

CLASSIFICATION AND EXPERIENCE RATING

A BRIEFING PAPER

INTRODUCTION

This is one of several briefing papers the Policy and Regulation Development Bureau is preparing on topics which may fall within the terms of reference of the Royal Commission.¹ This paper addresses issues relating to the WCB's classification system and its Experience Rated Assessment (ERA) plan.

BACKGROUND

The *Workers Compensation Act* establishes a "modified collective liability" system whereby employers as a whole are responsible for the benefit payments and administrative costs of the system. Employers' "collectively liability" is modified by grouping employers into classes and subclasses. An assessment rate is established for each subclass on the basis of the subclass cost experience. The assessment rate is an amount per \$100.00 of assessable payroll. Assessment rates are approved by the Board of Governors² and published annually in the *Classification and Rate List*.

The WCB maintains its classification system under the authority of sections 36, 37, and 42 of the *Workers Compensation Act*. Section 36 sets out the classes of industries. Section 37 gives the Board authority to create new classes and rearrange existing classes. Section 42 gives the Board authority to establish subclassifications and to adopt a system of experience rating. Under the *Act*, the Board has broad discretion to substantially alter its existing classification system, or adopt a new one.

¹ The purpose of these papers is to give background information that will orient the Commission or others to some major issues. The Board does not expect the Commission to make decisions on the basis of these documents. Rather, the Commission will make its own inquiries.

The papers do not pretend to cover all the issues that the Commission or others might raise. The general nature of the papers also means that they cannot include detailed discussion of all the issues. There may be relevant factors that are omitted with regard to some issues. The explanations of some matters may be less than would be desired if the issues were being considered for decision.

The papers refer to sources of additional information where known. There has been no attempt to exhaustively research all the issues. The papers do not include recommendations for resolving issues, or take a position with respect to them. They may discuss known alternatives, particularly when other jurisdictions have adopted them.

² The powers of the Board of Governors are currently carried out by a three member Panel of Administrators.

The WCB's Assessment Department is responsible for assigning employers to the appropriate subclass. A staff committee chaired by the Vice-President of Finance meets regularly to make decisions on difficult classification matters.³

The Experience Rated Assessment (ERA) plan allows the rates of individual employers within a subclass to be further modified in accordance with the employer's own claims cost experience. These modifications are made in the form of merits and demerits based on the employer's claims cost experience relative to the experience of the subclass as a whole.

The maximum merit and demerit is 33.3%.⁴ That is, employers can be assessed one third less or one third more than the average rate for their sub-class, depending on their own claims cost experience.

History

The present system has its roots in the recommendations of Sir William Meredith. Meredith recommended that employers in each industrial group be collectively liable for the payment of compensation, and that the Board be empowered:

...in determining the proportions of the contribution to be made to the accident fund to have regard to the hazard of each industry, and to fix the proportions of the assessment to be borne by the employer accordingly, and not to require that the proportions for each class or sub-class be uniform; and also to permit the Board, if in its opinion the character of any class of industry justifies that being done, to require a larger contribution to the reserve fund by the employers in any such class than is required from employer in other classes.⁵

In his 1916 *Report of the Committee of Investigation on Workmen's Compensation Laws*, Avard Pineo recommended that industries should be grouped into about 10 classes, and that express provisions should be made in the *Act* that "...the Board eventually establish an individual or merit rating system based on the comparative hazard and accident experience of the individual plants."⁶

³ The classification committee minutes, dating back to 1975, are available through the WCB library.

⁴ For firms that participate at the 100% level. For detailed information about participation rates see Appendices A & B.

⁵ Sir William Meredith, *Final Report on Laws relating to the liability of employers to make compensation to their employees for injuries received in the course of their employment which are in force in other countries, and as to how far such laws are found to work satisfactorily*, p.17.

⁶ Avard V. Pineo, *Report of the Committee of Investigation on Workmen's Compensation Laws*, (Victoria BC: King's Printer, 1916) p. 15.

The original 1917 *Workmen's Compensation Act* provided for 12 separate classes of employers,⁷ and provided the Board with the authority to consolidate, rearrange or create new classes, or transfer industries between classes.⁸

In 1932, a provision was added to the *Act* which gave the Board the power to establish "sub-classification, differentials, and proportions in the rates" within classes as the Board deemed just. This provision included the power to:

"...confer or impose upon that industry or plant a special rate, differential, or assessment to correspond with the relative accident cost or hazard of that industry or plant; and for that purpose may adopt a system of experience rating or schedule rating, or a combination of those systems..."⁹

Initially, a limited program of experience rating was applied only to the forest industry, which was the largest contributor to the Accident Fund at the time.

In 1942, a Royal Commission into the WCB was held by Chief Justice Sloan. The Report of this Commission noted the request of the BC Loggers' Association for greater financial reward for undertaking education and accident prevention programs.¹⁰ The Association requested subclasses be created which would have different ratings reflecting the results of their safety initiatives. Chief Justice Sloan concluded:

I favour permitting the British Columbia Loggers' Association a fair trial of their proposed plan...If successful in reducing the accident rate in their own group, then it seems reasonable they should be rewarded by lower assessments in that group. If unsuccessful, the associated companies will, at least, be losing their own money in the gamble.¹¹

In 1952, a second Royal Commission was held by Chief Justice Sloan. The Report on this Commission contained extensive discussion of experience rating. The Report noted that experience rating had been applied to the forestry industry in 1951. In response to a request from the BC Loggers' Association for an increase in the maximum merits, Chief Justice Sloan stated:

I am frank to say I have been unable to reach any satisfactory conclusion on the request from the B.C. Loggers' Association. I have found this merit-rating system a difficult, intricate, and perplexing business with which to grapple.

⁷ Section 25.

⁸ Section 26.

⁹ Gordon McGregor Sloan, *Report of the Commissioner Relating to the Workmen's Compensation Board*. (Victoria, BC: King's Printer 1942) p.176.

¹⁰ *Ibid.*, p. 179.

¹¹ *Ibid.*, p. 181.

This province, unlike any other Canadian Province, has at least formulated a workable and apparently practicable scheme. I do not feel I should attempt to tinker with it.¹²

The Report also set out the advantages and disadvantages of implementing an experience rating plan, noting:

The principal advantage is that by showing a reduction in the assessment rate it presents to the employers in a concrete form the known amount of premium saved through the reduction of accidents and thereby encourages accident-prevention measures...¹³

Some of the disadvantages discussed by Chief Justice Sloan were that the experience rating plan:

- was a qualification of the collective liability principle;
- placed a premium on bad fortune experienced by carefully conducted operations;
- could not be successfully applied to small employers;
- may be inequitable in some types of industries;
- tended to militate against the employment of workers with a disability; and
- provided for merits which considerably exceeded demerits and therefore could cause an increase in the base rate.¹⁴

He noted:

It should not be forgotten that “collective liability” is the principle upon which our workmen’s compensation laws are based, and that rates are set to cover the “cost” in so far as the group is concerned and to cover the “risk” in so far as the individual firm is concerned.¹⁵

Chief Justice Sloan also cited with approval the following comments of Mr. Justice Middleton who had conducted an inquiry in Ontario:

Great care would have to be taken in the application of any merit-rating system because the whole principle of collective liability is based on the doctrine of average. It is not enough that for a year, or even a short series of years, a particular factory escapes having any serious accident. The whole principle is that the fortunate must bear some portion of the burden of the unfortunate.¹⁶

¹² Gordon McGregor Sloan, *Report of the Commissioner Relating to The Workmen’s Compensation Act and Board*. (Victoria, BC: Queen’s Printer, 1952) p.187.

¹³ *Ibid.*, p. 183.

¹⁴ *Ibid.*, p. 184.

¹⁵ *Ibid.*, p. 184.

¹⁶ *Ibid.*, p. 185.

Following the Sloan Commission, in 1957, the logging industry secured its own experience rating plan, separate from the rest of the forest industry as a whole. In 1960, an additional experience rating plan was implemented for the construction industry.

By the time of the Tysoe Royal Commission in 1966, there were three types of experience rating plans: one for the forest industry excluding those engaged in logging; one for that portion of the forestry industry engaged in logging; and one for the construction industry. Each plan had different elements designed to respond to the characteristics and needs of the industry.

Mr. Justice Tysoe noted the construction industry's plan had been implemented despite the fact that the 1952 Sloan Report had cited the construction industry as one in which an experience rating plan would be difficult and inappropriate.¹⁷

Mr. Justice Tysoe noted that the classes set out in section 30 of the *Act* had been divided into subclasses. He noted the designation of subclasses was principally to provide a more exact classification of industries according to risk.

In response to concerns about misclassification of individual employers, Mr. Justice Tysoe supported the Board's assertion that classification of employers was carefully and sincerely done. He cited with approval the Board's explanation of how employers could become concerned through a misunderstanding as to the nature and purpose of the workers' compensation system:

I would like to stress here that because an employer has no accident cost, or only very little accident cost, it does not follow that he may be improperly classified. In workmen's compensation, as in any other form of insurance, some must pay more in premiums than the carrier pays out in claims, in order to offset those whose claims cost is greater than their premiums. A good illustration of this point came out a month or so ago, in connection with an employer engaged in the manufacture of adhesives. We had to raise the rate in that industry for the year 1964, and he was quite concerned about the fact that the rate had gone up, and wrote to us on it. He pointed out that he had been in business for four years. He had paid us \$195 and we had only paid out \$18 in claim costs, and he felt that he had been severely treated. I pointed out to him that one of the reasons for increasing the rate in adhesive-manufacturing was because we had had an accident costing \$18,000 in that industry...I think it is quite obvious that in an industry of that nature there must be many employers who pay \$195 against \$18 in order to make up the difference for us to have the money to pay that one severe claim that does turn up at odd intervals...I think if we had been talking about automobile insurance, he would have

¹⁷ Charles W. Tysoe, *Commission of Inquiry, Workmen's Compensation Act: Report of the Commissioner*. (Victoria, BC: Queen's Printer, 1966) p.99.

seen it without question, but because it was the workmen's compensation, he didn't relate it as being the same form of casualty insurance.¹⁸

Mr. Justice Tysoe noted the only stated advantage of experience rating was the effect it may have on encouraging safe practices or discouraging unsafe ones. He then quoted the Chief Assessment Officer of the Board as stating even this alleged advantage was more apparent than real. The Officer suggested, however, that other parts of the Board might not share his view.

The disadvantages of experience rating noted by Mr. Justice Tysoe echoed those expressed by Chief Justice Sloan in 1952, with the additional point that in the current plans there is "...too great a lapse of time between the conduct and the reward or punishment, and hence the sole purpose of the plan tends to be defeated."¹⁹

Mr. Justice Tysoe also noted the statements of Prof. C. A. Kulp who described the limitations on the use of experience rating as follows:

...a rate may be expected to encourage the reduction of loss. Sound insurance principle requires, however, that this objective be kept clearly secondary to those of equity and adequacy. Insurance after all is a device to pool risk and share losses...the condition definitely limits the role of the rate as a safety incentive. When safety is made the main end of the rate structure, this end, as in workmen's compensation schedule rating, may indeed be achieved but at the price of so great a failure in rate equity that (with rare exceptions) it has had to be abandoned. On the other hand, if the safety objective is kept subordinate to these other objectives, the effectiveness of the safety incentive is greatly restricted. This is because the amounts of reward and penalty that can fairly and safely be offered the insured will not be large enough to influence his attitude toward his risk.²⁰

Mr. Justice Tysoe concluded that if merit (experience) rating and the consequent departure from the principles of collective liability is warranted, "...then it is obvious that the degree of departure must be controlled, and there must come a time when some authority must say 'thus far and no further' if the whole foundation of the scheme is not to be eroded."²¹

Recent Reviews of the System

¹⁸ *Ibid.*, p. 98.

¹⁹ *Ibid.*, p. 108.

²⁰ C.A. Kulp, "The Rate-make Process in Property and Casualty Insurance -- Goals, Technics, and Limits," *Law and Contemporary Problems*, Autumn 1950, pp. 494-495. Somers and Somers, "Workmen's Compensation," John Wiley & Sons, Inc., N.Y., 1954, p.229 cited in *op cit.*, Tysoe, p. 110.

²¹ *Op cit.*, Tysoe p. 110.

In 1986, the WCB introduced a single universal experience rating plan. The plan replaced the different plans that had applied to forestry, logging, and construction. It applied to all classes, except deposit classes.

In 1992, the W.E. Upjohn Institute for Employment Research conducted an Administrative Inventory of the Board's Assessment Department. Two of the attention points in the final report of this Inventory were "classification problems" and "ERA program".

With respect to classification, the Inventory concluded:

To provide a firm foundation for classification policy, a review of the adequacy of the current classification system is needed. There has been no public consideration of the appropriateness of the entire classification system in British Columbia for many years. Such a study is needed to further enhance the public credibility of the assessment system.²²

With respect to experience rating, the Inventory concluded while the experience rating plan appeared to focus employer attention on safety and injury prevention, a study should be pursued by the WCB to determine the actual impacts of the plan.²³

In 1995, a follow up Administrative Inventory was conducted by the W.E. Upjohn Institute. This Inventory also included a review of the classification system and experience rating plan.

The comments in this Inventory with respect to classification centered on the continuing need for a re-examination of the sub-class structure.

The comments with respect to experience rating noted it continued to be a controversial subject. The authors referred to the lack of evaluation of ERA programs generally, noting that in Canada, only the Ontario plan had been comprehensively evaluated. The Inventory suggested:

Perhaps the new WCB study of the ERA program currently underway will promote a more productive dialogue about the policy design issues of experience rating, it is overdue.²⁴

²² H. Allan Hunt, *Workers' Compensation Board of British Columbia: Assessment Department Administrative Inventory*, (Kalamazoo, MI: W. E. Upjohn Institute for Employment Research, 1996) p. xviii.

²³ *Ibid.*, p. xix.

²⁴ H. Allan Hunt, Peter S. Barth & Michael J. Leahy, *Workers' Compensation System of British Columbia: Still in Transition*, (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1996), p. 260.

The WCB study referred to in the Inventory was conducted by the Board's Internal Audit and Evaluation department in 1994 and 1995.²⁵ The study was designed to evaluate ERA to determine how well it was meeting its stated objectives.

The evaluation outcomes, findings and conclusions of this study were folded into the Employer Services Strategy (ESS) project which was initiated by the Finance Division in 1996. With respect to this project, the 1996 Strategic Plan stated:

Employers and workers have indicated that the assessment, classification and the related experience rating program have significant flaws. Our own internal analysis has confirmed that within the classification system there exists anomalous situations in which cross subsidization exists among some employers. Subclasses may exist (such as the Retail subclass) where the assessment rates do not reflect a fair cost to some employers. When the situation exists, the current experience rating system which limits merit or demerit to a maximum of 33% only serves to exaggerate the unfairness.

In order to address this, the Board will commence a broad employer services project to deal with these issues. It will also consider other service and assessment features to make the system more understandable and effective in assigning costs to employers on a more equitable basis.

The Board will conduct a review of the performance of subclasses to identify anomalies mentioned above as the first step. This project will also address the concepts of hazard and risk, classification by employer size, caps on rate increases/decreases and on ERA, relief of costs and alternatives to the current ERA system.²⁶

While initially intended to address both classification and ERA issues, the focus of the ESS project is now the classification system and Assessment Department business processes.

²⁵ Workers' Compensation Board of BC, *Experience Rated Assessment (ERA) Evaluation Study*, (Richmond BC: Internal Audit & Evaluation, 1995).

²⁶ Workers' Compensation Board of BC, *Transforming the Workers' Compensation Board of British Columbia: A Strategic Plan* (Richmond, BC: 1996) p. 21.

DISCUSSION

A. CLASSIFICATION ISSUES

1. Principles of Classification

A discussion paper entitled "Classification - Conceptual Review", issued by the Workers' Compensation Commission of Newfoundland and Labrador in 1990, identified four operating principles of a sound workers' compensation classification system.

The principles²⁷ identified were:

actuarial soundness: This means the information upon which the classification process is based should be complete and reliable (i.e., statistically credible); and the classification structure should be efficient in generating sufficient revenue to meet expenses within the rate group.

rate stability: The rate group should be large enough so that a stable and reasonably accurate premium can be established based on reliable prediction about the frequency and severity of the group's accidents. The group should also be large enough to absorb the cost of unusually large claims without generating large fluctuations in the assessment rates.

consistency: The classification system should ensure consistency in classifying employers through clear and comprehensive guidelines, and rules for classification. The classification system should not create competitive advantage between competing employers.

administrative efficiency: The system should allow for an administratively efficient and open process of classification which takes into account the resource and knowledge demands of an ongoing, high volume process of classifying and updating. Administrative efficiency also requires the classification process be accepted and understood by employers.

Broadly speaking, the classification issues which have arisen in BC stem from a failure, or a perceived failure, of the current system in terms of adherence to these principles. More specific classification issues are discussed below.

2. Specific Classification Issues

²⁷ Some or all of these principles have also been discussed in other studies, including a study conducted by The Wyatt Company Consultants and Actuaries for the New Brunswick Board; a 1991 decision of the Newfoundland and Labrador WCAT (Case number 90024); and a 1990 Consultation Document published by the Workers' Compensation Board of Ontario, entitled "Revenue Strategy: The New Classification and Pricing System". The explanations provided in this paper are the result of a review of these discussions, and of the principles articulated in the WCB's *Assessment Policy Manual*.

2.1 Subclass Structure and Performance

Currently, BC has 69 rate groups, which is fewer than the other large Canadian provinces: Quebec has 319 rate groups, Ontario has 219, and Alberta has 119.

The limited number of rate groups in BC, along with a lack of ongoing systematic review of individual classifications and sub-class structure, has led to performance problems within individual subclasses. On this issue the 1992 Inventory noted:

...employer representatives maintain that there are whole industries where everyone is at maximum merit or demerit, because of inappropriate sub-class construction. This is the inescapable consequence of a sub-class structure that includes a limited number of classifications to accommodate hundreds of different industries. These problems could also be addressed through a review and public discussion of the WCB classification system...The outcome should provide greater perceived equity and stakeholder commitment to the WCB assessment system.²⁸

The 1995 Inventory similarly focused on problems created by the current sub-class structure:

The recent furor over reorganization of class 621, Retail Stores²⁹ provides an object lesson in the damage an inappropriate classification structure for rate-making can do. The fact that one identifiable group of employers was responsible for virtually all the sub-class deficit is a clear demonstration that there was something wrong with the sub-class. Further, the combination of limited experience rating and annual swing limits at the sub-class level prevented the system from being able to correct itself. Reclassifying more frequently and in smaller pieces is much less painful than all at once. There are probably several other sub-classes that have similar, though smaller, problems. Further, the new program of round table discussions with 'troubled' industries that has been implemented by the WCB should surface these problems earlier and in a more appropriate environment. However, it would also be appropriate for the WCB to increase its vigilance for sub-class problems and for classification inequities, in the long-term interest of the perceived sub-classes are in surplus by more than one years' assessment revenues should motivate a re-examination of sub-class structure.³⁰

The subclass situation has not improved since the Inventory was conducted. At the end of 1996, there were 31 subclasses in deficit. The most distressed include

²⁸ *Op cit.*, Assessment Department Administrative Inventory, p. 65.

²⁹ See Appeal Division decision #96-0333 (12 WCR 29) for a discussion of the restructuring of 0621 and an interpretation of the Board's obligations under section 42.

³⁰ *Op cit.*, *Still in Transition*, p. 259.

shipbuilding, general retail stores, coal mining, fishing, pulp and paper, and heavy construction. In all, 19 subclasses were less than 85% funded, with a total deficit of \$172 million.³¹

As a starting point for re-designing BC's system, a survey of classification systems in other Canadian jurisdictions was conducted by Nexus Actuarial Consultants on behalf of the WCB in 1996. The survey consisted of a questionnaire which was completed by each jurisdiction. The results of the survey were then analyzed to identify trends, common issues, and possible solutions.

The survey found that historically, most Canadian jurisdictions used "end product" or "predominant industry" as the basis for classification. BC's classification system has been referred to as "a hybrid of an 'end product' and a 'predominant industry' classification system."³²

One of the purposes of classification is to group employers with like hazards or risks together. There are a variety of methods which can be employed to achieve this end, including:

- **Classification by predominant industry:** This system classifies according to the predominant industry of the employer. The industry of the employer encompasses all work incidental, supportive and ancillary to the production of goods and services.
- **Classification by end-product:** This system classifies employers on the basis of the products or services provided.
- **Classification by occupation:** This system focuses on classification of employers by the occupation of its workers.
- **Classification by business activity:** This system groups employers with similar business activities together.

On its face, the distinctions between the different systems is not clear. Employers with similar "business activities" are also likely to have the same "end product", and be engaged in the same "industry". The significant differences appear to lie less in the factors used to classify employers, and more in the interpretation and implementation of the various types of systems. For example, classification by "business activity" has generally been interpreted to allow for more rate groups and consequently more flexibility in the classification of employer activities, than has classification by "end product" or "predominant industry".

The WCB survey identified a general trend towards "business activity" classification. In 1996, eight Canadian jurisdictions used "business activity" as the basis for their classification system, compared to four in 1992.³³ The jurisdictions that have

³¹ The Board has begun monitoring subclass performance to identify subclasses which are experiencing difficulties. For more information on these initiatives see discussion at page 13 below.

³² *Survey of Canadian Workers' Compensation Jurisdictions Final Report* August 8, 1996 (Nexus Actuarial Consultants Ltd.).

³³ *Ibid.*, p. 7.

established a “business activity” classification system have based their systems on Statistics Canada’s Standard Industrial Classification (SIC) system.

The SIC system was designed to gather financial and statistical data on industrial output (goods and services by economic activity). The SIC system has approximately 850 classification units for the basic collection of data. Most Canadian jurisdictions have found that there are too many units for their purposes, and have subsequently modified the SIC system for use as a workers’ compensation classification system.

The survey found that since 1992, Ontario, New Brunswick, PEI, Nova Scotia, and Newfoundland have made major changes to their classification systems. Ontario, New Brunswick and PEI moved to classification by “business activity”, while Newfoundland moved to classification by “primary industrial undertaking”. Nova Scotia has retained a system of classification by “business activity”, but has significantly decreased the number of rate groups to make the system more statistically credible.

The survey found the initial result of a move to classification by “business activity” is a dramatic increase in the number of classification units. However, this initial increase is offset by a significant reduction in the number of classification units in subsequent years.³⁴

The critical success factors for a classification system identified by other Boards included:

- consistency in classification;
- employers classified with competitors;
- ease of classification; and
- a dynamic and responsive system.

The ESS project has developed conceptual foundations for a new classification model. These concepts address the questions of subclass structure and criteria for classification. They also address requirements for insuring the viability of individual rate groups. The preliminary recommendations at the end of the first phase of this project included:

- classifying employers by their outputs into classification units using SIC as a template;
- having a detailed description of each classification unit;
- setting minimum unit sizes for useful statistics and full credibility;
- grouping classification units into industries by families of outputs;
- grouping industries into rate groups by cost rates;
- creating viable rate groups through re-insurance for disasters and catastrophic excess claim costs; and

³⁴ Appendix C provides information about the classification systems used by other Canadian jurisdictions.

- implementing automated classification and restructuring.

The details of these concepts will be developed during Phase II of the ESS project.

In the meantime, the Board is implementing mechanisms to address immediate subclass issues. These mechanisms include what is referred to in the 1996 Strategic Plan as “Industry and Account Management”. The Strategic Plan stated:

...the various industry subclasses will be aggregated into several...major industrial sectors for management purposes. Dedicated management focus will be applied to these sectors in terms of monitoring and scrutiny of injury and cost performance.³⁵

It is anticipated this new focus will enable the Board to better monitor and manage subclass performance until the systemic overhaul of the classification system has been completed, and into the future.

2.2 Multiple Classifications

Historically, all jurisdictions attempted to group an employer’s activities into one industry classification. As business operations became increasingly complex and diversified, and old industries were replaced by new ones, more and more exceptions were created. The result was a breakdown in the classification structure itself, with direct competitors being classified in different industries.

In response, Boards have developed policies allowing employers to have multiple classifications for their business activities.

Rules governing multiple classifications vary across jurisdictions. The 1996 survey found most Canadian jurisdictions require employers to meet the following minimum criteria to be eligible for more than one classification:

- the employer must have more than one business activity as defined by the classification system (and there must not be one classification that covers all of the employer’s activities);
- there must be segregated payroll; and
- there must be no intermingling of workforce between business activities.

Some jurisdictions such as Alberta and Newfoundland also require separate locations for each business activity. Alberta also requires employers to have separate financial statements for each business activity. New Brunswick requires each business activity to have more than 50% of its revenue derived from non-affiliated companies.

³⁵ *Op cit.*, *Strategic Plan*, p. 22.

In BC, the multiple classifications policy is found in item #30:20:20 of the *Assessment Policy Manual*. The policy provides criteria to enable Assessment Department staff to determine whether an employer conducts several business activities within one industry, or whether the employer is engaged in more than one industry, and is therefore subject to the multiple classifications policy. The criteria include:

- the operation must be one which is performed by specific personnel as their sole function;
- the product or service must be offered to the public at large with the intent of producing revenue from sales to non-affiliated companies. The operation must not be an incidental, supportive, inescapable or ancillary part of the firm's main industry; and
- generally, the operation must generate at least 25% of the firm's revenue.

While one of the aims of the multiple classification policy is to avoid inequities between employers, questions have arisen as to whether the current policy adequately addresses situations where certain high cost industrial activities are performed by employers whose primary activity is a relatively low cost industrial activity. Where these activities are found to be incidental or ancillary to the employer's primary activities, the employer receives a lower assessment rate, and therefore an advantage over competitors.

This issue is one which has been identified by the Senior Executive Committee as requiring a policy decision by the Panel of Administrators in the short term. In the longer term, issues relating to multiple classifications will be addressed in the context of re-designing the classification system as a whole.

2.3 Assigning Employer Classifications

In addition to structural questions about BC's classification system, issues have arisen in relation to the appropriate classification of individual employers within the parameters of the current system.

Governors' published policy found in the *Assessment Policy Manual* offers the following general guidelines for classifying employers:

Classifications are assigned to accounts on the basis of the industry in which the employer is operating. In assigning the classification, some of the factors being considered are the type of product or service that is being provided and the type of industry with which the employer is in competition. It is desirable that the assessment classification system not be an economic factor in the way business is conducted in the province.³⁶

The *Manual* also states:

³⁶ *Assessment Policy Manual Number 30:20:10.*

This manual does not contain the specific criteria for putting a firm in a particular classification, because of the immense number and detailed nature of these rules.³⁷

This statement reflects the complex nature of the classification process and the fact it requires in-depth knowledge and expertise. This expertise is found in the Board's Assessment Department, which has responsibility for classifying employers. In addition, a Classification Committee made up of Board staff meets regularly to make decisions on difficult classification matters.

The importance of correct classification is clear once it is appreciated that the assignment of an employer to a sub-class can mean a difference of two or three hundred percent in the annual assessment to be paid by the employer. Ensuring a correct assignment is, however, a difficult and highly complex process.

The 1992 Inventory noted while there was an absence of data with which to estimate the error rate in classification decisions, a few "horror stories" went a long way toward shaking credibility in WCB decision-making. The authors of the Inventory commented that while the problem may be one of perception, the issue must nevertheless be dealt with by the Board.

The Inventory also noted the inherent difficulties in making classification decisions, and questioned whether adequate training was being provided to Assessment Department staff. The authors of the Inventory suggested part of the problem was a lack of information being provided to employers about the classification process. The Inventory stated:

From the author's interaction with individual employers and employer representatives, it must be reported they definitely are not satisfied that classifications are being correctly made. Almost without exception, they called for the process to be more open and available to review. Since employers feel they do not know the system, they cannot make a determination of whether they are being treated equitably.³⁸

The Inventory concluded the Assessment Department needed to make greater efforts to provide information to employers in order to explain its policies and justify its decisions on assessment matters.³⁹

³⁷ *Ibid.*

³⁸ *Op cit., Assessment Department Administrative Inventory*, p. 26.

³⁹ Before 1991, the only recourse for employers who were dissatisfied with their classification or assessment was a review of the decision by the Commissioners. In 1991, amendments to the *Act* made matters related to assessments appealable to the newly constituted Appeal Division. In 1996, 3.5% of matters appealed to the Appeal Division were assessment matters.

The *Assessment Policy Manual* was subsequently revised to include policies and procedures relating to the disclosure of assessment information, based on the provisions of the *Freedom of Information and Protection of Privacy Act*. The Board also changed its policy to make the classification of all employers available as a matter of public record.⁴⁰

The follow up Inventory conducted in 1995 noted significant improvements in employer satisfaction with the Assessment Department's performance:

In our 1995 interviews, we encountered considerable employer resentment about the WCB, but it centered on either the basic adjudication process (Compensation Services Division) or the appellate bodies (especially the Appeal Division), not the Assessment Department. This is a remarkable turnaround in just three short years.⁴¹

They went on to state:

Unfortunately, there are no hard data available to make a credible evaluation of the adequacy of initial classification decisions...It is not possible without a detailed study to determine whether incorrect initial classification or subsequent changes in employer situations are contributing more to the error rate.⁴²

An employer survey completed by the Finance Division in 1995 found 31% or 46,000 employers either don't believe, or don't know if their firm has the proper classification or experience rating.

The current study of the classification system being conducted under the umbrella ESS project has identified a number of barriers to successful classification. These include:

- An inadequate classification manual that fails to explicitly define the business activities included and excluded in the classification group.
- Inadequate centralized control of the classification system.
- Lack of specific information being collected and recorded on all employers at initial registration and review.
- Lack of independent inspection and review of individual employer classification.

As a result, one of the focal points of the ESS project is improved administrative efficiency in making classification decisions. Specifically, the project is seeking to identify ways to make the classification model more accessible to employers by simplifying the classification process, increasing availability of information, and

⁴⁰ More information on disclosure issues will be provided in a forthcoming briefing paper.

⁴¹ *Op cit., Still in Transition* p. 178. The Inventory also noted positive changes in Assessment Department procedure in relation to the disclosure of information.

⁴² *Ibid.*, p. 178.

developing systems which will facilitate and enhance the accuracy of classification decisions.

B. EXPERIENCE RATING

1. The Impact on Assessment Equity and Occupational Health & Safety

The objectives of the Board's ERA plan are set out in item #30:50:41 of the *Assessment Policy Manual*. The objectives are to:

- create an incentive for firms to improve their safety performance thereby reducing worker injuries and lowering claim costs; and
- provide a more equitable system whereby firms with good safety records are rewarded, and firms with poor safety records are penalized.

Questions about whether or not BC's ERA plan is successful in meeting these objectives are longstanding. In 1992, the Inventory of the Assessment Department's activities concluded:

It is this author's opinion that the current WCB Experience Rated Assessment (ERA) program does help to focus additional employer attention on safety and injury prevention, without unduly compromising the principle of collective liability.⁴³

But went on to state:

It is conceded that the ERA program does produce employer "interest" in claims, and that inappropriate claims avoidance behaviors by employers can defeat the goal of fair and effective compensation for injured workers under the Act. A carefully designed, definitive study should be pursued by the WCB to determine the actual impacts of the ERA program.⁴⁴

The Inventory suggested immediate improvements could be made by establishing greater linkage between OSH inspections, and ERA merits and demerits. The Inventory suggested an empirical study of movements in merit/demerits and OSH inspection results would reveal whether the current maximum variations provided sufficient incentives to motivate employer behaviour.

In 1995, the Inventory again noted:

Experience rating has been very much more controversial in Canada than in the United States, partly due to the "collective liability" principle. In Canada, *employers as a whole* have the responsibility for paying workers'

⁴³ *Op cit.*, Assessment Department Administrative Inventory, p. 64.

⁴⁴ *Ibid.*, p. 64.

compensation benefits to injured workers, it is a social obligation. The slow development of experience rating in Canada can be traced to labour's philosophical opposition to such schemes. Labour has believed that such programs, especially those based only on monetary payments, create incentives for "claims avoidance" rather than "claims prevention". Nevertheless, employer pressures have mounted for experience rating in Canada and the political system has responded. As a result, the past decade has seen experience rating schemes spread steadily across Canada. However, the details of these plans differ dramatically among jurisdictions, and so do the incentives created.⁴⁵ (emphasis in original)

The 1995 Internal Audit & Evaluation Study noted that the beneficial impact of ERA on prevention depends on how strong, visible, and acceptable the link is between ERA and prevention. The study also pointed out that claims data or claims experience only partly measure the likelihood of accidents occurring in workplaces. The study noted:

The WCB uses claims costs adjusted for assessable payroll as a measure of workplace safety. Concerns have been raised...about the representativeness of this indicator. The less accurate this indicator, the weaker the link between ERA ratings and the incentives provided by the ERA plan to improve workplace safety. Alternative indicators do exist for measuring the likelihood of workplace accidents -- some of which could use WCB Prevention data -- however, these measures may be more difficult and confusing to use.⁴⁶

With respect to ERA's impact on assessment equity, the study concluded:

The ERA plan helps increase the extent to which firms' assessments reflect meaningful differences in claims experiences. It also attempts to ensure that no firm is overburdened by the assessments it pays.

Nonetheless, the calculations used to determine meaningful differences do not work as well for small firms as for large firms. The claims cost experience for small firms tends to be more volatile. In order to account for this and other potential threats to equity, the plan includes design features such as varying levels of participation and maximum merit/demerit limits. Notwithstanding these design features, some employers reportedly are overburdened by the assessments calculated under the ERA plan.⁴⁷

In addition to the impact of ERA on equity and occupational safety and health, the Internal Audit study also noted other impacts, both intended and unintended, including:

⁴⁵ *Op cit.*, *Still in Transition*, p. 215.

⁴⁶ *Ibid.*, p. 14.

⁴⁷ Workers' Compensation Board of BC, *Experience Rated Assessment (ERA) Evaluation Study Document Review* (Richmond, BC: Internal Audit & Evaluation), p. ii.

- the ERA plan requires more administration and is more costly to operate than a base rate assessment plan;
- the ERA plan may create barriers to the efficient performance of claims adjudication and vocational rehabilitation processes; and
- the ERA plan may be negatively impacting some workers by diverting employers' attention from accident prevention to claims suppression/avoidance activities.⁴⁸

This last point echoes the main debate in the literature with respect to experience rating. In Canada, the United States, and internationally, questions continue to be asked about whether or not ERA actually has a positive effect on employer occupational safety and health practices, and consequently on the incidence of workplace injuries.

Francois Vaillancourt, in his 1994 work, *The Financing of Workers' Compensation Boards in Canada, 1960-1990*, reviews the arguments for and against experience rating as follows:⁴⁹

As Chelius and Smith state, "Experience rating [WCB] insurance premiums...serves two social goals. One goal is the appropriate allocation of costs to responsible employers, and the other is the provision of incentives for firms to avoid harm to their workers."⁵⁰ Given these goals, why is experience rating not more widely acclaimed and implemented? The reason is that most observers agree that the favourable impact of experience rating on the frequency and/or severity of accidents has not been conclusively shown. Although some argue that such a plan is likely to have positive results at little cost, others disagree. Let us contrast two voices from the Prairies on this point.

First, the pro side (Alberta):

The assessment system provides equity between industries while encouraging accident reduction. Experience rating is designed to provide equity between employers within an industry and also encourages accident reduction. For the process to be fair, the industry classification system needs to be reasonably precise, and that is an advantage of the larger classification system used in Alberta...

⁴⁸ *Ibid.*, p. iii

⁴⁹ Francois Vaillancourt, *The Financing of Workers' Compensation Boards in Canada, 1960 -1990*. (Toronto, ON: Canadian Tax Foundation, 1994) p. 82, 87.

⁵⁰ James Chelius and Robert S. Smith, *Small Business and the Financing of Workers' Compensation: Issues, Evidence and Options* (Washington, DC: National Federation of Independent Business, 1987), p.3, cited in *Vaillancourt*, p. 82.

An assessment system based on industry costs and experience rating that rewards the good operator provides a substantial economic incentive for constructive action by employers.

If the experience rating system was based on the number of accidents, then the concerns of trade unions about “gimmick” actions by employers might be more valid, but the system is based on costs of injury. The kind of questionable employer action envisaged by the trade unions would only have maximum impact on an experience rating system based on the number of claims rather than their cost and, therefore, does not appear to be a serious problem. It is the serious accidents, where the worker is incapacitated for months or years, that should have a priority prevention, and it is they that have the major impact on costs and on employers’ experience rating.⁵¹

Next, the con side (Manitoba):

Financial considerations, however, are only one aspect of the decision not to recommend merit rating. The objectives of those who argue for merit rating are to promote occupational health and safety. Merit-rating plans do not, however, measure success in prevention of injury and disease; they measure the success in reducing claims costs. Aside from better health and safety promotion, there are ways of reducing claims costs, most of which have a negative effect on the workers’ compensation system. For instance, we heard numerous instances of how attempts were made to suppress injury reporting, direct work injuries to private insurance coverage, pressure workers to stay on the job when medical attention was clearly required, coerce workers back to work too soon, etc. - all this occurring in jurisdictions which had a merit-rating plan in effect. In other words, efforts tended toward reducing claims cost rather than reducing injuries. While some claims control is necessary in workers’ compensation, too much leads to the adversarial system we are so much trying to avoid in Manitoba.⁵²

Vaillancourt then considers whether studies of experience rating provide guidance in the face of these two opposing views. He notes the lack of Canadian studies on the impact of experience rating, and states:

Reviewing the US evidence in 1987, Chelius and Smith argue that “the evidence on experience-rating does not indicate much, if anything, of an

⁵¹ Alberta, *Report of the Task Force on the Workers’ Compensation Board* (Edmonton, Alberta; November, 1988), p.55, cited in *Vaillancourt*, p. 82.

⁵² The Workers’ Compensation Act Legislative Review Committee, *Report of the Workers’ Compensation Review Committee* (Winnipeg, Manitoba: The Committee, May 1987) p.147, cited in *Vaillancourt*, p. 87.

effect on injury rates,"⁵³ while Lanoie writes, "Concerning experience-rating, it is not clear from the studies discussed above that it has any impact on the incidence of accidents."⁵⁴ Indeed, one study by Lanoie⁵⁵ shows that in the case of Quebec, the number of rate groups, a crude measure of experience rating, did not have an effect on the rate of accidents reported. A recent Canadian study,⁵⁶ however, shows a reduction in the fatality rates in the forestry and construction industries in Ontario following the introduction of experience rating in these two sectors, while recent American work shows a reduction in workdays lost to injuries.⁵⁷

Vaillancourt concludes: "In our experience a degree of experience rating is thus warranted. It should be implemented through both the use of a reasonable number of rate groups and some individualized premiums".⁵⁸ However, others have reached the opposite conclusion on the basis of the same evidence.⁵⁹

Outside the North American context, in Australia, similar questions are being asked of "incentive schemes" which were introduced by several States in the late 1980s. The first incentive scheme in Australia was introduced in New South Wales in 1987. Victoria followed suit in 1988. South Australia implemented its program in 1990.⁶⁰

A 1994 Australian study of the impact of these programs on health and safety stated:

The most striking conclusion to be drawn from the available overseas evidence and the Australian experience is that unambiguous evidence of the impact of premium incentives schemes on compensation claims is

⁵³ *Op cit.*, Chelius and Smith, p. 44, cited in Vaillancourt, p. 87.

⁵⁴ Paul Lanoie, "Government Intervention in Occupational Safety: Lessons from the American and Canadian Experience" (March 1992), 18 *Canadian Public Policy* 62-75 at p. 70, cited in Vaillancourt, p. 87.

⁵⁵ Paul Lanoie, "The Impact of Occupational Safety and Health Regulation on the Risk of Workplace Accidents: Quebec 1983-87" (Fall 1992), 27 *Journal of Human Resources* 643-60, cited in Vaillancourt, p. 87.

⁵⁶ Christopher J. Bruce and Frank J. Atkins, "Efficiency Effects of Premium-Setting Regimes Under Workers' Compensation: Canada and the United States" (mimeograph, Department of Economics, University of Calgary, 1991), cited in Vaillancourt, p. 87. But see a more recent Canadian study by Boris Kralj, "Experience Rating of Workers' Compensation Insurance Premiums and the Duration of Workplace Injuries" in Terry Thomason and Richard P. Chaykowski, *Research in Canadian Workers' Compensation* (Kingston, ON: IRC Press, 1995) 106. Kralj found that in Ontario's construction industry, ERA did not have the desired effect of decreasing duration, but in fact increased it. The same conclusion was reached by Lanoie (1992) using aggregate, industry level data for Quebec. Kralj did find that experience rating decreased duration for more severely injured workers.

⁵⁷ John Ruser, "Workers' Compensation and Occupational Injuries and Illnesses" (1991), 9 *Journal of Labour Economics* 325-41, cited in Vaillancourt, p. 88.

⁵⁸ *Op cit.*, Vaillancourt, p. 88.

⁵⁹ See, for example, Terence Ison, *Compensation Systems for Injury and Disease: The Policy Choices* (Toronto, ON: Butterworth, 1994), pp. 201-216.

⁶⁰ Queensland has had a merit bonus paid to employers achieving a certain level of performance since 1962. The scheme does not penalize poor performers. Data on the impact of its effectiveness and impact are not available, so it has not been reviewed in recent studies.

very hard to come by. The studies which have been done and the data so far published by compensation authorities in Australia are largely inconclusive...⁶¹

The questions raised in the Australian study are similar to those considered in the North American context. That is, whether changes in claims rates are the result of a change in employer health and safety practices or simply a change in reporting practices; and the effectiveness of premium incentives given the limits on the extent to which they can reflect experience, in light of the need to preserve the “collective” nature of the workers’ compensation scheme. The study concludes:

There are *a priori* reasons to believe that the introduction of premium incentive schemes is a desirable development from a health and safety point of view...But there is very little empirical evidence which bears unequivocally on the issue. There is a pressing need for further research, and particularly for research which distinguishes claims rates from actual injury rates. If the phenomenon of claims suppression turns out to be widespread, and especially if it is more prevalent in some industries than others, this is likely to distort the claims data and possibly result in the misdirection of some of the targeted prevention work carried out by inspectorates.⁶²

Some new initiatives have been introduced in other provinces in recent years. These initiatives reflect a focus on looking behind costs and injury rates, and more directly at employer behaviour through audits and reviews of safety programs. The new approaches address some of the problems associated with claims-cost based approaches. They create incentives for small firms which might otherwise participate in experience rating plans at only limited levels, and provide new incentives for firms which are already at maximum merit or demerit.

A new program is currently being piloted in BC. The *BC Diamond Worksafe Plan* was described in the 1996 Strategic Plan as follows:

Achieving the general objectives of the strategic plan requires a framework. The BC Diamond Concept provides that framework by focusing resources on firms which demonstrate above-average injury rates. Under the framework, firm performance is monitored and measured with evaluation criteria that focus on worker participation and involvement and management commitment. This plan will:

- Provide customized and cohesive services to both small and large firms.

⁶¹ Andrew Hopkins, “The Impact of Workers’ Compensation Premium Incentives on Health and Safety” *Occupational Health Safety* 1994 10(2) 129-136 at p. 133.

⁶² *Ibid.*, p. 135-136.

- Develop new and innovative ways to encourage workplace cooperation.
- Create mechanisms to facilitate increased internal responsibility for occupational safety and health.⁶³

2. Program Design

In spite of the continuing questions about the effectiveness of experience rating, the trend in Canada is towards greater experience rating, coupled with “incentive rating”. There is, however, no consensus as to the appropriate model or method.

The following discussion considers issues relating to four aspects of experience rating programs:

- participation levels;
- sensitivity of the experience rating formula;
- maximum merits and demerits; and
- included/excluded costs.

Detailed comparative information about experience rating plans across Canada can be found in Appendices A & B.

2.1 Participation

Generally, most provinces restrict participation in their experience rating systems to employers of a certain size. In Alberta,⁶⁴ Quebec, New Brunswick, Nova Scotia, PEI, and Newfoundland and Labrador, participation in the program only occurs if the average industry assessment rate in previous years exceeds a set minimum. Except in Quebec, the minimum assessment required is an average of \$1000 per year over the previous three years.⁶⁵ In some provinces, once the minimum is met, employers participate fully. In other provinces the rate of participation increases incrementally until full participation is reached.

In BC, there is no minimum average assessment required for participation, although a distinction is made between smaller and larger firms. Employers with two years assessable payroll participate at the 50% level when their payroll is less than two times the maximum wage rate (\$55,800) in both years. Employers with payrolls in excess of two times the maximum wage rate in both years participate fully. Manitoba requires all firms with one or more years of experience to participate fully.

⁶³ *Op cit.*, *Strategic Plan*, p. 24.

⁶⁴ In Alberta, the participation rate also reflects the years of experience, with participation multiplied by one third for employers with one year of experience, and by two thirds for firms with two years.

⁶⁵ Quebec requires the assessment to have averaged \$18,350 over the previous three years.

The different approaches to participation reflect differing objectives and priorities. A policy of limiting participation by small employers reflects an emphasis on rate stability and predictability. The exclusion of small employers prevents the possibility of a large increase resulting from a single accident. Provinces which have taken this approach also focus on the fact the experience of small employers is not actuarially significant. Years of accident free status may merely reflect the small size of the employer's labour force, rather than a safe work environment.

On the other hand, a policy of full participation by even the smallest firms reflects an emphasis on consistency in the treatment of employers, and on the use of market forces to influence employer behaviour. This approach allows even small firms with good safety records to benefit from their performance, but can also result in small employers receiving a significant financial penalty for a single accident. On this issue, the 1995 Inventory noted:

Smaller firms also participate in the ERA program. Actuarial credibility argues against the participation of small firms, since their short-term accident and claims record reflects a greater influence of random factors. But equity suggests that they too should have the opportunity to reduce their workers' compensation costs through effective injury prevention programs. The WCB allows smaller employers to participate in ERA, but at a reduced degree of participation.⁶⁶

Despite this reduced level of participation, the impact of ERA on small employers remains a problematic component of the design of BC's current ERA plan.

2.2 The Experience Rating Formula

Experience rating is based on the difference between individual employer experience, and subclass experience. Most provinces calculate experience rating using a comparison between employer costs over employer payroll, and industry costs over industry payroll. The difference between these ratios is calculated as a percentage of the industry ratio, and then multiplied by a fraction between 1/4 and 1. The multiplication factor represents the degree to which experience rating will be used to vary the base assessment rate of an employer. For example, the formula used in BC is:

$$\frac{\text{Subclass Claim Costs}/\text{Subclass Payroll} - \text{Firm Claim Costs}/\text{Firm Payroll}}{\text{Subclass Claim Costs}/\text{Subclass Payroll}} \times 1/3$$

The 1/3 figure in this formula can be thought of as the "sensitivity" factor. The larger the sensitivity factor, the greater the response of assessment rates to variations in claim costs. The lower the sensitivity factor, the smaller the change in assessments in relation to increases in claim costs. In other words, the closer the multiplication factor is

⁶⁶ *Op cit., Still in Transition*, p. 185.

to 1, the more direct the relationship between changes in claim costs, and assessments.

Saskatchewan, PEI, and Newfoundland have low sensitivity factors of 1/4. Alberta, Manitoba and Nova Scotia have high sensitivity factors of 1. BC has a relatively low factor of 1/3. The choice of sensitivity factor often reflects the maximum demerit choice. For example, in BC the factor is 1/3, and the maximum demerit is 33.3%.

The argument in favour of high sensitivity factors is that it creates a greater incentive for firms to reduce accident costs. On the other hand, highly sensitive rates can lead to large swings in assessments, even for relatively small changes in claims experience.

Even with BC's relatively low sensitivity factor, the 1992 Inventory noted the problem of excessive annual swings in merits/demerits and suggested the WCB could impose an annual swing limit so the rate responded more slowly to wide swings in claims activity. Alternatively, the Inventory suggested a limit to the dollar size of a single claim, so as to prevent a single large claim from overwhelming an otherwise sound performance.

2.3 Maximum Merits and Demerits

Maximum merits and demerits are used to limit the impact of experience rating. Maximum merits range from a high of 40% in Alberta and New Brunswick, to a low of 20% in Nova Scotia and Newfoundland. Maximum demerits range from a high in Quebec of 100%, to a low in Nova Scotia and Newfoundland of 20%. Most provinces have balanced maximum merits with equal maximum demerits. The maximum merit and demerit in BC is 33.3%.

Restrictive maximums, such as Nova Scotia's 20%, reduce the potential for large annual swings when a firm has experienced a particularly bad year in accident claims. However, restrictive maximum merits and demerits can also restrict any beneficial impact of experience rating. Once a firm has reached maximum demerit, any additional deterioration in claims performance has no effect on assessment rates. Similarly, firms at maximum merit have little incentive to further improve their performance.

2.4 Included/Excluded Costs

Claim costs are used to measure claims experience and to calculate experience ratings. However, not all claim costs are used in the experience rating calculation. Certain categories of costs are excluded in BC: those falling outside the thirty month claims costs review period; those the Board determines by policy should be excluded; and those excluded by statute.

Decision 49 of the former Commissioners (1 WCR 210) sets out the basic philosophy of including claims for experience rating purposes, and dismisses the argument that claims should be excluded on the basis of fault:

The system of experience rating is based to some extent on notions of fault. It reflects the view that some accidents are preventable, and that employers in whose operations injuries are more frequent or substantial should pay higher assessments than those in whose operations injuries are less frequent and less substantial. But to the extent that the system concerns itself with fault, it does so by reference to aggregated data, not by moral judgments on individual claims. To take out of this accounting a particular accident because it was adjudged not to be the fault of the particular employer would, therefore, introduce a distortion rather than an improvement in accuracy.⁶⁷

The 1995 Internal Audit & Evaluation Study noted two general issues that have arisen in relation to the inclusion and exclusion of costs:

1. Do ERA calculations include most of the costs appropriate to them?
2. Does the exclusion of certain types of costs reduce or bias ERA incentives?

The study noted ERA calculations use roughly one third of the claims costs that are used in the base assessment rate calculations. The cost used in the ERA calculations differ from those used in the base rate calculations in three main ways:

- the types of claims costs included (and excluded);
- the types of firms included; and
- the cost review period used.

The ERA calculation uses the claim costs charged on two years of new claims over their first thirty months. The base assessment rate calculations use the claim costs charged on all claims (old and new) in one year. The ERA calculation uses a smaller number of claims and a higher proportion of the short term disability costs on these claims than the base rate calculations. The result is the ERA rating is “driven primarily by the frequency of the injury, rather than the severity of the injury.”⁶⁸

The study concluded that as a result of exclusion of certain types of claims costs from the ERA calculation:

...this could limit or bias the incentives certain employers or groups of employers receive, e.g. those who consistently experience claims with pension costs.

As well, Era ratings are reduced by participation levels and maximum merit/demerit caps. The dollar value of the incentives provided may be further limited by firms' base rate levels (including caps) and assessable

⁶⁷ Parts of this decision are reproduced in policy 30:50:51 of the *Assessment Policy Manual*.

⁶⁸ *Op cit.*, *Assessment Department Administrative Inventory*, cited in Workers' Compensation Board of BC, *Experience Rated Assessment (ERA) Evaluation Study Document Review*, (Richmond, BC: Internal Audit & Evaluation), p. 13.

payroll size. Finally, the Era plan provides more in discounts than it does in surcharges.

The documents reviewed suggest that Era's safety incentives perform best among employers who are aware of the incentives provided and understand what they mean, e.g., how their operations and ratings compare to those with similar firms. As well, employers who accept their ERA ratings as fair and relevant to their current operations should be more motivated to reduce their claims costs than those who do not.⁶⁹

The types of costs which are excluded by policy include:

- Costs recovered by way of a third party action.
- Investigation and compensation costs paid out on a disallowed claim.
- Costs transferred to the class or subclasses of another employer under section 10(8).
- Costs assigned to the funds created by section 39(1)(d) and (e).
- Occupational disease claims which typically involve exposure or latency periods of two or more years.
- Costs after 13 weeks where section 5(3) applies.⁷⁰
- Costs from accidents due to personal illness.⁷¹
- Injuries during a retraining program sponsored by the Vocational Rehabilitation Department.
- Injuries or aggravations occurring in the course of treatment or rehabilitation.⁷²

The claim costs exclusion which has received the most attention in recent years is relief of costs under Section 39(1)(e) of the *Act*. Section 39(1)(e) requires the Board to maintain a reserve for payment of a portion of compensable disabilities that are enhanced by a pre-existing disease or condition. Under this section, relief of some, or all, of the cost of enhanced disability is provided to individual employers.

If employers can obtain relief and thereby avoid the costs of a claim, it will not be used for the purposes of calculating their experience rating. Since 1991, there has been a dramatic increase in the number of applications under section 39(1)(e). The 1995 Inventory noted:

⁶⁹ *Ibid.*, p. i.

⁷⁰ Section 5(3) provides "Where the injury is attributable solely to the serious and wilful misconduct of the worker, compensation shall not be payable unless the injury results in death or serious or permanent disablement."

⁷¹ Where a claim is allowed for an injury substantially due to a personal illness, the costs are excluded from the employer's experience rating. See #15.30 & #115.30 of the *Rehabilitation Services & Claims Manual*.

⁷² In addition, ERA does not include the actual cost of the fatal claim experienced by an employer. Rather, it includes for each claim the average cost for all fatal claims in the year. Details about the exclusions can be found in #115.30 of the *Rehabilitation Services & Claims Manual* and #30:50:52 of the *Assessment Policy Manual*.

Over the last five years, an aggressive consultation industry has grown up to help employers find examples of, and file applications for, relief of these costs, thereby lowering their assessment bills retrospectively. The consultants generally receive a contingent fee of up to one-third of the firm's recovery.

There are a number of unfortunate aspects to this situation. First, it feeds the fears of labour that ERA's major impact is to encourage "claims avoidance" behaviour rather than accident prevention behaviour. Second, there is no question that these allocations affect individual employer costs, but it is difficult to see what difference it makes to the general welfare whether a given claim is charged to an individual employer or to the sub-class as a whole. In fact, it could be argued that these after-the-fact adjustments could endanger the adequacy of claim reserves, especially since they are not offset by other employers being assigned responsibility for cases that were not charged to their account.⁷³

The Inventory suggested that the WCB's study of ERA may provide a new source of policy debate on ERA and cost relief for BC. Since the time of the Inventory, the Panel of Administrators has identified relief of costs under section 39(1)(e) as a distinct policy issue requiring consideration in 1997.⁷⁴

3. Preliminary Findings of the ESS Project

Preliminary discussions with respect to revising BC's ERA plan include:

- the creation of a small employer plan which forgives a non-repeating single event;
- 25% maximum discount for sustained good results; and
- 200% maximum surcharge for prolonged poor results.

For medium and large employers, a separate plan would:

- re-insure catastrophic excess claim costs;
- have a 50% maximum discount for sustained good results;
- have a 200% maximum surcharge for prolonged poor results; and
- measure fully reserved claim costs.

Future options also include a supplementary "incentive rating" plan which would involve input from the Prevention and Compensation Divisions. This plan could amplify

⁷³ *Op cit., Still in Transition*, p. 186.

⁷⁴ The 1996 cross-jurisdictional survey indicates almost all jurisdictions in Canada have some form of claim cost relief for pre-existing conditions. Like BC, Ontario and Saskatchewan have no limit on the "window" or period of time from date of accident when employers can apply for cost relief. Unlike BC, Ontario and Saskatchewan both apply the cost relief to the year in which it is awarded. BC and Alberta both apply relief retroactively, although for the plan Alberta plans to introduce in 1998 the Board has limited the time period for applying for cost relief to four years.

experience rating modifications by up to 50%, but would only amplify when the experience rating and incentive rating measures are consistent. The plan would be designed to have no significant impact on Board revenue.

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APPENDICES

APPENDIX B
DETAILED EXPERIENCE RATING PROGRAM INFORMATION*

BRITISH COLUMBIA

Assessment Period: The ERA calculation is based on the claims experience in the first two of the previous 3 years, and the cost of those claims over the first 2 1/2 years of the previous 3 years. For example, the assessment rate in 1996 would be adjusted based on claims experienced in 1993 and 1994 and costs incurred as a result of those claims in 1993, 1994 and the first half of 1995.

Participation: Firms with no assessable payroll in the 2 year period do not participate. Firms with less than a full year of experience, or who have an assessable payroll of less than twice the maximum insurable wage in at least one of the 2 years, participate at the 50% rate. Firms with more than 2 years of assessable payroll, both years over twice the insurable wage, participate fully. In 1997, the maximum assessable wage is \$55,800.

The farming industry has a separate plan with a 25% participation rate not described here.

Maximum Merit or Surcharge: The maximum merit or surcharge is 33.3% of the firm's assessment.

Maximum per Claim Cost: There is no maximum limit on the cost per claim.

ALBERTA

Alberta presently has two levels of experience rating, a compulsory prospective plan called the Experience Rating Plan, and a voluntary retrospective plan called the Voluntary Incentive Plan. Like British Columbia's plan, this plan involves a system of merits and surcharges applied prospectively according to a firm's claims cost experience relative to its class.

* Adapted from AWCBC, *Workers' Compensation Industry Classifications, Assessment Rates, and Experience Rating Programs in Canada, 1996*. Updated with information from a 1996 WCB cross-jurisdictional survey, and information from individual Boards.

1. Experience Rating

Assessment Period: The claims cost experience in the first 3 of the previous 4 years are used to calculate the merit or surcharge applied to a particular year's assessment. For example the assessment for 1996 would be based on costs paid in 1992, 1993 and 1994 for claims initiated in the same period.

Participation: The program is compulsory for firms with an industry base rate of over \$3000 in the preceding 3 year period. For each \$2500 in industry rate assessments paid during the assessment period the firm receives a 1% participation factor. The minimum participation rate is 5%. (This would apply to all firms which had industry rate assessments between \$3,000 and \$12,500 over the previous three years.) The maximum participation factor is 50%.

Firms also receive an eligibility factor based on their years of experience:

<u>Factor</u>	<u>Experience</u>
1	3 or more years
2/3	2 years
1/3	1 year

Maximum Merit or Surcharge: The maximum merit or surcharge is 40%.

Maximum Annual Change in the Assessment Rate: No maximum annual change is imposed.

Maximum per Claim Cost: The cost per claim is restricted to a maximum of 10% of the firm's total 3 year industry rate assessment.

2. Voluntary Incentive Plan

This plan is offered to larger employers in the province and offers further incentive to improve workplace safety and reduce claims costs. The plan is retrospective, and compares the firm's actual claims cost with its expected claims.

Assessment Period: The plan measures costs paid in the program year for claims arising in that year as well as in the previous year. These costs are compared to the expected cost which is calculated using industry class data from the preceding three years.

Participation: Participation is voluntary. To participate firms must have at least \$75,000 in expected costs. Firms with lower expected costs can form a group in order to participate. The employer must also have a health and safety audit and meet certain minimum standards.

Maximum Refund or Surcharge: The refund or surcharge is calculated as a percent of the expected claims cost. A firm can elect to limit the refund or surcharge in 5% increments. This election must be made at the time of enrollment each year. The minimum election is 10% and the maximum refund or surcharge is 100% of expected claims.

Maximum per Claim Cost: There is no maximum per claim cost.

3. Future Plans

Alberta is planning several changes to their experience rating model. In early 1997, the Board of Directors approved the implementation of a new model called "Performance Pricing". The model will incorporate the following components:

- Experience Rating Plan - This plan will affect employers with \$15,000 or more in industry rate premiums over three years. The changes will be implemented in 1998, with the exception of cost relief. Starting in 1999, cost relief will be available on an employer's experience record for a four year period after the year of the claim.
- Poor Performance Surcharge - Additional surcharges will be levied on employers who continue to receive a maximum surcharge in the Experience Rating Plan. This will be implemented in 1999.
- Small Business Discount and Surcharge - Starting in 1998, employers with less than \$15,000 in industry rate premiums over three years will receive a 5% discount from their premium if they have not had any lost time claims in the previous five years. If they have had five or more lost time claims in the previous five years, they will receive a 5% surcharge.

SASKATCHEWAN

This plan was created in 1992 and unlike British Columbia's plan involves a system of merits and surcharges applied retrospectively according to a firm's claim cost experience relative to its class.

Assessment Period: In June of each year a merit or surcharge is calculated based on the claims cost experience in the previous 3 years. For example a merit or surcharge is calculated in June of 1997 based on claims and the costs paid in 1994, 1995 and 1996 for claims initiated in the same period.

Participation: The program is mandatory for firms with 3 or more years of experience. Firms with less than 3 years of experience cannot participate. Only firms whose total claims costs in the period do not exceed their assessments in

the period are eligible for a merit. Only firms whose total claims costs exceed their assessments in the period and who have at least 2 claims will be subject to a surcharge.

Maximum Merit or Surcharge: The maximum merit or surcharge is 25% of the firm's assessment, or \$100,000.

Maximum per Claim Cost: There is no maximum per claim cost in the program.

MANITOBA

This plan was created in 1989 and like British Columbia's plan involves a system of merits and surcharges applied prospectively according to a firm's claims cost experience relative to their class.

Assessment Period: The claims and cost experience in the 1 year period from September 30 to September 30 is used to adjust the assessment rate for the upcoming year. For example the assessment for 1996 would be based on costs paid in the period from September 30, 1994 to September 30, 1995 regardless of when the claim was initiated.

Participation: The program is mandatory for all firms with more than 1 year of experience. Firms with less than a full year of experience cannot participate.

Maximum Merit or Surcharge: The maximum merit is 25% of the annual industry rate assessment. The maximum surcharge is 40% of the annual industry rate assessment.

Maximum Annual Change in the Assessment Rate: The maximum annual increase in the firm's rate is limited to 15%, and the maximum decrease is limited to 10%.

Maximum per Claim Cost: There is no maximum per claim cost.

ONTARIO

1. NEER

This plan, referred to as NEER, was created in 1984 and unlike British Columbia's plan involves a system of merits and surcharges applied retrospectively according to a firm's claim cost experience relative to their class.

Assessment Period: Retrospective adjustments are made each year to the assessment based on the costs arising in the first 3 years following a claim made in the assessment year. For example, the assessment for 1995 would be reviewed in 1996 by comparing expected claims costs to actual costs and a refund or surcharge would be paid in September of 1996. Costs paid from claims arising in 1995 are reviewed again in 1997 and 1998 and a further refund or surcharge is calculated.

Participation: Participation generally varies between 25% and 90% depending on the firm size.⁷⁵ The participation rate, referred to as the "rating factor" is calculated by dividing the firm's initial assessment by the sum of the initial assessment and 5 times the maximum compensable earnings. The construction industry is subject to a separate plan, called CAD-7, the details of which are not discussed here.

Maximum Merit or Surcharge: The maximum merit or refund is equal to the expected claims cost for the firm. This will be paid when a firm has no claims in a given year. The maximum surcharge is equal to 2 times the expected claims cost. This occurs when a firm's claims are at least 3 times the expected claims cost in a given year.

Maximum per Claim Cost: The per claim cost is limited to 4 times the maximum insurable salary. In 1996 this was \$222,400 (4 x \$55,600). A per firm limit is imposed of 3 times the expected claim cost for any given year.

The expected claims cost is calculated from the claims costs of similar sized firms within the industry group. The costs include administration costs of the claims as well as an estimate of future costs relating to the claim.

Costs Excluded from Calculation: Costs relating to long latency industrial diseases and pre-existing conditions are excluded.

⁷⁵ Except for a small number of firms within the farming industry who participate at the 3% level.

2. Work Well Program

This program, introduced in 1989, is retrospective and designed to reward firms which have exemplary health and safety programs and procedures, and to penalize those which operate unsafe work environments. Application of this program has been limited to a few outstanding firms.

Participation: This program applies to most firms who are subject to an industry based assessment,⁷⁶ although actual rewards and punishments under the program appear to be relatively infrequent.

Maximum Refund or Surcharge: Refunds and surcharges range from 10% to 75% of assessments, to a maximum of \$100,000 per firm.

Formula: In order to receive a refund a firm must have had little or no work injury lost-time and must have an organizational health and safety program in place to contain accident.

Firms which demonstrate a poor injury record for their rate group or have a history of non-compliance with the *Occupational Health and Safety Act* are evaluated. The criteria for evaluation include health and safety procedures and program development, promotion and implementation. After an initial visit the employer is given an opportunity to do remedial work. Finally if the remedial work is not satisfactory, a surcharge is applied.

QUEBEC

1. Personalized Plan

This plan was created in 1990. It involves a system of merits and surcharges applied prospectively.

Assessment Period: The assessment is based on the claims and cost experience in the previous three years. For example the assessment in 1996 will be adjusted based on claim costs incurred in 1992, 1993, and 1994.

Participation: The plan is mandatory for firms whose payroll multiplied by the industry base rate assessment averaged over \$18,350 in the previous three years (i.e. a total assessment for the previous 3 years of \$55,000 before adjustments). For firms of this size, 4% of their assessment is based on their own cost experience and the remaining portion is the industry base rate. For larger firms, the percentage of their assessment based on their own cost experience is calculated as:

⁷⁶ Firms within Schedule 1 of the Act.

Firm payroll for three year period x industry base rate assessment
1,325,500

up to a maximum of 100%. Firms with a total annual assessment of over \$440,000 before adjustments will therefore have a fully personalized rate as their entire rate for the coming year will be based on their own experience in the previous three years.

Maximum Merit or Surcharge: There is no maximum merit or surcharge.

Maximum per Claim Cost: The cost per claim is limited to 20% of the maximum insurable wage.

2. Retrospective Plan

Participation: This plan applies only to very large employers who receive a 100% personalized rate. For example, only employers whose 1994 payroll multiplied by the 1996 unit rate exceeds \$440,000 would be eligible for the program in 1996.

Assessment Period: The 1996 adjustment would be done on the following time table:

1995 -	Information about rates and choices of the limit
1996 -	Initial personalized rate contribution
1997 -	Provisional adjustment
1998 -	No work on file
1999 -	Final Adjustment

The provisional adjustment is based on actual costs for the first 15 months beginning in January of 1996. The final adjustment is based on three years of costs arising from claims in 1996.

Maximum Merit or Surcharge: The provisional contribution will not exceed 150% of the initial contribution.

Maximum per Claim Cost: Firms choose to limit the maximum per claim cost. The maximum can be set to 50%, 100%, 200% or 300% or the maximum insurable wage.

NEW BRUNSWICK

This plan was created in 1990 and like British Columbia's plan involves a system of merits and surcharges applied prospectively according to a firm's claim cost experience relative to their class.

Assessment Period: The assessment is based on the claims and cost experience in the previous three years. For example the assessment in 1996 will be adjusted based on claims experienced and costs incurred in 1992, 1993, and 1994.

Participation: Firms with average annual assessments at least \$1,000 over the previous three years are required to participate.

Maximum Merit or Surcharge: The maximum merit 40% of the firm's assessment. The maximum surcharge is 80%.

Maximum per Claim Cost: There is no maximum limit on the cost per claim.

2. Risk Management Initiative (MPI)

This program was introduced as a pilot program in 1995 and 1996. The program was tested on 84 large employers. The program included a safety audit, based on the Industrial Accident Prevention Association (IAPA) protocol. Firms who improved their performance during the period received financial reward as well as public recognition.

The Commission is currently planning to extend a modified version of the MPI program to small and medium sized firms. This program would involve a self-administered audit. Firms that successfully complete the audit and demonstrate an adequate safety record would be eligible for an assessment rebate. This extension of the MPI program is still in the planning stages.

NOVA SCOTIA

This plan was created in 1996 and like British Columbia's plan involves a system of merits and surcharges applied prospectively according to a firm's claim cost experience relative to their class.

Assessment Period: The assessment is based on the claims and cost experience in the previous three years. For example the assessment in 1996 will be adjusted based on claims experienced and costs incurred in 1992, 1993, and 1994.

Participation: Firms with average annual assessments at least \$17,500 are required to participate fully. Smaller firms participate proportionately less.

Maximum Merit or Surcharge: The maximum merit or surcharge is 20% of the firm's assessment.

Maximum per Claim Cost: There is no maximum limit on the cost per claim.

PRINCE EDWARD ISLAND

This plan was created in 1996 and like British Columbia's plan involves a system of merits and surcharges applied prospectively according to a firm's claim cost experience relative to their class.

Assessment Period: The assessment is based on the claims and cost experience in the previous three years. For example the assessment in 1996 will be adjusted based on claims experienced and costs incurred in 1992, 1993, and 1994.

Participation: Firms with average annual assessments at least \$1,000 over the previous three years are required to participate. Firms with the minimum required annual assessment participate at the 25% rate. Each additional \$1,000 of annual assessment raises the firm's participation rate by 5% so that firms with more than \$16,000 of annual assessment will participate fully.

Maximum Merit or Surcharge: The maximum merit or surcharge is 25% of the firm's assessment.

Maximum per Claim Cost: There is no maximum limit on the cost per claim.

NEWFOUNDLAND AND LABRADOR

1. Experience Rating Plan

This plan was extended to virtually all rate codes in 1995 and like British Columbia's plan involves a system of merits and surcharges applied prospectively according to a firm's claim cost experience relative to their class.

Assessment Period: The assessment is based on the claims and cost experience in the previous three years. For example, the assessment in 1996 will be adjusted based on claims experienced and costs incurred in 1992, 1993, and 1994.

Participation: Firms with average annual assessments at least \$1,000 over the previous three years are required to participate. Firms with the minimum

required annual assessment participate at the 25% rate. Each additional \$250 of annual assessment raises the firm's participation rate by 1% so that only firms with more than \$19,750 in average annual assessment will participate fully.

Maximum Merit or Surcharge: The maximum merit or surcharge is 20% of the firm's assessment.

Maximum per Claim Cost: There is no maximum limit on the cost per claim.

Costs Excluded from Calculation: Costs relating to long latency industrial diseases, those recovered from 3rd parties, denied claims, overpayments and interest from delays are excluded from the calculation.

Administrative costs, occupational health and safety costs, and known and estimated future liabilities are also excluded.

2. Work Safe Plan

This plan was created in 1995 as a pilot project and was extended to 1996. The plan is a joint venture between the Workers' Compensation Commission and the Department of Employment and Labour Relations.

Assessment Period: For the 1996 program, costs paid in 1992 for accidents in 1992, costs paid in 1993 for accidents in 1993 and costs paid in 1994 for accidents in 1994 are calculated for determining eligibility. The calculation of expected claims cost uses costs paid from 1993 to 1995 for accidents occurring from 1992 to 1995. Costs paid in the year of the accident occurred and the following year are included except for accidents in 1995, for which only 1995 costs are included and accidents in 1992 for which only 1993 costs are included.

Participation: The program is voluntary for firms with claims cost exceeding \$75,000 in average claims costs over the three year period.

Formula: The difference between actual claims and expected claims for the period is multiplied by 50% to calculate the refund. If actual claims costs are greater than expected claims costs no refund is given. The firm must also pass a safety audit.

Maximum Refund: The maximum refund is 25% of the base assessment.

Other Features of the Program: The program also makes available loans to businesses for initiatives designed to improve safety standards and reduce accidents.

APPENDIX C

	<u>British Columbia</u>	<u>Yukon</u>	<u>NWT</u>	<u>Alberta</u>	<u>Sask.</u>	<u>Manitoba</u>	<u>Ontario</u>	<u>Quebec</u>	<u>New Brunswick</u>	<u>PEI</u>	<u>Nova Scotia</u>	<u>Nfld.</u>
# of classes	14	6	8	12 (1996) 12 (1997)	11	8	9	5	10	6	14	7
# of rate groups	69	6	30	125 (1996) 119 (1997)	76	247	219	319	35	38	38	85
classified by:												
business	•		•	•	•	•	•	•	•	•		
industry	•										•	•
# of accounts	143,000	2,300	3,000	76,358		21,800	approx. 184,000	185,000	12,700	4,700	16,000	13,318
percentage of accounts with multiple classifications	5%	2%	1%	5%	15%-20%	7%	10%-15%	approx. 3%	10%	7-8%	5.1%	3%
classification reviewed:												
at payroll audit	•	•	•	•	•	•	•		•	•	•	•
at employer request	•	•	•	•	•	•	•	•	•	•	•	•
other	cursory review each time account handled including year end payroll reporting	yearly	have a review procedure similar to audit selection		annual assessing process	if reviewing an industry	when there is reason to believe there is misclassification. problem	upon request from the regional office		internal review after annual filing		internal investigation of a file or industry
number of years since last classification system review	15+ years	2	5+	systemic review completed between 1990 & 1995	6	unknown	4	6	1	3	ongoing since 1995	6

