief or payroll changes that are processed during the year would be carried forward as part of the next year's required rate calculation, changing the next year's required rate.
- In the first year, the required rate would reflect the firm's cost history over an extended period (up to 15 years). The WCB's actuary advises that an extended period should be used to calculate the required rate to ensure that the WCB is rating the firm fairly, and not basing the rate on short-term data that may be subject to fluctuation.
- After the first year in the program, the required rate would reflect a rate calculated over a rolling extended period of up to 15 years (the "extended period rate"), or a rate reflecting a rolling five-year period blended with the extended period rate, but only if the five-year rate is lower than the extended period rate. The weighting of the extended period rate and the five-year rate to determine the required rate would be set in practice, with the extended period rate counting for 80 percent of the required rate and the five-year rate counting for 20 percent. This would maintain the

statistical credibility of the required rate, yet still allow a firm to improve its required rate (and pay lower premiums) by improving cost performance while participating in the program.

- The required rate would be capped at 500 percent of a firm's yearly-established classification base rate. This would limit the possibility of self-insurance (i.e. a firm directly paying its costs) for a firm with a cost rate over five times its base rate.

A firm would be stepped towards the required rate over four years, and would reach that rate in the fifth year of participating in the program. The progression toward the annually recalculated required rate would function as follows:

	(A) Starting Rate	(B) Yearly- calculated Required Rate	(C) ECS Calculation	(D) ECS-adjusted Net Rate Calculation for Year
Year 1	Firm's net rate from the prior year as calculated under the ER system	Required rate for Year 1	$\frac{(B) - (A)}{5}$	(A) + (C)
Year 2	ECS-adjusted net rate from prior year	Required rate for Year 2	$\frac{(B) - (A)}{4}$	(A) + (C)
Year 3	ECS-adjusted net rate from prior year	Required rate for Year 3	$\frac{(B) - (A)}{3}$	(A) + (C)
Year 4	ECS-adjusted net rate from prior year	Required rate for Year 4	$\frac{(B) - (A)}{2}$	(A) + (C)
Year 5 (and subsequent years)	ECS-adjusted net rate from prior year	Required rate for Year 5	$\frac{(B) - (A)}{1}$	(A) + (C) (equals the yearly calculated required rate)

In the fifth year, and subsequent years, the firm will pay at the annually recalculated required rate. A firm can exit the ECS program when it meets the criteria to do so.

4.1.3 Criteria allowing firms to exit the ECS program

Under the proposed ECS program, a firm may exit the program when, for two consecutive years:

- The firm's surcharge as calculated under the ER system is below 90 percent; or,
- The firm's claim cost to payroll ratio, as calculated by the WCB within the three-year ER window, is less than three times that of its rate group.

Using these criteria would mean that a firm would remain within the ECS program for a minimum of two years.

4.2 The Construction ER Program

The WCB's Construction Industry ER Program limits the application of the ER system to construction industry firms, so that the maximum discount or surcharge available in that industry is 33.3 percent. This program is scheduled for review by the end of 2010.

Since the proposed ECS program would adjust the maximum surcharge that the WCB may apply to a firm, the question arises as to whether the ECS program should apply to construction firms. At present, there are no construction industry firms that would have an ER surcharge above 90 percent, even if the caps were not in place. However, this may not be the case by 2010, and the application of the proposed ECS program to construction firms could be considered as part of the 2010 review of the Construction Industry ER Program.

4.3 Other WCB Programs for Firms with High Costs

It is worth noting that firms showing high cost trends may also be subject to increased occupational health and safety attention from the WCB, including strategies such as account manager involvement, the Focus Firm initiative, and the Focus on Safety program. In the last four years, all five firms used as examples in the table in section 3.2 above have had orders written, and three have been focus firms. The ECS program would provide firms with increased motivation to participate in the safety and return to work programs offered by the WCB.

5. OTHER JURISDICTIONS

The WCB reviewed the experience of other workers' compensation jurisdictions concerning firms with high costs. Four other jurisdictions have surcharges that are somewhat comparable with those considered for the ECS.

Alberta currently has a Poor Performance Surcharge for large employers who have had the maximum surcharge for their size for two or more consecutive years and four or more claims used in experience rating for two or more consecutive periods. Currently the surcharge can be up to 40 percent (meaning an employer could pay 80 percent more than their industry premium rate). In 2006 the Alberta Board decided to raise the maximum surcharge amount to 200 percent, effective January 1, 2008.

Under their experience rating programs, Manitoba and Saskatchewan provide for a maximum surcharge/risk category of 200 percent, reflecting the maximum amount provided under the poor performance surcharge for Alberta. This could also be done in British Columbia. However, simply doubling the current surcharge limit in British Columbia would not address the imbalance created by certain firms under consideration for the ECS program, as their costs are significantly in excess of 200 percent of base rate.

In 2008, Nova Scotia will introduce its Poor Safety Performance Surcharge for companies whose cost experience is consistently at least three times worse than their peers' average. This surcharge is cumulative and does not apply until an employer consistently shows poor experience over at least four consecutive Experience Rating Statements. The maximum surcharge possible under this program would reflect the firm's actual cost experience percentage, or the amount the firm's costs exceed those of its rate group's. Qualifying firms will be stepped to this level in increments of 20 percent of the rate group's base rate. Firms were provided over two years' notice before the commencement of this program.

6. OPTIONS AND IMPLICATIONS

Option 1: Status quo

Under this option, no changes would be made to the current ER system.

Implications

- Certain firms would continue to have their significantly high claim costs subsidized by their competitors on an ongoing basis.

Option 2: Adopt an Excess Cost Surcharge Program

Under this option, the WCB would adopt an ECS program as described in this paper, for the 2009 rate year. Under the proposed program, participating firms would be charged rates that more closely reflect their costs.

Draft policy reflecting this option is attached as Appendix A.

Implications

- Firms with significantly high claim costs would have their high costs less subsidized by their competitors.
- These firms would be provided with increased financial incentives to reduce their costs by improving their occupational health and safety and return to work practices.

7. CONSULTATION

Stakeholders are invited to provide feedback on the discussion paper, options, draft policy, and any additional comments that may be relevant to the issue.

Stakeholder comments will be accepted until **November 9, 2007**. When responding, please provide your name, organization, and address. Comments may be sent by mail, fax or e-mail to:

By mail: Cameron Angus
Senior Policy Analyst
Policy and Research Division
WorkSafeBC
P.O. Box 5350, Stn. Terminal
Vancouver, B.C. V6B 5L5

By fax: 604 279-7599

By e-mail: policy@worksafebc.com

WorkSafeBC's governing body, the Board of Directors, will consider the options expressed by stakeholders before it adopts any amendments to the current policies.

Please note that all comments become part of the Policy and Research Division's database and may be published, including the identity of organizations and those participating on behalf of organizations. The identity of those who have participated on their own behalf will be kept confidential according to the provisions of the *Freedom of Information and Protection of Privacy Act*.

**APPENDIX A
DRAFT ASSESSMENT MANUAL POLICY
REFLECTING AN EXCESS COST SURCHARGE**



WORKING TO MAKE A DIFFERENCE

ASSESSMENT MANUAL

RE: Experience Rating

ITEM: AP1-42-1

BACKGROUND

1. Explanatory Notes

Experience rating is a means of adjusting individual employers' assessment rates to reflect their actual claims cost experience. Employers whose experience is better than their rate group average receive a discount. Employers whose experience is worse than their rate group average pay a surcharge.

The experience rating program attempts to promote positive safety attitudes and to provide equity through a system of recognition and accountability for claims costs. The goal is to encourage employers with high injury costs to reduce them, and to encourage employers with low injury costs to keep them low. The desired outcome is a reduction in the social and economic costs of work-related injuries and diseases.

2. The Act

Section 42:

The Board must establish subclassifications, differentials and proportions in the rates as between the different kinds of employment in the same class as may be considered just; and where the Board thinks a particular industry or plant is shown to be so circumstanced or conducted that the hazard or cost of compensation differs from the average of the class or subclass to which the industry or plant is assigned, the Board must confer or impose on that industry or plant a special rate, differential or assessment to correspond with the relative hazard or cost of compensation of that industry or plant, and for that purpose may also adopt a system of experience rating.

POLICY

(a) The Experience Rating Plan

Effective January 1, 2000, a new experience rating ("ER") plan took effect. The main features of the plan are:

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- (1) The ~~same~~ ER plan applies to all employers and independent operators in rateable classes.
- (2) The ER plan is prospective in application. ER adjustments are calculated on the basis of past claims costs and payroll and are applied to employers' assessments. Thus, a firm's experience is a measure of a firm's performance relative to its rate group based on information derived by the Board from appropriate past claims costs and payroll.
- (3) ER adjustments are based solely on claims costs. The costs used are those directly associated with compensation claims, including the capitalized value of pensions awarded. The cost used for fatal claims is the five-year moving Board-wide average rather than the actual cost of each claim.
- (4) The Board's administrative costs are not included in the ER calculation.
- (5) The ER plan uses claims costs arising from claims commenced in the three calendar years prior to the year in which the calculation is made (the "ER Window"). This includes all costs of those claims up to and including June 30th of the year of calculation.
- (6) The costs included are subject to maximum limits for each claim as follows:
 - 100% of the first \$70,000;
 - 50% of the next \$50,000; and
 - 10% of all costs above \$120,000.
- (7) An employer's cost to assessable payroll ratio is compared to the cost to assessable payroll ratio of the rate group to which the employer is assigned.
- (8) The payroll used is the total assessable payroll used to calculate employers' assessments in the ER Window. This amount excludes earnings above the maximum wage, and includes Personal Optional Protection amounts.

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- (9) In determining the cost to assessable payroll ratio in the ER Window, the most recent year is weighted at 50%, the prior year at 33.3%, and the most distant year at 16.7%.
- (10) The calculation involves combining an employer's cost experience in the ER window with its ER factor for the previous year. The ER factor reflects the fact that employers participate at different levels, based on the size of the employer's assessment before the ER adjustment. The higher an employer's base assessment, the higher its level of participation in the plan. A higher level of participation means an employer's ER adjustment is more responsive to its claims costs experience in the current ER window.
- (11) The minimum participation level is set at 10%.
- (12) The maximum ER discount is 50%. The maximum ER surcharge is 100%, **except where the excess cost surcharge applies.**
- (13) Employers enter the plan for the first time when they have had some payroll within the current ER window.
- (14) Where any part of an employer's payroll has been estimated, any resulting discount will not be applied. If a surcharge results, it will be applied. If an estimate is replaced by the actual payroll information, the experience rating will be recalculated.
- (15) The employer for experience rating purposes is the legal entity operating the business. If an employer operates divisions, whether they are separately registered with the Board or not, the employer's combined experience determines the rating for all the employer's operations.
- (16) Employers registered voluntarily under sections 3(5) to (7) of the *Act* or by a variance from a general exemption order under section 2(1) of the *Act* are excluded from participating in the experience rating plan.
- (17) For simplicity, ER discounts or surcharges are generally expressed as percentage adjustments to employers' base assessment rates.

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(b) The Excess Cost Surcharge

The Board may apply an excess cost surcharge in addition to the maximum ER surcharge, where:

- a firm is active and its claim cost to payroll ratio, as calculated by the Board within the ER window, has exceeded that of its rate group by three times or more for three consecutive years; and
- the firm has a calculated ER surcharge adjustment of 90 percent or more; and,
- the firm has had 50 or more non-health care only claims in five years.

Where a firm qualifies for an excess cost surcharge, the Board will determine a required rate for the firm, to enable the calculation of the firm's excess cost surcharge. The required rate will be set annually based on the following:

- (i) In the first year a firm enters the excess cost surcharge program, the Board will determine the required rate using claims costs arising from claims commenced in a period of up to 15 calendar years prior to the year in which the calculation is made.
- (ii) After the first year in the program, the required rate will be the lower of:
 - a rate set as described in (i), above; or
 - a rate set using a weighting determined by the Board that blends a rate using claims costs arising from claims commenced in the five years prior to the year in which the calculation is made, with a rate set as described in (i), above, where the five-year rate is lower than the rate set as described in (i).
- (iii) The required rate is not subject to recalculation based on changed information after the initial determination; any cost relief decisions or payroll changes that are processed during the year will be carried forward as part of the next year's required rate calculation.
- (iv) The required rate is capped at 500 percent of a firm's yearly-established classification base rate.

While participating in the excess cost surcharge program, a firm is stepped toward the required rate over four years, and will be charged premiums at the required rate in the fifth and subsequent years of participation. The progression toward the required rate functions as follows:

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Year 3	ECS-adjusted net rate from prior year	Required rate for Year 3	$\frac{(B) - (A)}{3}$	(A) + (C)
Year 4	ECS-adjusted net rate from prior year	Required rate for Year 4	$\frac{(B) - (A)}{2}$	(A) + (C)
Year 5 (and subsequent years)	ECS-adjusted net rate from prior year	Required rate for Year 5	$\frac{(B) - (A)}{1}$	(A) + (C) (equals the yearly calculated required rate)

A firm will exit the excess cost surcharge program when, for two consecutive years:

- the firm's ER surcharge as calculated under the conventional ER system is below 90 percent; or,
- the firm's claim cost to payroll ratio, as calculated by the Board within the three-year experience rating window, is less than three times that of its rate group.

PRACTICE

Further information on the experience rating system can be found on the WCB WorkSafeBC website at http://www.worksafebc.com/for_employers/premiums/experience_rating/default.asp.

For any other relevant PRACTICE information, readers should consult the Practice Directives available on the WCB website.

EFFECTIVE DATE: June 1, 2005
AUTHORITY: s. 42, *Workers Compensation Act*.

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- CROSS REFERENCES:** See also Requesting a Variance from a General Exemption (AP1-2-2), Personal Optional Protection (AP1-2-3), Extending the Application of the *Act* (AP1-3-1) with regard to sections 3(5) to 3(7) of the *Act*, Classification – Changes (AP1-37-3), Registration of Employers (AP1-38-1), Payroll Estimates (AP1-38-5), Maximum Wage Rate (AP1-38-6), ER Cost Inclusions/Exclusions (AP1-42-2) and Transfer of Experience Between Firms (AP1-42-3) in the *Assessment Manual*.
- HISTORY:** Updated to define “experience” effective June 1, 2005. Replaces Policies No. 30:50:10 and 30:50:41 of the *Assessment Policy Manual* and Decision No. 401 in Volumes 1 - 6 of the *Workers’ Compensation Reporter*. This Item results from the 2002 “editorial” consolidation of all assessment policies into the *Assessment Manual*. The POLICY in this Item continues the substantive requirements of the policies and items referred to in the HISTORY as they existed prior to the Effective Date, with any wording changes necessary to reflect legislative and other changes since the policies and items referred to in the HISTORY were issued.
- APPLICATION:** ~~The amended policy applies to all decisions made on or after June 1, 2005.~~