

# 2010 Budget and 2010-2012 Financial Plan

Workers' Compensation Board - Alberta



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## EXECUTIVE SUMMARY

In 2009, we continued to have a strong financial performance in our core operational activities with continued improvement in service delivery and successful claims resolution and return-to-work initiatives. We expect the momentum to carry over into 2010. To the end of September 2009 investment returns have recovered from the negative returns experienced in 2008, but are expected to remain volatile for the remainder of 2009 and into 2010.

The economic picture, provincially and nationally, has changed remarkably in the last 18 months, transforming from a rapidly expanding economy to a recession. Alberta is still struggling under the economic recession that started in the fall of 2008. Although government infrastructure and incentive programs were expected to keep job losses relatively modest, the provincial unemployment rate has risen to 7.4% as of August 2009. Reduced energy prices have dampened investment and this has led to fewer jobs in the province. Since the start of the recession, Alberta has lost 49,400 jobs.

Some sectors experienced huge job losses, while other sectors remained relatively intact. According to the most recent Survey of Employment, Payrolls and Hours, key industries for WCB that were the hardest hit were manufacturing (-20,551), and construction (-16,280). Despite depressed drilling activity and substantial media attention, the energy sector has fared better, down only 2,495 jobs. These employment trends by industry sector are consistent with trends experienced by WCB in insurable earnings this year.

Federal infrastructure incentives are now beginning to make their way to provincial and local projects in an attempt to spur economic growth and curb unemployment. As the economy recovers, there is concern that these incentives may contribute to price inflation, forcing the central banks to raise interest rates. If such an increase were to happen too quickly or go too high, insurable earnings and investment returns could be impacted. Conversely, if the current optimism indicating the beginning of a recovery is premature, concerns over price deflation may again surface. It is clear however, that there is currently no consensus as to when Alberta's economy will recover.

As seen in past recessions and this recession, claim duration has increased and has led to rising benefit costs but lower time-lost claim volumes are helping to dampen this affect, which also traditionally happens when economic activity slows. This ends up producing a minimal net cost impact on WCB's core business operations.

Given the current volatility of the economy to date, conservative estimates were derived for the key drivers and assumptions which were used to develop the 2010 - 2012 financial plan. This resulted in an initial average industry premium rate for 2010 of \$1.26. Due to continued economic uncertainty in the economy, a \$0.06 or \$46.5 million premium margin to enhance the stability in the Funded Position was included, resulting in an average premium rate for 2010 of \$1.32, keeping it the same as the 2009 and 2008 budget rates.

Overall, the resulting Operating Surplus for 2010 is set at \$121.9 million which stems from:

- \$52.5 million surplus from customer operations – the \$0.06 margin and the Occupational Disease Reserve funding requirements are the main drivers of this surplus
- (\$16.6 million) deficit from investments – the shortfall between investment income realized into the income statement and the interest requirement on the claim benefit liability
- \$86.0 million surplus from claim benefit liability adjustments

## 2010 Budget Highlights

### Core Business Drivers and Assumptions

#### Insurable earnings

Insurable earnings forecasts are a key component in determining the average premium rate. Insurable earnings were originally forecast to grow by 0.5% to \$74.0 billion in 2009 and increase by another 4.6% to \$77.4 billion in 2010. These have been modified to reflect the historical effects of past recessions and their impact on insurable earnings. Insurable earnings are now forecast to grow by 1.4% to \$74.6 billion in 2009 and remain constant at \$74.6 billion in 2010.

#### Claim volume and duration

In 2009, time-loss claim (TLC) and disabling claim volumes have continued to decline. The prediction for TLC volume is for continued reductions of 14.3% for 2009 and 1.8% for 2010. As a result, both the TLC rate and disabling injury rate are expected to decline in 2010 as claim volume continues to drop and the number of covered workers increases.

Successes in injury management reached a historical low of 32.1 days in average claim duration at the end of 2008. Efforts to manage claims to early resumption of employment will continue, however duration is expected to increase in 2009 to 34.3 days and continue to increase in 2010 to 36.3 days. This increase in duration is primarily due to recessionary impacts on the Alberta economy and the extra effort required to help an injured worker return to full employment.

#### Administration

Administrative operating costs are expected to grow by 1.8% from \$164.9 million in 2009 to \$167.8 million in 2010 primarily as a result of inflationary increases to staff benefits. Operating efficiencies are planned that will help offset wage growth and other cost inflation that is anticipated for 2010.

#### Investment returns

The rate of return on the investment portfolio is volatile from year to year due to high capital market volatility. The expected return for 2009 is 9.5%, which reflects year to date returns to August 31 and 0.0% return for the remainder of 2009. For 2010 to 2012 the assumed rate of return is 5.7%. This rate is not a forecast return but is the mid-point within a wide range of possible outcomes based on expected long-term rates of return and historical return volatility.

#### Claim benefit liabilities

The claim benefit liability real discount rate is 3.0% (5.58% nominal rate less long-term inflation of 2.58%) for 2009 and remains unchanged in 2010 and throughout the forecast period.

Detailed information on all the business drivers and assumptions can be found under Time-Loss Claim Volume.

## 2010 Budget Highlights

Key Result Areas	2008 Actual	2009 Budget	2009 Forecast	2010 Budget
<b>Operating highlights (millions)</b>				
Premium revenue	\$ 993.8	\$ 975.0	\$ 965.0	\$ 984.7
Investment income	(421.3)	5.7	153.3	241.7
Transaction year claim costs	(555.2)	(577.1)	(563.7)	(558.6)
Net provision	(334.5)	(407.6)	(40.9)	(323.1)
Administration expenses	(155.0)	(164.9)	(160.9)	(167.8)
Other expenses	(41.6)	(48.4)	(48.5)	(55.0)
<b>Operating surplus (deficit)</b>	<b>\$ (513.8)</b>	<b>\$ (217.3)</b>	<b>\$ 304.3</b>	<b>\$ 121.9</b>
<b>Financial Management highlights (millions)</b>				
Investments	\$ 5,423.7	\$ 6,060.9	\$ 6,036.8	\$ 6,476.7
Claim benefit liabilities	4,905.7	5,276.2	4,890.0	5,146.7
Special dividend (millions)	-	-	-	-
Funded Position (after dividends)	590.3	892.8	1,254.4	1,479.9
<b>Key performance metrics</b>				
Funded ratio (after dividends)	111.7%	116.5%	125.0%	128.1%
Claim volume	32,800	32,100	28,100	27,600
Claim duration (days)	32.1	32.7	34.3	36.3
<b>Key drivers and assumptions</b>				
Insurable earnings (billions)	\$ 73.6	\$ 74.0	\$ 74.6	\$ 74.6
Wage growth (AB)	4.0%	4.0%	4.5%	2.8%
Claimant wage growth	3.7%	4.0%	4.5%	2.8%
Inflation rate	1.1%	2.8%	0.5%	2.7%
Investment return	-15.1%	6.4%	9.5%	5.7%
<b>Premium rate</b>				
Average required premium rate	\$ 1.20	\$ 1.32	\$ 1.17	\$ 1.26
Margin for Economic Uncertainty				\$ 0.06
Funding Surplus	\$ 0.13	\$ -	\$ 0.13	\$ -
Average budgeted (collected) premium rate (including ODR)	\$ 1.33	\$ 1.32	\$ 1.30	\$ 1.32

## FUNDING REQUIREMENTS

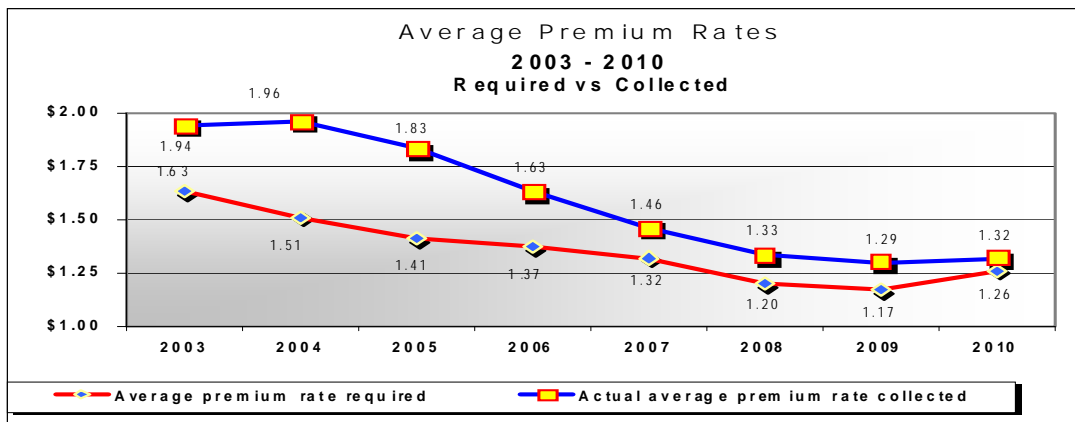
### Overview

The preliminary 2010 premium revenue requirements were developed from operating expenditures and actuarial estimates of liability projections in the Three Year Financial Plan. Due to economic uncertainty in the Alberta economy, a margin to enhance stability in the funded position has been added to the average premium rate for 2010. The overall 2010 average premium rate across all industry sectors is calculated as follows:

#### 2010 Premium Revenue Requirement

Rate Setting (\$ millions)	2009 Budget	2010 Budget	Change	
<b>Operating Expenses</b>				
Fully funded claim costs	\$740.4	\$699.9	(\$40.5)	(5.5%)
Administration	164.9	167.8	2.9	1.8%
<b>Statutory Obligations</b>				
Medical Panel and Appeals Commission levies	9.9	10.4	0.5	5.1%
Safety Association & WH&S	38.9	44.7	5.8	14.9%
<b>Subtotal</b>	<b>954.1</b>	<b>922.8</b>	<b>(31.3)</b>	<b>(3.3%)</b>
<b>Funding Requirements</b>				
Occupational Disease Reserve maintenance	20.9	15.4	(5.5)	(26.3%)
<b>Total revenue requirements</b>	<b>\$975.0</b>	<b>\$938.2</b>	<b>(\$36.8)</b>	<b>(3.8%)</b>
Margin for economic uncertainty	\$ -	\$ 46.5	\$ 46.5	n/a %
<b>Total Budgeted Premium Revenue</b>	<b>\$975.0</b>	<b>\$984.7</b>	<b>\$9.7</b>	<b>1.0%</b>
Insurable earnings	\$74,000	\$74,600	\$600	0.8%
<b>Premium Rate</b>				
Average required premium rate	\$ 1.32	\$ 1.26	(\$0.06)	(4.5%)
Margin for economic uncertainty	\$ -	\$ 0.06	\$ 0.06	n/a %
<b>Average budgeted premium rate</b>	<b>\$ 1.32</b>	<b>\$ 1.32</b>	<b>\$ -</b>	<b>- %</b>

The table below presents a eight-year trend comparison of required versus collected premium rate. From 2003 to 2005, the average premium rate included a levy for Accident Fund replenishment. The Funding Policy requires that premium rates and resulting revenue cover the fully funded claim costs for current year injuries.



## Funding Policy Requirements

The target funding range is 114% to 128% with the Occupational Disease Reserve at 6% of claim benefit liabilities and a minimum dividend threshold of 1% of claim benefit liabilities.

The Funded Position is forecast to remain within the funding policy target range of 114% to 128% for 2010. Should the Funded Position ever fall below 114%, the funding policy would require a replenishment levy be added to the premium rate to return the Funded Position to the target range.

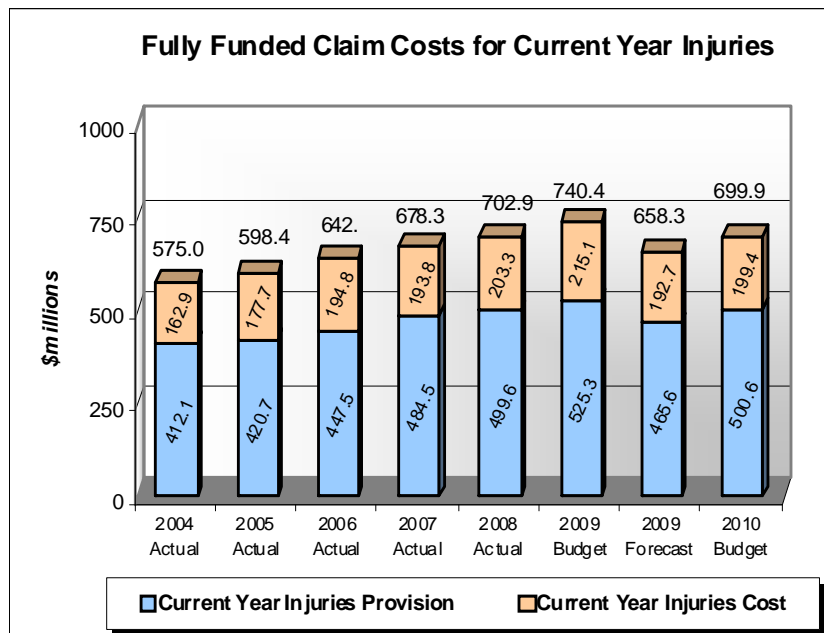
## Funding Components

### Operating expense requirements

Total revenue requirements for premium rate-setting purposes represent projected operating expenses for the fiscal year, and are comprised of fully funded costs of claims arising in the current year, administration costs related to those claims, general administration expenses for WCB operations and transfer levies.

The impact of the key drivers and assumptions on these rate components determines our required premium rates, and along with our investment performance, determines our resulting Funded Position.

**Fully Funded Claim Costs** represent those costs that relate to injuries incurred during the current year, as well as future costs arising from those claims. It consists of current year injuries' costs and the provision for future costs of current year injuries.



### Additional funding requirements

For rate-setting purposes, \$15.4 million is the amount predicted to be required in 2010 to maintain the Occupational Disease Reserve at the funding policy level of 6% of claim benefit liabilities.

## CORE ECONOMIC ASSUMPTIONS

Internal and external sources were used in the development of the key planning assumptions which drive 2010 to 2012 financial planning. Internal sources included WCB staff in the investment, actuarial, health care, and program development and risk management departments. External sources include economic forecasts from the Conference Board of Canada, the Government of Alberta and a variety of major Canadian banks. The most recent insurable earnings and covered worker estimates were also referenced in the calculation of claim volume estimates.

### Economic Assumptions

Financial Services conducted a thorough review of major internal and external sources of economic data. Based on this review, the recommended core economic planning assumptions were formulated for 2009 to 2012:

<b>Core Economic Assumptions</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
General Inflation (Alberta)	0.50%	2.65%	2.50%	2.50%
Cost of Living Adjustment (COLA)	4.07%	2.20%	2.00%	2.00%
Employment Growth (Alberta)	(1.30%)	1.00%	2.25%	2.25%
Wage Growth (Alberta)	4.50%	2.75%	3.50%	3.50%
Wage Growth (Claimants)	4.50%	2.75%	3.50%	3.50%
Health care Inflation *	7.40%	5.20%	4.20%	5.50%
Claim Duration (in days)	34.3	36.3	35.2	34.0
Employment Growth (Covered Workers)	(4.10%)	1.00%	5.50%	5.00%

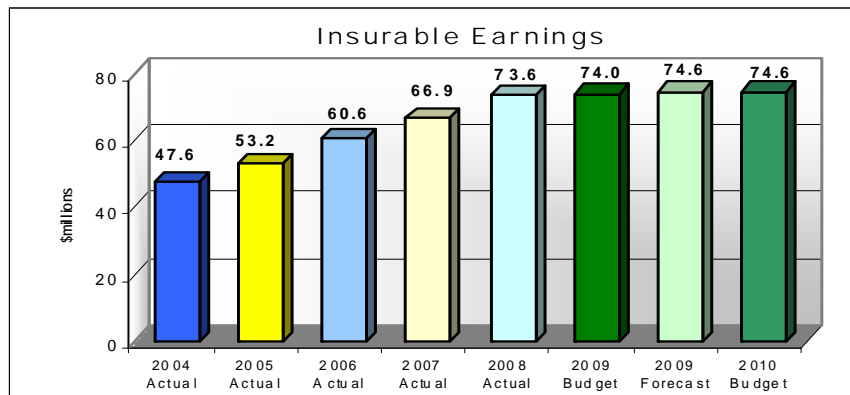
## CUSTOMER OPERATIONS: BUSINESS DRIVERS AND ASSUMPTIONS

The core economic assumptions were used to update the key business drivers and assumptions and are as follows:

Business Drivers	2009	2010	2011	2012
Insurable Earnings (\$billions)	\$74.60	\$74.60	\$80.93	\$88.39
Insurable Earnings Growth	1.36%	0.00%	8.48%	9.22%
Covered workers (millions)	1.76	1.77	1.90	1.96
Time-Lost Claim (TLC) Volume	28,100	27,600	29,000	30,300
Claim Duration (Days)	34.3	36.3	35.2	34.0
Time-Lost Claim Rate (per 100 workers)	1.6	1.6	1.6	1.5
Disabling Claim Rate (per 100 workers)	2.8	2.8	2.6	2.5

### Insurable earnings

The economic recession has proven to be difficult for Alberta businesses and employees. Lower forecasts for both employment and wage growth will impact our forecast on insurable earnings. Insurable earnings were originally forecast to grow by 0.5% to \$74.0 billion in 2009 and increase by another 4.6% to \$77.4 billion in 2010. Due to recent uncertainty in the Alberta economy, the estimate of insurable earnings growth is now forecast to grow by 1.4% to \$74.6 billion in 2009, due primarily to wage growth, and hold constant at \$74.6 billion in 2010.



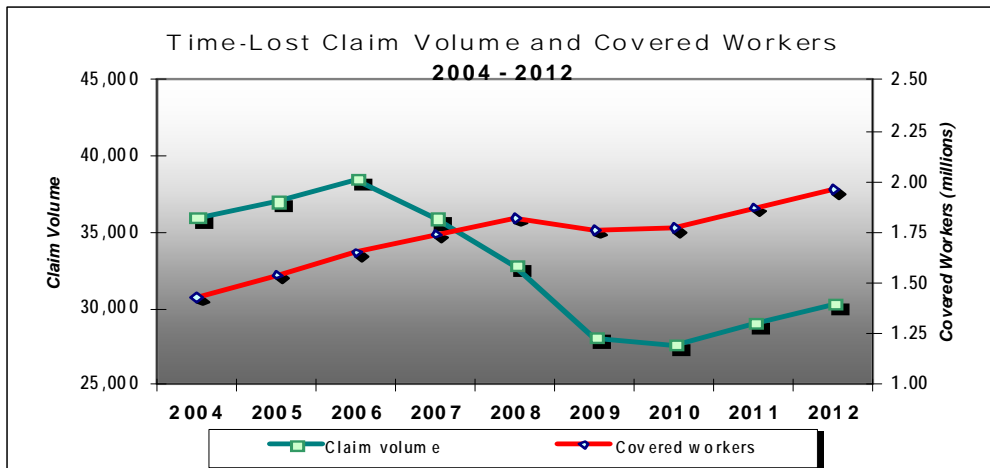
### Covered worker volume

Based on current trends, Alberta will be losing jobs in 2009. Many economists are expecting a rebound in the labour market at some point in 2010. As a result, the number of workers covered by WCB-Alberta is forecast to decline by 3.5% in 2009 to 1.76 million workers and then increase slightly to 1.77 million in 2010. As the economy recovers, covered workers are projected to show steady growth, increasing to 1.9 million and 2.0 million workers in 2011 and 2012 respectively.

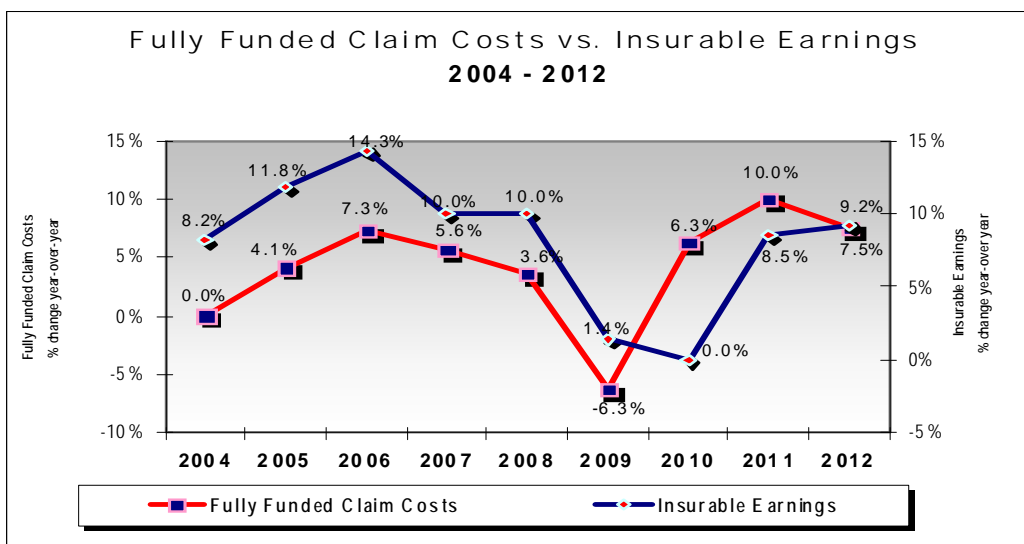
### Time-lost claim volume

Time-lost claim (TLC) volume change has been volatile, with maximum year-over-year change ranging from a high of a 9.8% increase to a decrease of 14.3% in the period since 1997. Although TLC growth does track the Alberta Labour Force over the long term, periods where claim volume declines despite moderate increases in the labour force are not unusual.

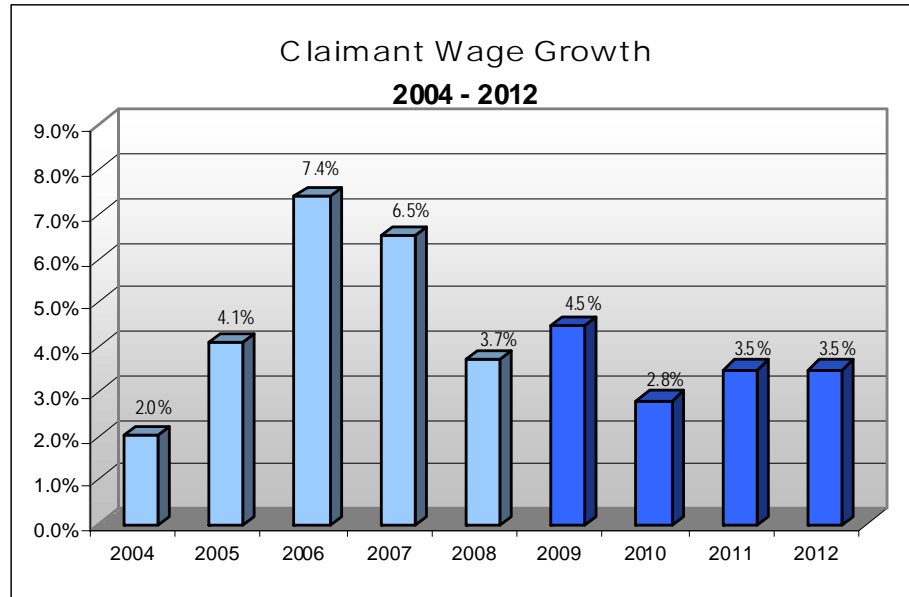
The recent decline in TLC volume is expected to continue for 2009 and 2010 due to the recessionary impacts on covered workers and economic activity, as well as employers' improved safety practices and management of disabling injuries. Moderate growth in claim volume is anticipated to be 29,000 claims in 2011, and 30,300 claims in 2012, in response to improved economic conditions.



The chart below indicates somewhat consistent growth between insurable earnings and fully funded claim costs as wage growth continues to impact expenditure growth.

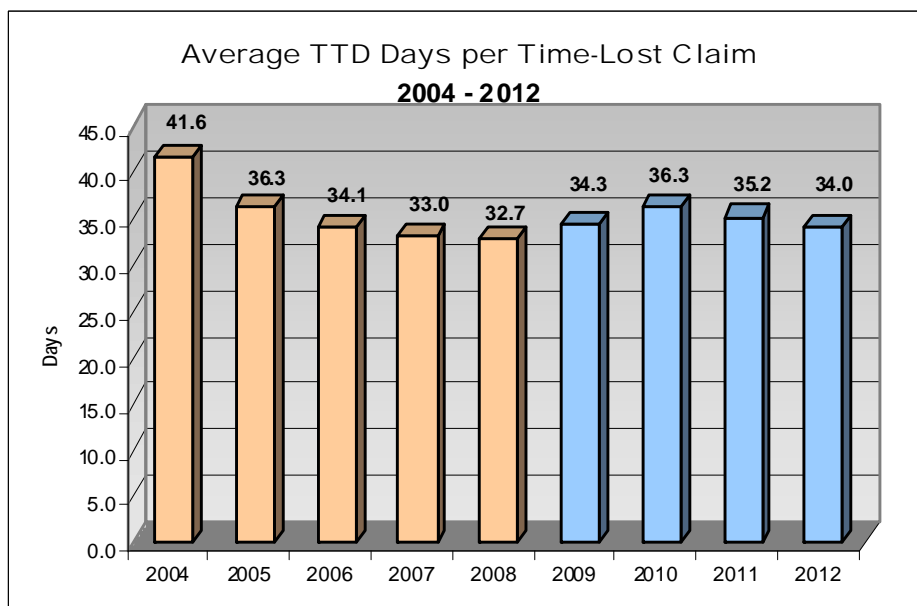


The chart below identifies the recent history of claimant wage growth as well as the increases forecast from 2009 through to 2012.



### Claim Duration

Recent corporate objectives have focused on effective claims resolution through return-to-work planning, modified work, and expedited medical care. While the momentum and success of return-to-work initiatives at WCB should keep duration at relatively modest levels over the long term, the effects of Alberta’s economic recession are expected to increase duration to 34.3 days in 2009 and 36.3 days in 2010. As the economy recovers, duration is expected to slowly drop to 35.2 days in 2011 and settle to 34.0 days by 2012.



## Time-lost and Disabling Claim Rate

There has been a general decline in the time-lost claim (TLC) rate per 100 covered workers in recent years, due in part to the increase in modified work opportunities provided by employers. During this time, there has been significant growth in no-time-loss (NTL) modified work claims as a proportion of Disabling Claims (28.5% in 2003 to 46.7% in 2008); this proportion has fallen marginally so far in 2009, to 42.3% of all Disabling Claims.

As a result of TLC volumes declining at a faster pace than the number of covered workers, the TLC projected rate for 2009 is 1.6 per 100 workers. In comparison, the forecast disabling-injury rate (TLC rate and modified-work cases), although dropping, is considerably higher at 2.8 disabling injuries per 100 workers. A prolonged economic downturn would likely reduce the availability of modified work positions, thereby adding uncertainty to our forecast. Claim volumes are expected to decline again in 2010 while the number of covered workers is projected to increase slightly, therefore, we project the rate at which time-lost injuries will occur to be 1.6 per 100 covered workers for 2010. Similarly, the disabling injury rate is expected to remain relatively constant at 2.8 per 100 covered workers.

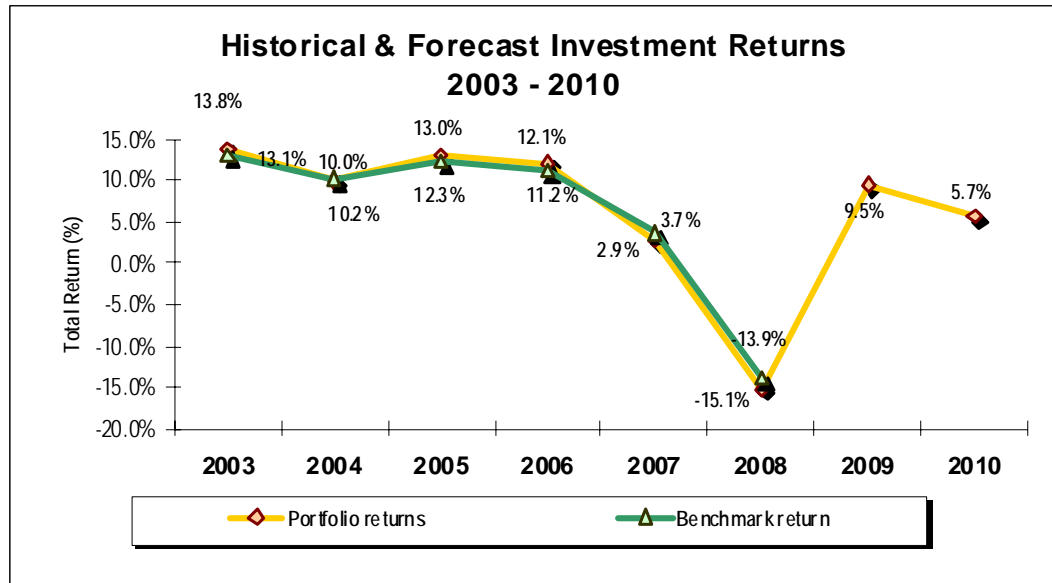
## Administration

Operating expenditures will increase by 1.8% from budget of \$164.9 million in 2009 to \$167.8 million in 2010.

Capital expenditures are anticipated to be \$15.5 million, a decrease of \$2.9 million (-15.8%) from the 2009 budget.

**ASSET LIABILITY MANAGEMENT: ASSUMPTIONS**

Investments

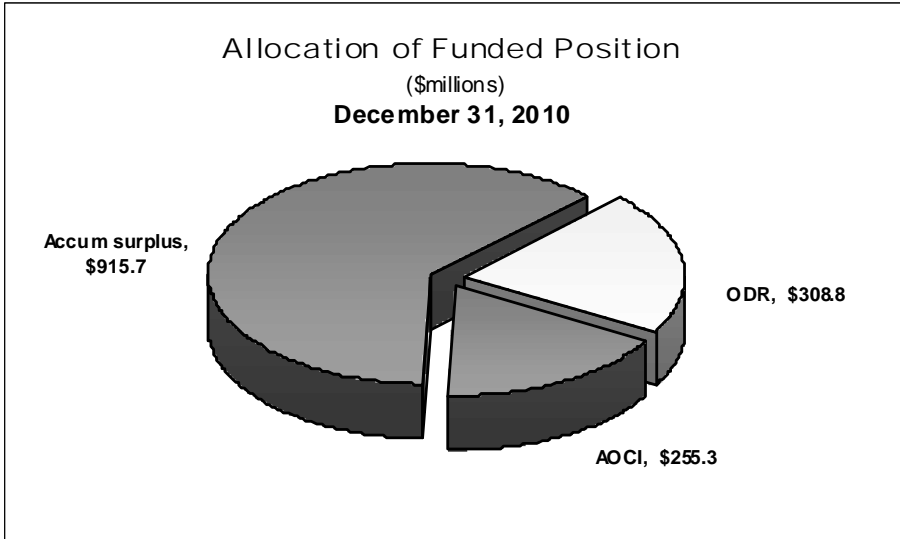


The chart above shows the historical and forecast rates of return for the WCB-Alberta portfolio. Since 2003, the portfolio has earned actual returns within a range of -15.1% (2008) and 13.8% (2003). The forecast return for 2009 is set at 9.5%, which reflects year to date returns to August 31, 2009 and assumes a 0.0% return for the remainder of 2009.

For 2010 and onward, the assumed rate of return is 5.7%. Importantly, this rate of return is not a specific forecast, but is the midpoint of a wide range of possible outcomes. The assumed rate of return is slightly lower than the long term expectation used in 2008 due to lower expected returns on cash equivalents, bonds and real return bonds

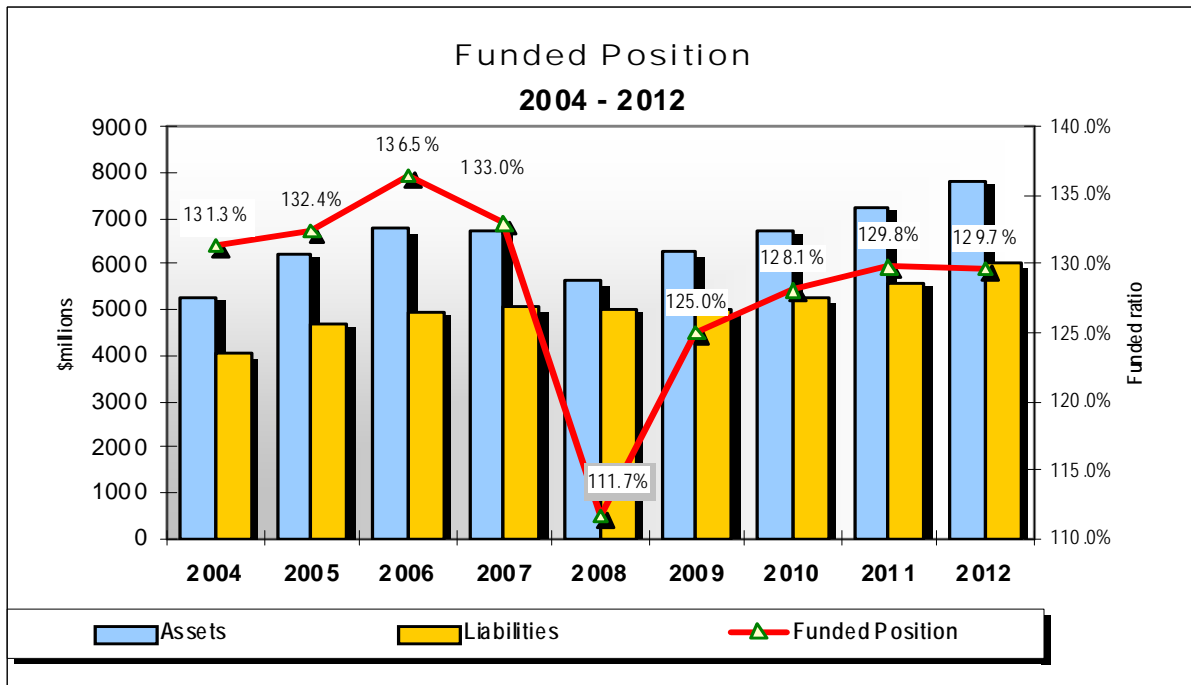
## FUNDED POSITION

The Funded Position (net assets or the ratio of total assets to total liabilities) for 2009 is expected to be 125.0% and 128.1% is forecast for 2010. Viewed from another perspective, WCB would have total assets in 2010 of \$6.7 billion to cover estimated liabilities of \$5.3 billion.



**Funded Position**, the all-inclusive metric of financial strength and stability, is measured by the ratio of assets to liabilities, and is comprised of accumulated equity generated by operating surplus, other comprehensive income, and reserves.

The chart below presents a 9-year trending for Funded Position from 2004 through 2012.



## Fund Balance

For the 2009 forecast, the Fund Balance is comprised of \$809.2 million in Accumulated Operating Surplus (AOS) and \$151.8 million in Accumulated Other Comprehensive Income (AOCI). For 2010, AOS is forecast to increase to \$915.7 million and AOCI is predicted to increase to \$255.3 million based on the planning assumption of 5.7% for the portfolio return.

The **Fund Balance**, comprised of accumulated operating surpluses and AOCI, represents a financial buffer to protect employers from rate volatility.

## Occupational Disease Reserve

At year-end 2010, the Occupational Disease Reserve (ODR) is expected to have a balance of \$308.8 million to cover potential liabilities related to latent occupational disease. The ODR balance for the 2009 year-end is expected to be \$293.4 million. The Funding Policy stipulates maintaining the ODR funding at 6% of claim benefit liabilities.

The **Occupational Disease Reserve (ODR)** is a reserve appropriated from the Fund Balance, and is a component of Funded Position. The ODR provides for costs arising from latent occupational diseases where a causal link has not yet been established to specific workplace conditions, but which may be in the future.

## Managing Funded Position

Funded Position is managed in accordance with the funding rules established under the Funding Policy. Special dividends or levies are the primary means by which the funded ratio is restored to the target range.

## FINANCIAL STATEMENT PROJECTIONS

### Workers' Compensation Board - Alberta

#### 2010 - 2012 Budget Assumptions Highlights

Key Result Areas	2008 Actual	2009 Budget	2009 Forecast	2010 Budget	2011 Plan	2012 Plan
<b>Operating highlights (millions)</b>						
Premium revenue	993.8	975.0	965.0	984.7	1,023.8	1,093.6
Investment income	(421.3)	5.7	153.3	241.7	307.3	343.6
Transaction year claim costs	(555.2)	(577.1)	(563.7)	(558.6)	(577.9)	(609.0)
Net provision	(334.5)	(407.6)	(40.9)	(323.1)	(398.6)	(456.4)
Administration	(155.0)	(164.9)	(160.9)	(167.8)	(173.7)	(179.8)
Other expense	(41.6)	(48.4)	(48.5)	(55.0)	(60.5)	(63.7)
<b>Operating surplus (deficit)</b>	<b>(513.8)</b>	<b>(217.3)</b>	<b>304.3</b>	<b>121.9</b>	<b>120.4</b>	<b>128.3</b>
<b>Financial highlights (millions)</b>						
Investments	5,423.7	6,060.9	6,036.8	6,476.7	6,947.4	7,497.9
Claim benefit liabilities	4,905.7	5,276.2	4,890.0	5,146.7	5,471.3	5,842.5
Special dividend (millions)	-	-	-	-	-	61.4
Funded Position	590.3	892.8	1,254.4	1,479.9	1,667.3	1,796.2
<b>Key performance metrics</b>						
Funded ratio	111.7%	116.5%	125.0%	128.1%	129.8%	129.8%
Claim volume	32,800	32,100	28,100	27,600	29,000	30,300
Claim duration (days)	32.1	32.7	34.3	36.3	35.2	34.0
<b>Key drivers and assumptions</b>						
Insurable earnings (billions)	73.6	74.0	74.6	74.6	80.9	88.4
Wage growth (Alberta)	4.0%	4.0%	4.5%	2.8%	3.5%	3.5%
Claimant wage growth	3.7%	4.0%	4.5%	2.8%	3.5%	3.5%
Inflation rate	1.1%	2.8%	0.5%	2.7%	2.5%	2.5%
Investment return	-15.1%	6.4%	9.5%	5.7%	5.7%	5.7%
<b>Budget recommendations</b>						
Average required premium rate	\$1.20	\$1.32	\$1.17	\$1.26	N/A	N/A
Margin for Economic Uncertainty				\$0.06		
Funding Surplus	\$0.13		\$0.13			
Average budgeted/(collected) premium rate (including ODR)	\$1.33	\$1.32	\$1.30	\$1.32	N/A	N/A

Note: Financial projections for 2011-2012 do not reflect the potential impacts from the adoption of International Financial Reporting Standards (IFRS)

2010 Budget and 2010-2012 Financial Plan Workers' Compensation Board - Alberta

