

2012 Budget and 2012-2014 Financial Plan

Workers' Compensation Board - Alberta





Workers'
Compensation
Board

Alberta

THREE YEAR PLAN 2012 - 2014

2012 FINANCIAL PLAN AND OPERATING BUDGET

OCTOBER 2011

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EXECUTIVE SUMMARY

WCB-Alberta's 2012 integrated budget planning framework involves a comprehensive process that commenced in early 2011 with the preparation of key economic assumptions and estimates. Throughout the remainder of the year, management has reviewed corporate and economic performance against these initial assumptions, and updated the key financial drivers and assumptions culminating in this 2012 Budget and 2012-2014 Financial Plan document.

The key tenets of WCB's funding policy guide the development of the financial plan:

- minimize the risk of being unfunded;
- minimize cost volatility for employers;
- minimize the total cost charged to employers;
- ensure that premium rates reflect the fully funded cost of current year accidents.

However, WCB's budget and financial plans are significantly influenced by key economic assumptions on our estimates on insurable earnings, covered workers and claim volume. The pace of the economic activity in 2011 and future years will have a significant impact on results presented in this Financial Plan.

Economic overview

WCB continues to have a strong financial performance in our core operational activities which is reflected in our ongoing commitment of returning injured workers to safe and meaningful work in a timely manner.

Macro economic overview

Despite improving employment in Alberta so far this year, recent economic indicators are predicting a slower than expected recovery for the rest of 2011 and into 2012. Canada's economic growth has slowed amid global financial market uncertainty. In the United States, high unemployment along with a weak housing market has dampened economic growth. The 2012 budget was developed on the basis of an Alberta economic backdrop that consists of a slow steady recovery supported primarily by continued development in the northern Alberta oil sands. WCB economic modelling shows that the industry sectors most closely associated with oil sands activity will experience the highest economic growth in 2012 and beyond. With positive growth in Alberta, the 2012 budget assumes that Alberta will experience job growth of 2.5%, and average wage increases of 3.5%. This will increase the number of workers covered by WCB which will impact WCB business drivers noted below. General inflation is expected to rise by 2.3% in 2012 which impacts both injured worker benefits and administrative costs.

WCB's funding position is directly impacted by global investment markets and portfolio returns realized on WCB's Accident Fund. The global financial markets have seen a significant increase in volatility and instability in the later half of 2011 triggered by the credit crisis in Europe and compounded by excessive debt loads and economic instability in other parts of the world. It is extremely difficult to predict how these events will unfold and impact WCB business activities. Despite uncertainty regarding the resolution of these events, the 2012 budget assumes an overall WCB portfolio return of 5.2% in 2012.

WCB-specific economic drivers

Development of the 2012 budget required deciding on certain economic assumptions. Actual results will deviate from this budget should the economy not perform as expected. A sensitivity analysis allows the presentation of a range of results under alternative economic scenarios.

- Based on higher wages and employment, insurable earnings are predicted to increase by 6.7% to \$86.1 billion. Changes in the economy could result in insurable earnings in the range of \$82.7 billion to \$89.5 billion.
- The number of covered workers is expected to increase by 3.9% to 1.84 million.
- Lost-time claim (LTC) volume is expected to increase to 28,400 (3.7%) as more inexperienced workers enter the labour market.
- Claim duration is anticipated to increase to 38.0 days due to lagging recessionary impacts on the Alberta economy and the extra effort required in returning injured workers to full employment.
- The LTC rate (1.5 per 100 workers) and disabling injury rate (2.8 per 100 workers) are expected to remain stable.

Rate setting drivers and assumptions

Insurable earnings

The forecast of insurable earnings is a key component in determining the average premium rate. Earlier in 2011, insurable earnings were forecasted to grow by 8.9% to \$83.2 billion in 2011 and by 8.2% to \$90.0 billion in 2012. More recently, economic growth expectations for Alberta and the global economy have been tempered. As a result, we have reduced our insurable earnings estimates for 2011 and 2012 to \$80.7 billion (5.6%) and \$86.1 billion (6.7%), respectively.

Claim volume and duration

In 2011, lost-time claim (LTC) and disabling claim volumes increased over 2010 levels in response to the gradual but ongoing economic recovery in Alberta. The 2011 forecast for LTC volume is 7.5% over 2010 levels. In 2012, we expect LTC volumes will continue to increase, but only modestly at 3.7%. Based on expectations of covered worker growth, claim volumes, and the availability of modified work, we expect a slight rise in both the LTC and disabling injury rate in 2011, with stabilization occurring in 2012.

Although we are seeing continued improvements in injury management, the positive outcomes were somewhat offset by the effects of high unemployment rates and rising claim volumes resulting in increased duration. Although efforts to manage claims to early resumption of employment will continue, duration is expected to increase in 2011 to 37.2 days and to 38.0 days in 2012, which is consistent with the long-term trend we have observed. The expected increases in duration are primarily due to lagging recessionary impacts on the Alberta economy and the extra effort required in returning injured workers to full employment.

Administration

Administrative operating costs are expected to grow by 4.9% from \$170.2 million in 2011 to \$178.6 million in 2012. This increase is primarily due to salary and benefit level adjustments and new hires that were required to handle increased claim volumes.

Asset liability management drivers and assumptions

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 2011 is 2.0%. For 2012 to 2014, the assumed rate of return is 5.2%. 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 a two tiered assumption using 2.0% in the short term (4.55% nominal rate less impact of long-term inflation of 2.5%) followed by 3.0% (5.58% nominal rate) thereafter. This assumption remains unchanged throughout the forecast period.

Detailed information on all the business drivers and assumptions can be found starting on page 7.

Bottom line

The WCB is expecting to maintain a stable financial position in 2012 as premium rates are budgeted to cover the fully funded cost of 2012 accident year injuries. The average premium rate is budgeted to remain stable due to increased insurable earnings/premium revenues sufficiently covering increased injury volumes/costs as a result of a growing Alberta workforce. The Funded Position, representing WCB's overall financial health, is expected to remain comfortably in the green zone as a result of stable results from operating activities and expectations to achieve the required portfolio returns.

2012 Budget Highlights

Key Result Areas	2010 Actual	2011 Budget	2011 Forecast	2012 Budget
Comprehensive Income highlights (\$ millions)				
Operating				
Premium revenue	1,031.5	982.3	1,005.3	1,066.5
Transaction year claim costs	(584.1)	(578.4)	(667.9)	(704.5)
Administration	(166.3)	(170.2)	(168.2)	(178.6)
Net provision adjustments	(92.8)	(155.7)	(92.9)	(107.1)
Other	(52.8)	(57.9)	(55.6)	(58.0)
Operating Surplus (Deficit)	135.5	20.1	20.7	18.3
Asset-Liability Management (ALM)				
Investment income	644.3	352.6	119.0	351.7
Claim benefit liability interest requirement	(259.0)	(272.1)	(229.1)	(242.2)
Claim experience gain (loss)	(63.3)	87.0	(17.5)	30.5
ALM Surplus (Deficit)	322.0	167.5	(127.6)	140.0
Comprehensive Income (Loss)	457.5	187.6	(106.9)	158.3
Financial Position highlights (\$ millions)				
Investments	6,854.6	7,058.4	6,791.1	7,416.0
Claim benefit liabilities	5,278.9	5,612.8	5,595.3	5,886.9
Special dividend	230.1	-	-	-
Funded Position (after dividends)	1,664.5	1,663.6	1,557.6	1,715.9
Key performance metrics				
Funded ratio (after dividends)	129.4%	129.0%	127.2%	128.4%
Claim volume	25,500	24,300	27,400	28,400
Claim duration (days)	36.1	34.8	37.2	38.0
Key drivers and assumptions				
Insurable earnings (billions)	\$ 76.4	\$ 79.2	\$ 80.7	\$ 86.1
Wage growth (AB)	4.6%	3.0%	5.0%	3.5%
Claimant wage growth	3.5%	4.0%	5.0%	3.5%
Inflation rate	1.0%	2.1%	2.4%	2.3%
Investment return	10.2%	5.6%	2.0%	5.2%

Please refer to Financial Statement Projections for the 2012-2014 financial plan highlights.

FUNDING REQUIREMENTS

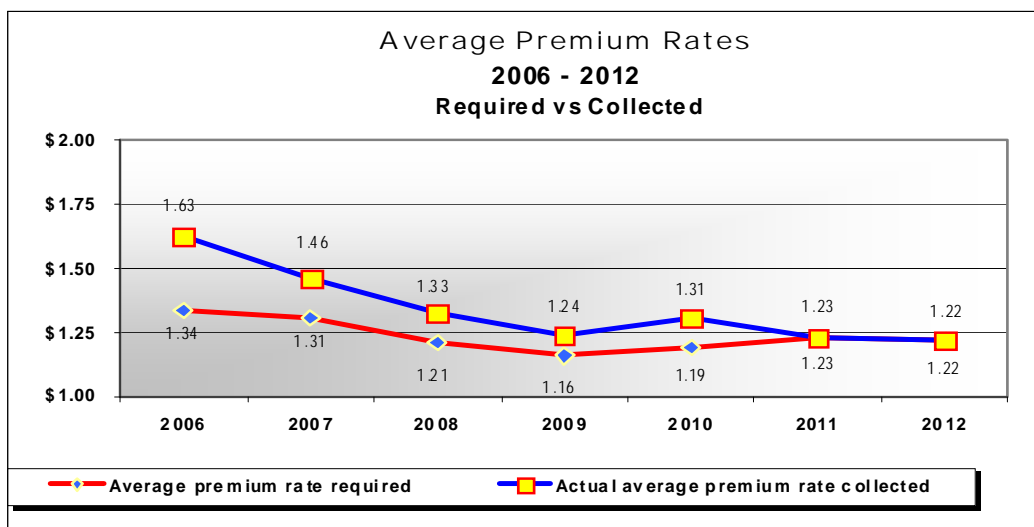
Overview

The 2012 premium revenue requirement is developed from budgeted operating expenditures and actuarial liability projections. The overall 2012 average premium rate across all industry sectors is calculated as follows:

2012 Premium Revenue Requirement

Rate Setting (\$ millions)	2011 Budget	2012 Budget	Change	
Operating Expenses				
Fully funded claim costs	721.7	797.0	75.3	10.4%
Administration	170.2	178.6	8.4	4.9%
Statutory Obligations				
Medical Panel and Appeals Commission levies	9.6	10.3	0.7	7.3%
Safety Association and WH&S	48.3	47.7	(0.6)	(1.2%)
Subtotal	949.8	1,033.6	83.8	8.8%
Funding Requirements				
Occupational Disease Reserve maintenance	17.1	17.5	0.4	2.3%
Total Budgeted Premium Revenue	966.9	1,051.1	84.2	8.7%
Insurable earnings	79,200	86,100	6,900	8.7%
Premium Rate				
Average budgeted premium rate	1.22	1.22	-	-

The table below presents a seven-year trend comparison of required versus collected premium rate. 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 projected to be slightly in excess of the funding policy target range of 114% to 128% for 2012, 2013, and 2014. A dividend is not assumed in the budget as the funding surplus arising in these years does not meet the minimum requirement for a dividend payment.

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.

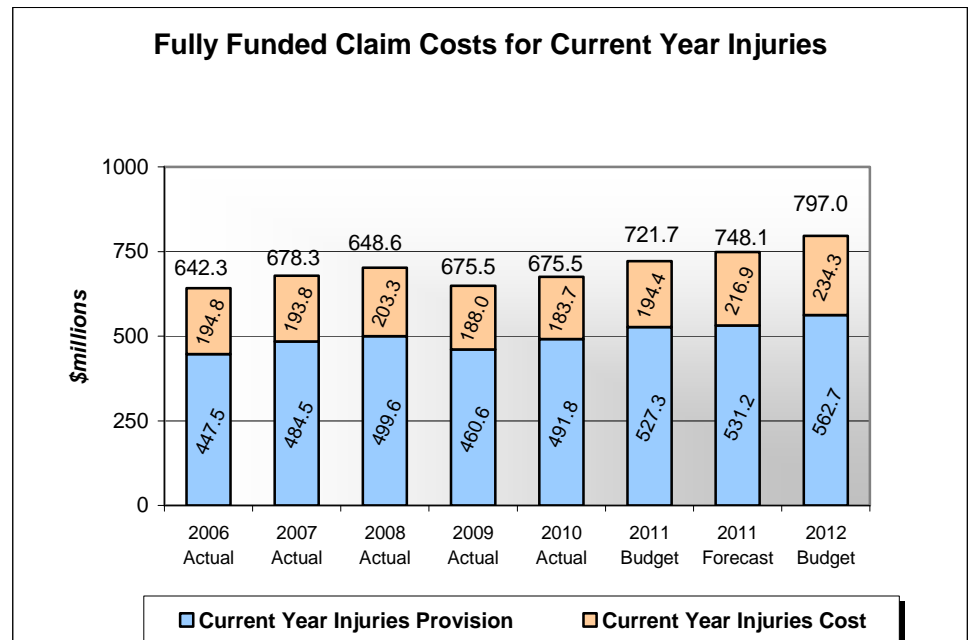
Funding Components

Operating expense requirements

Total revenue requirement for premium rate-setting purposes represents the budgeted 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 and statutory 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, \$17.5 million is the amount predicted to be required in 2012 to maintain the occupational disease reserve at the funding policy level of 6% of claim benefit liabilities.

ECONOMIC ASSUMPTIONS & BUSINESS DRIVERS

Internal and external sources were referenced in order to develop the key planning assumptions used to drive 2012 to 2014 financial planning. External sources include economic forecasts provided by the Conference Board of Canada, the Government of Alberta, and major Canadian banks. The most recent insurable earnings and covered worker estimates were considered when estimating claim volumes.

Economic Assumptions

As a result of our review of the significant internal and external sources of economic data, we have concluded on the following core economic planning assumptions for 2011 to 2014:

Core Economic Assumptions	2010				
	Actual	2011	2012	2013	2014
General inflation (Alberta)	1.0%	2.4%	2.3%	2.5%	2.5%
Cost of living adjustment (COLA)	2.2%	0.0%	0.5%	2.0%	2.0%
Employment growth (Alberta)	(0.4)%	3.2%	2.5%	2.6%	2.6%
Wage growth (Alberta)	4.5%	5.0%	3.5%	3.5%	3.5%
Wage growth (Claimants)	3.5%	5.0%	3.5%	3.5%	3.5%
Health care inflation	5.5%	5.6%	5.3%	5.6%	6.0%
Claim duration (average days)	36.1	37.2	38.0	38.5	38.5
Employment growth (covered workers)	(1.3)%	3.9%	3.8%	3.9%	3.2%

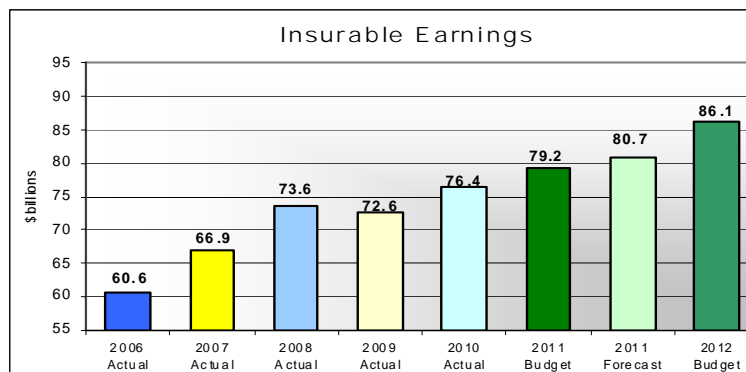
Business Drivers

The key business drivers and assumptions are as follows:

Business Drivers	2011	2012	2013	2014
Insurable earnings (\$ billions)	80.7	86.1	91.8	97.7
Insurable earnings growth (%)	5.6	6.7	6.6	6.4
Covered workers (millions)	1.77	1.84	1.91	1.98
Lost-time claim (LTC) Volume	27,400	28,400	29,000	29,600
Claim duration (days)	37.2	38.0	38.5	38.5
Lost-time claim rate (per 100 workers)	1.5	1.5	1.5	1.5
Disabling claim rate (per 100 workers)	2.8	2.8	2.7	2.7

Insurable earnings

Reflecting the planning assumption of a slow yet gradual economic recovery, insurable earnings are expected to increase steadily over the planning period. With recoveries in wages and employment, and considering re-invigoration within higher-earning energy-producing sectors and related feeder industries, insurable earnings are forecasted to grow by 5.6% to \$80.7 billion for 2011, increasing by 6.7% to \$86.1 billion in 2012, 6.6% to \$91.8 billion in 2013 and 6.4% to \$97.7 billion in 2014.



Insurable earnings are projected to vary across different industry sectors as follows:

Insurable Earnings by Sector (\$ millions)				
Key indicators	2010 Actual	2011 Budget	2011 Forecast	2012 Budget
Agriculture/forestry	348	373	368	396
Mining/oil and gas	8,801	8,301	9,744	10,431
Manufacturing	7,656	7,859	7,817	8,204
Construction	15,233	17,582	16,472	17,941
Transportation	6,095	5,802	6,292	6,662
Trade	11,583	11,722	12,113	12,830
Municipal government, education and health	13,933	14,032	14,642	15,533
Provincial government	1,729	1,830	1,717	1,813
Business/personal/professional services	11,047	11,699	11,535	12,290
Total	76,425	79,200	80,700	86,100

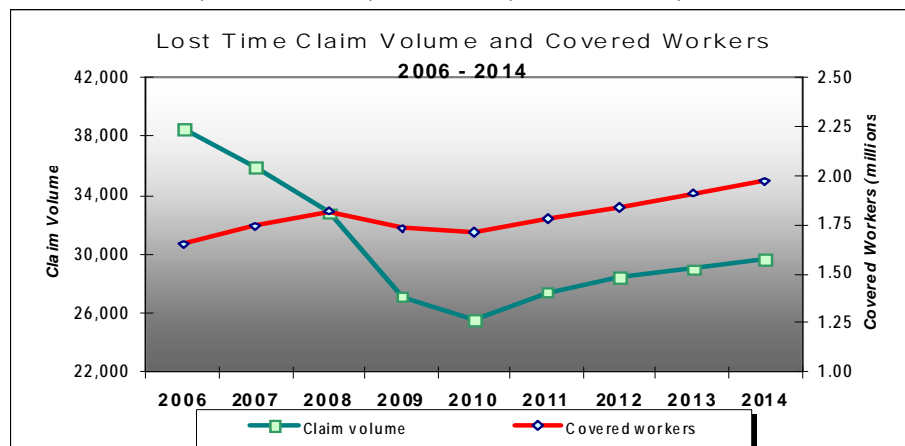
Covered worker volume

After experiencing consecutive years of covered worker decline in 2009 and 2010, strengthening employment figures in 2011 are expected to lead to an increase in the number of workers covered, with 2011 growth estimated at 3.9% over 2010. While slightly down from prior estimates, projected growth in the covered workforce is estimated to be stable and moderate over the planning period, with growth of 3.8%, 3.9%, and 3.2% for 2012 to 2014, respectively.

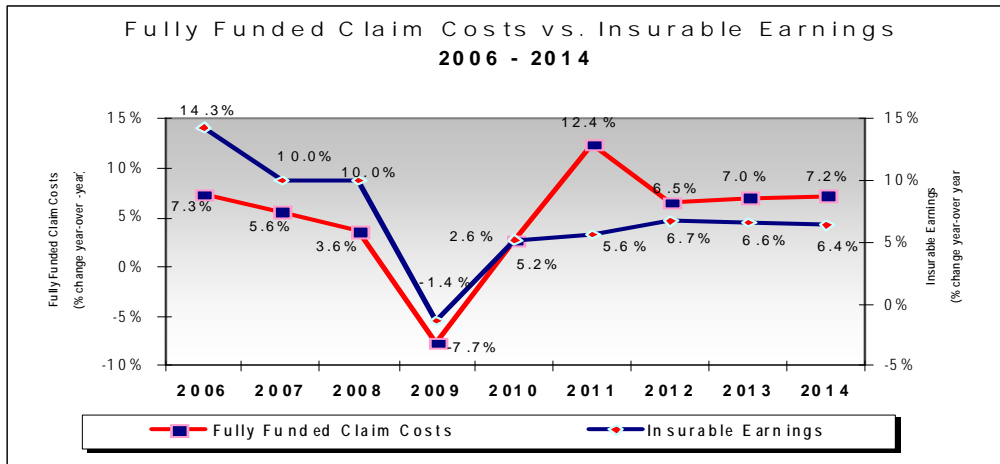
Lost-time claim volume

The recent historic trend for lost-time claims (LTC) has been one of steadily declining volumes. LTC volume fell by 10.0% from a high of 39,900 in 2000 to 35,900 in 2007. With economic slow-down beginning in early 2008, and the onset in late 2008 of a full force economic crisis, severe contractions in employment across all sectors, and particularly within higher-risk industries, lead to a much more pronounced decline in claim volumes in 2008 than witnessed during previous decline years. Volumes subsequently plummeted in 2009 (-17.5%), with further significant declines again in 2010 (-5.9%).

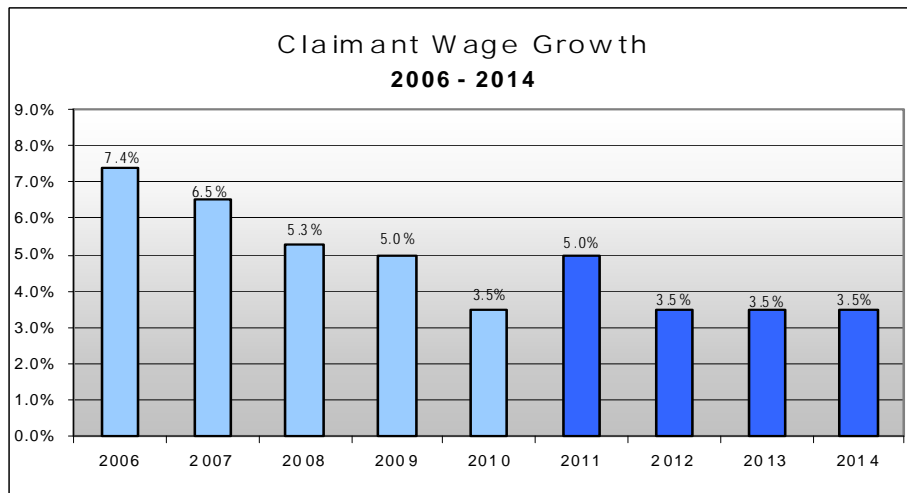
In conjunction with recent and gradual economic growth, 2011 has thus far witnessed some significant year-over-year increases in lost-time claim volume, particularly earlier in the year. The rate of increase in LTC volume has moderated over the latter half of 2011, and current projections are for a 7.5% growth in 2011 over 2010, or 27,400 claims. With sustained operational focus on modified work and the continued promotion of worksite safety, occurring in tandem with gradually increasing economic activity and shifts back into high-rated industries, net expectations are for near-term increases in lost-time claim volumes. Projections are for a 3.7% increase in 2012 (28,400 claims), and 2.1% in 2013 (29,000 claims) and 2014 (29,600 claims).



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 forecast change from 2011 through to 2014.



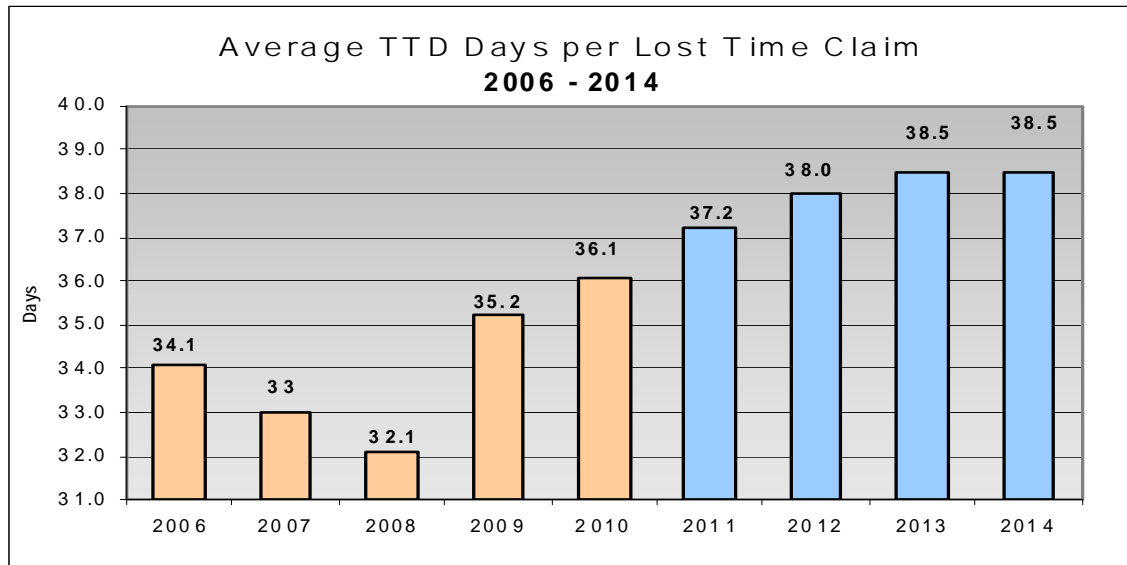
Claim duration

Operational focus on timely and effective claims resolution through early modified work planning, expedited medical care, and tailored return-to-work and vocational planning, all contribute to the increased chances of a safe, timely and successful return to work. Substantial gains were made in claim duration over the past 10 years, with a reduction of approximately 26 days from a peak of 58 days in 2001 to 32 days in 2008. Had it not been for the impact of the economic recession in late 2008, in all likelihood further reductions in duration days, though perhaps not as marked as in more recent years, were plausible.

While lost-time claim volumes underwent a dramatic decline the two years following the economic downturn, the austerity of economic conditions in all markets made it more difficult to get those who were injured back to some level of pre-accident or at least modified work duties. Combined with an increase in the recurrence of older claims occurring during the same period, duration days moved upwards, to 35.2 days in 2009 and 36.2 days in 2010.

While improving economic conditions have the potential to deliver some positive impacts on claim duration in the immediate future, the more likely effect in the short-term will be one of a period of slightly increasing duration as the economy finds its footing and lost-time volumes continue to rise. As such, duration is forecast to increase to 37.2 days in 2011, 38.0 days in 2012 and 38.5 in each of 2013 and 2014.

The graph below shows the impact of the recession on duration days and expectations for the forecast period.



Lost-time and disabling claim rate

There has been a general decline in the LTC rate per 100 covered workers in recent years, due in part to the increase in modified work opportunities provided by employers and improved company safety initiatives. 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 45.3% in 2010).

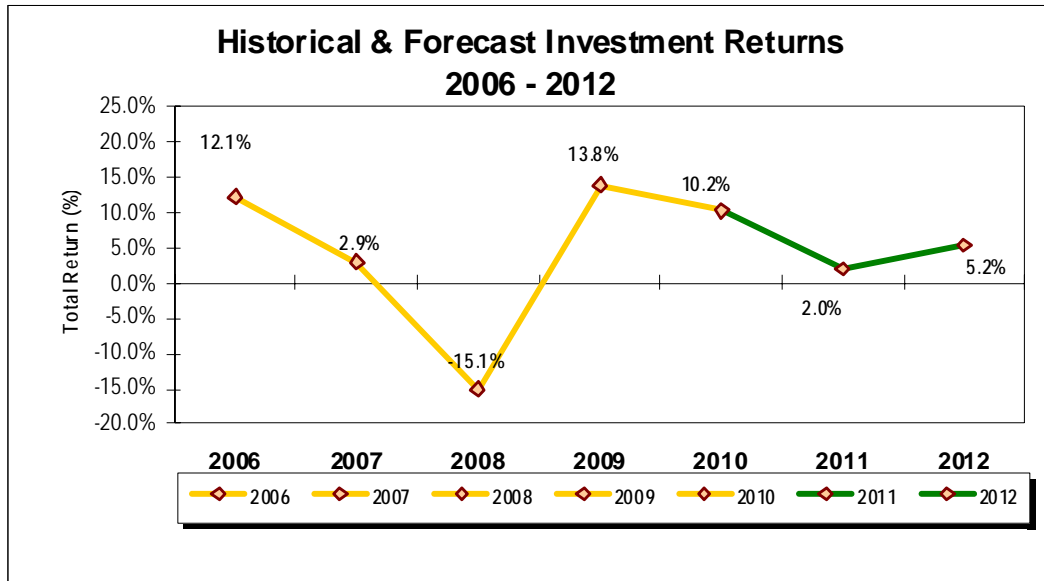
Lost-time injury rates have been declining for years, attributable in large part to improved jobsite safety performance, focus on modified work, and employer incentive programming. More recently, however, significant declines in the injury rate have been driven, in part, by the effects of the economic downturn, wherein the gap between year-over-year changes in covered workers and lost-time volumes were much wider than that which perhaps would have been expected during more stable periods. The plunge in lost-time claim volumes in 2009 and 2010 likely considerably outpaced that which would have been expected by the decline in covered worker figures. Current expectations are for lost-time volume growth to outpace covered worker numbers in 2011, providing for a year where the injury rate is forecast to increase by 3.4% to 1.54. It is anticipated that there will be little movement in the lost-time rate in 2012 as the historic trending between covered workers and lost-time volumes begins to normalize, with the rate declining to 1.52 and 1.50 in 2013 and 2014, respectively.

Administration

- **Operating expenditures** will increase by 4.9% from budget of \$170.2 million in 2011 to \$178.6 million in 2012. This increase will cover higher salary and benefit costs.
- **Capital expenditures** are anticipated to be \$13.3 million, no change from the 2011 budget.

ASSET LIABILITY MANAGEMENT: ASSUMPTIONS

Investments



The chart above shows the historical and forecast rates of return for the portfolio. Since 2006, the portfolio has earned actual returns within a range of -15.1% (2008) and 13.8% (2009). The forecast return for 2011 is set at 2.0%, which reflects year-to-date returns to September 30, 2011 of -0.3% and assumes a 2.3% return for the remainder of 2011.

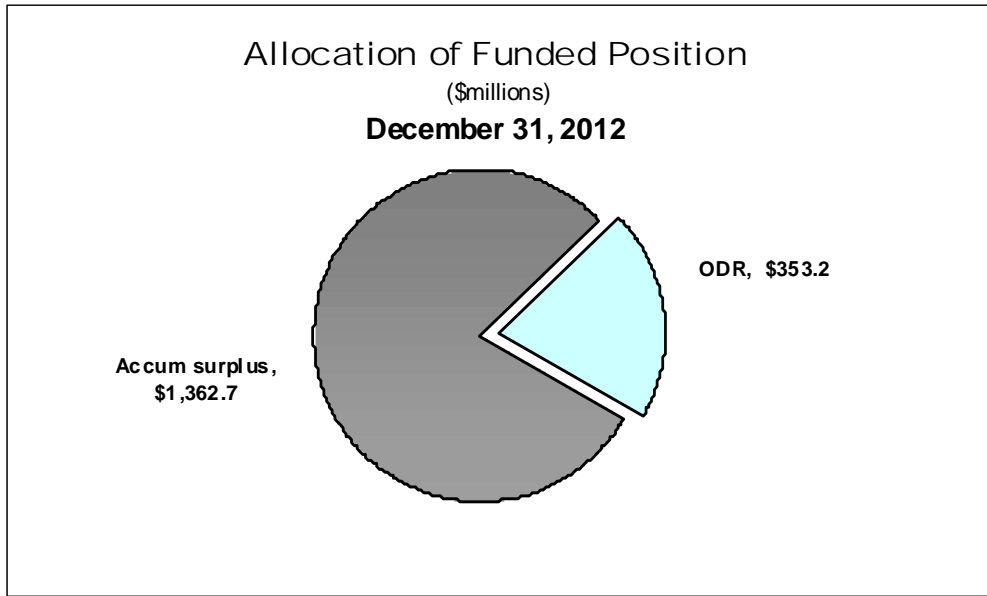
For 2012 and onward, the assumed rate of return is 5.2%. Importantly, this rate of return is not a specific forecast, but is the midpoint of a wide range of possible outcomes. The assumed rate of return is slightly lower than the long term expectation used in 2011 due to lower expected returns on cash equivalents, bonds and real return bonds going forward.

Based on current market fundamentals and historical experience, a range of returns with associated probabilities can be computed for the portfolio. The rate of return should be between -2.3% and 12.7%, in 67% of all periods (2 out of 3 years) and between -3.5% and 20.8%, in 95% of all periods (19 out of 20 years).

FUNDED POSITION

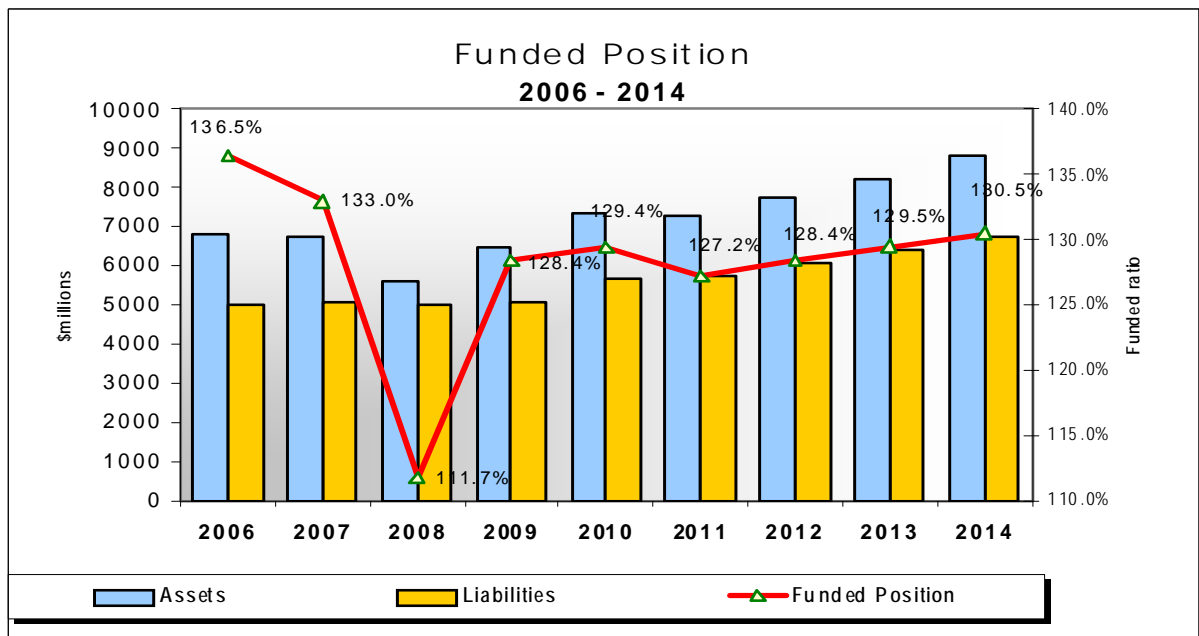
The Funded Position (net assets or the ratio of total assets to total liabilities) for 2011 is forecasted to be 127.2% and budgeted in 2012 at 128.4%. Viewed from another perspective, WCB would have total assets in 2012 of \$7.8 billion to cover estimated liabilities of \$6.0 billion.

The implementation of IFRS in 2011 is still ongoing. Adjustments to the Funded Position are therefore possible. One outstanding item is recognition of the unfunded liabilities related to WCB's participation in the provincial employee pension plans. The impact on 2011 Funded Position could be as high as \$90 million and has not been included in this financial plan.



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 comprehensive income and reserves.

The chart below presents a nine-year trending for Funded Position from 2006 through 2014.



Occupational Disease Reserve

At year-end 2012, the Occupational Disease Reserve (ODR) is expected to have a balance of \$353.2 million to cover potential liabilities related to latent occupational disease. The ODR balance for the 2011 year-end is expected to be \$335.7 million. The Funding Policy stipulates maintaining the ODR funding at 6% of claim benefit liabilities.

The **Occupational Disease Reserve** 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

The 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

2011 - 2014 Budget Assumptions Highlights

Key Result Areas	2010 Actual	2011 Budget	2011 Forecast	2012 Budget	2013 Plan	2014 Plan
Comprehensive Income highlights (millions)						
Operating						
Premium revenue	1,031.5	982.3	1,005.3	1,066.5	1,134.7	1,205.9
Transaction year claim costs	(584.1)	(578.4)	(667.9)	(704.5)	(714.3)	(750.6)
Net provision adjustments	(92.8)	(155.7)	(92.9)	(107.1)	(158.7)	(185.7)
Administration	(166.3)	(170.2)	(168.2)	(178.6)	(183.4)	(187.5)
Other	(52.8)	(57.9)	(55.6)	(58.0)	(63.4)	(67.7)
Operating Surplus (Deficit)	135.5	20.1	20.7	18.3	14.9	14.4
Asset-Liability Management (ALM)						
Investment income	644.3	352.6	119.0	351.7	374.2	397.8
Claim benefit liability interest requirement	(259.0)	(272.1)	(229.1)	(242.2)	(255.1)	(269.0)
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Financial position highlights (millions)						
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Claim benefit liabilities	5,278.9	5,612.8	5,595.3	5,886.9	6,214.3	6,566.8
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Funded Position	1,664.5	1,663.6	1,557.6	1,715.9	1,879.2	2,057.1
Key performance metrics						
Funded ratio	129.4%	129.0%	127.2%	128.4%	129.5%	130.5%
Claim volume	25,500	24,300	27,400	28,400	29,000	29,600
Claim duration (days)	36.1	34.8	37.2	38.0	38.5	38.5
Key drivers and assumptions						
Insurable earnings (billions)	76.4	79.2	80.7	86.1	91.8	97.7
Wage growth (Alberta)	4.6%	3.0%	5.0%	3.5%	3.5%	3.5%
Claimant wage growth	3.5%	4.0%	5.0%	3.5%	3.5%	3.5%
Inflation rate	1.0%	2.1%	2.4%	2.3%	2.5%	2.5%
Investment return	10.2%	5.6%	2.0%	5.2%	5.2%	5.2%
Budget recommendations						
Average required premium rate	\$1.19	\$1.22	\$1.23	\$1.22	n/a	n/a
Funding Surplus (Deficit)	\$0.12					
Average budgeted/(collected) premium rate (including ODR)	\$1.31	\$1.22	\$1.23	\$1.22	n/a	n/a

