WCB-Alberta

Management Discussion and Analysis of Consolidated Financial Statements and Operating Results

For the year ended December 31, 2019

Management Discussion and Analysis of 2019 Consolidated Financial Statements and Operating Results

The Management Discussion and Analysis (MD&A) provides management's perspective on key issues that affect current and future performance of the Workers' Compensation Board–Alberta (WCB). The MD&A, prepared as of April 28, 2020, should be read in conjunction with the audited consolidated financial statements and accompanying notes for the year ended December 31, 2019.

Forward-looking statements

This report contains forward-looking statements about certain matters that are by their nature subject to many risks and uncertainties, which may cause actual results to differ materially from the statements made herein. Forward-looking statements include, but are not limited to, WCB objectives, strategies, targeted and expected financial results. They also include the outlook for WCB's business and for the Alberta and global economies. Risks and uncertainties include, but are not limited to, changing market, industry and general economic factors or conditions; changes in legislation affecting WCB policies and practices; changes in accounting standards; the ability to retain and recruit qualified personnel; and other risks, known or unknown. Some are predictable or within WCB control; many are not. The reader is hereby cautioned not to place undue reliance on these forward-looking statements.

Unless otherwise indicated, all amounts shown are in millions of Canadian dollars.

Business Overview

Corporate profile

Founded in 1918, WCB is a statutory corporation with a legislative mandate under the *Workers' Compensation Act* (the Act) to administer the workers' compensation system for the province of Alberta. While accountable to the Minister of Labour and Immigration, WCB is independently funded and operated. Through the payment of premiums, over 159,000 employers fund the system, which covers more than 1.8 million workers.

WCB's mandate

In Canada, workers' compensation is a no-fault disability system that protects both employers and workers against the economic impact of work-related injuries and occupational diseases. Based on the Meredith Principles, the system covers injured workers for lost employment income and provides health care, rehabilitation and other services required due to a work-related injury, while employers are shielded from litigation. This system brings economic stability to the workplace through collective liability that minimizes the risks and expenses of injury. To achieve these objectives, the Act established the Accident Fund and imposed a statutory obligation on WCB to ensure that it be fully funded.

At the highest and simplest level, WCB is involved in two significant and complementary business activities: customer operations and asset liability management (ALM).

Customer operations provide disability management for workplace injuries. Key business processes include rate setting, assessment and collection of premiums from employers, payment of compensation benefits to injured workers, return-to-work services and administration.

Asset liability management involves a risk-based approach to manage assets and liabilities so that sufficient assets are available to pay for claim-related obligations. Key business processes include strategic financial planning, investment management, claim benefit liability analysis and valuation, financial risk management and financial performance reporting. Prudent asset liability management not only ensures security of benefits for workers and fair premiums for employers, but also provides appropriate tools for evaluating how effectively WCB is meeting its financial obligations.

WCB's vision and mission

The core principles set out in WCB's vision and mission shape the corporate beliefs and values that guide the organization's operating philosophy.

> *Vision*
>
> ***Albertans working—a safe, healthy and strong Alberta.***
>
> *Mission*
>
> ***WCB-Alberta, working together with our partners, will significantly and measurably reduce the impact of workplace illness and injury on Albertans.***

WCB's strategic vision is to make a positive and lasting impact on the people, society and economy of Alberta through what it does, while the mission statement describes the guidelines for how it intends to conduct business.

2019 Financial Performance

OPERATING HIGHLIGHTS

The funding model for WCB operates on the premise that in a given year, a link exists between current premiums and the cost of current year injuries, and asset liability management activities will generate investment returns sufficient to cover the annual interest requirement on the claim benefit liability. Given the volatile performance of local and global economies, forecasting these activities is subject to a great deal of uncertainty and risk. Consequently, actual results will likely differ significantly from even the most rigorously developed plans. Surpluses or deficits can arise when actual costs and returns are different from forecast expectations, which rely on economic and business assumptions based on available information at a point in time. Surpluses and deficits accumulate and are reflected in the funded position.

In 2019, WCB experienced an overall operating surplus of $276.1 million. The factors contributing to the surplus are better understood by reorganizing the Consolidated Statement of Comprehensive Income to represent WCB's main business activities as follows:

Customer operations - $278.7 million deficit as a result of higher claim costs and lower premium revenues.

- The Alberta economy showed some improvement throughout 2019, although the recovery remained slow and fell short of budget expectations. Despite these economic challenges, WCB maintained focus and commitment in the care of helping injured workers through the uncertainty caused by a work injury.
- Employer assessable earnings of $103.9 billion were $3.7 billion (3.4%) below budget, and $1.6 billion (1.6%) above 2018. Premium revenue ended the year at $1,124.2 million, which was $38.3 million (3.3%) under budget and $49.5 million (4.6%) above 2018. Claim benefit expense of $1,246.4 million was $26.0 million (2.1%) over budget, and $140.1 million (12.7%) above 2018, due to increased costs for 2019 accidents, and higher benefit costs driven by changes in actuarial assumptions and methods. Overall, the premium rate collected was $1.08, compared to a required rate of $1.35.
- Disabling claim volume decreased slightly to 51,000 (1.4%) from 51,700 in 2018, and the resulting disabling injury rate per 100 covered workers remained stable to 2018 at 2.7. Lost-time claim (LTC) volume increased to 30,100 (5.2%) from 28,600 in 2018, and the resulting LTC rate per 100 covered workers remained relatively flat at 1.6.

Asset liability management - $554.8 million surplus as a result of higher investment returns offset by actuarial losses.

- Investment returns were significantly higher in 2019, delivering net investment income of $1,433.9 million, which was $904.6 million (170.9%) above budget, and $1,329.5 million (1,273.5%) above 2018. The portfolio earned a rate of return of 13.7% for the year, exceeding the budget expectation of 5.0% and the benchmark return by 0.4%. The strength of the portfolio was a reflection of all asset classes performing well.
- Actuarial remeasurement adjustments resulted in a loss of $479.4 million, which was driven primarily by changes in actuarial methods and assumptions, as well as claim experience losses resulting from higher claim costs in most cost categories.

The year-end Funded Position was $1,986.6 million and the funded ratio (total assets over total liabilities) was 119.2%.

The following tables represent the operating highlights for each of WCB's key business activities:

Operating results by business activity

($ millions)	2019 Budget	2019 Actual	2018 Actual
Customer operations			
Premium revenue	$ 1,162.5	$ 1,124.2	$ 1,074.7
Claim benefit expense	(1,220.4)	(1,246.4)	(1,106.3)
Corporate administration and injury reduction	(169.5)	(156.5)	(160.0)
Deficit from customer operations	(227.4)	(278.7)	(191.6)
Asset liability management			
Investment income	572.0	1,474.4	145.3
Investment management expense	(42.7)	(40.5)	(40.9)
Net investment income	529.3	1,433.9	104.4
Interest expense on claim benefit liabilities	(395.8)	(394.8)	(365.3)
Remeasurement loss on claim benefit liabilities	-	(479.4)	(267.6)
Other expense items	(3.8)	(4.9)	(4.5)
Asset liability management expenses	(399.6)	(879.1)	(637.4)
Surplus (deficit) from asset liability management	129.7	554.8	(533.0)
OPERATING SURPLUS (DEFICIT)	$ (97.7)	$ 276.1	$ (724.6)

Sources of operating surplus (deficit)

($ millions)	2019 Budget	2019 Actual	2018 Actual
Deficit from customer operations			
Premium revenue			
Premium revenue shortfall resulting from the actual premium rate collected of $1.08 (2018 – $1.05) being lower than the required premium rate of $1.35 (2018 – $1.24), based on assessable earnings	$ (227.4)	$ (284.2)	$ (195.4)
Other revenue items	-	5.5	3.8
	(227.4)	(278.7)	(191.6)
Surplus (deficit) from asset liability management			
Investments			
Excess (shortfall) of net investment income over the interest expense on claim benefit liabilities $394.8 million (2018 – $365.3 million)	133.5	1,039.1	(260.9)
Other expense items	(3.8)	(4.9)	(4.5)
	129.7	1,034.2	(265.4)
Actuarial remeasurement			
Changes in actuarial methods and assumptions	-	(347.6)	(45.9)
Loss due to claims experience	-	(131.8)	(221.7)
	-	(479.4)	(267.6)
	129.7	554.8	(533.0)
OPERATING SURPLUS (DEFICIT)	$ (97.7)	$ 276.1	$ (724.6)

Customer Operations

PREMIUMS

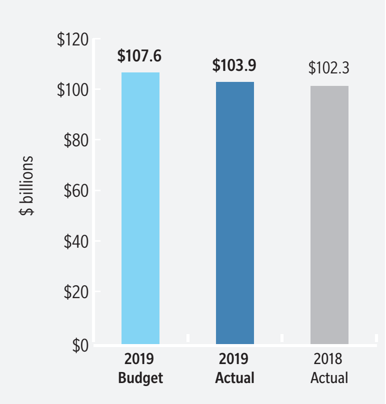
Assessable earnings

$3.7 billion (3.4%) under budget

$1.6 billion (1.6%) higher than prior year

The Alberta economy showed some improvement in 2019. Assessable earnings were higher than the prior year but below budget expectations. The increase over the prior year primarily reflected an increase in average hourly wages in the province. The construction sector represented the largest decline against budget.

Assessable Earnings



Premium revenue

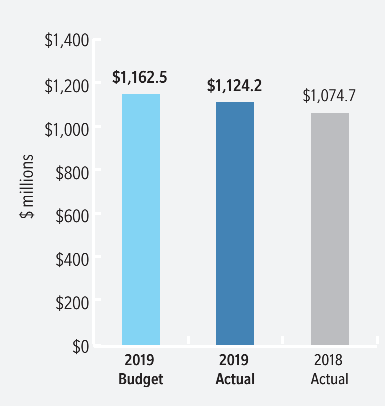
$38.3 million (3.3%) under budget

$49.5 million (4.6%) higher than prior year

Following the negative budget variance in assessable earnings, premium revenue also fell short of budget by $38.3 million. The construction sector represented the largest decline against budget.

Premium revenue increased by 4.6% to $1,124.2 million in 2019, due in part to a year-over-year increase of 1.6% in employer assessable earnings.

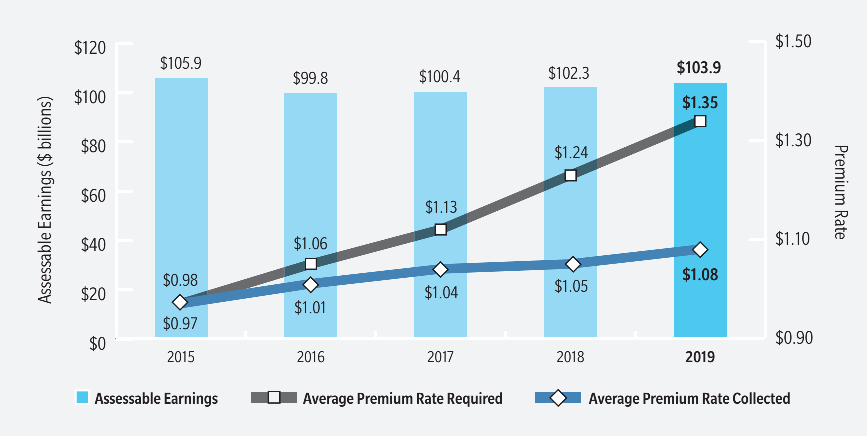
Premium Revenue



Premium rates and assessable earnings

The chart below presents assessable earnings versus average premium rate required and collected from 2015 through 2019. Since 2015, the rate required has been on a growth trajectory under a backdrop of low assessable earnings growth and rising claim expense. While assessable earnings in 2019 saw a slight increase, claim expense continued to grow at a faster pace, resulting in a 8.9% increase in the required rate.

Assessable Earnings versus Average Premium Rate Required



CLAIM BENEFIT EXPENSE

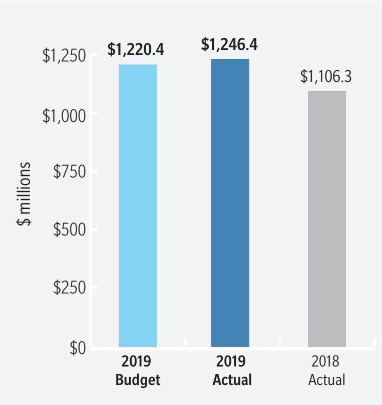
Claim expense is an estimate of current and future costs arising from compensable injuries and exposures to occupational diseases occurring in 2019, as well as the current and future costs to administer these claims.

$26.0 million (2.1%) over budget

$140.1 million (12.7%) higher than prior year

Claim benefit expense was higher than budget and prior year primarily due to increased costs for 2019 accidents, and changes in actuarial methods and assumptions.

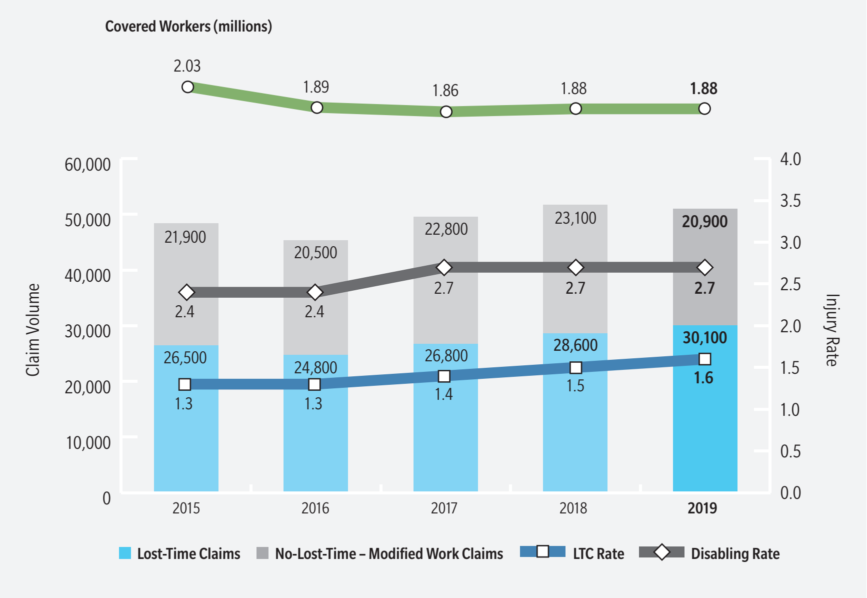
Claim Benefit Expense



Claim volume and injury rates

Disabling claim volume comprises two components: claims resulting in lost-time from work and those resulting in no lost time due to a return to modified duties. The lost-time component grew in 2019 by 5.2% but was more than offset by a 9.5% decline in the no-lost-time modified work component. The net impact was a slight 1.4% decline in disabling volume in 2019. The number of covered workers remained flat in 2019. Changes in claim volume were not enough to move the lost-time and disabling injury rates; both holding relatively flat.

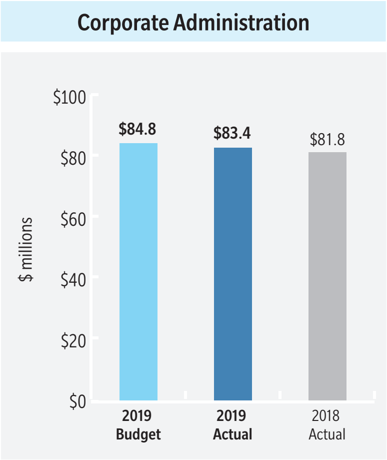
Claim Volume and Injury Rates



CORPORATE ADMINISTRATION

- **$1.4 million (1.7%) under budget**
- **$1.6 million (2.0%) higher than prior year**

Corporate administration expenses exclude costs for administering claims (2019 – $118.0 million, 2018 – $120.6 million) that are included in claim benefit expense. Corporate administration was essentially within budget and saw minimal year-over-year growth due to inflation.



Asset Liability Management

The Act requires that the Accident Fund remain fully funded such that sufficient assets are maintained to pay for the liability obligations of the fund. It follows that the financial risks inherent in those assets and liabilities need to be fully understood and carefully managed in order to limit the risk that fluctuations on either side do not cause the Accident Fund to become unfunded. ALM helps determine an appropriate investment strategy to reduce funding risk.

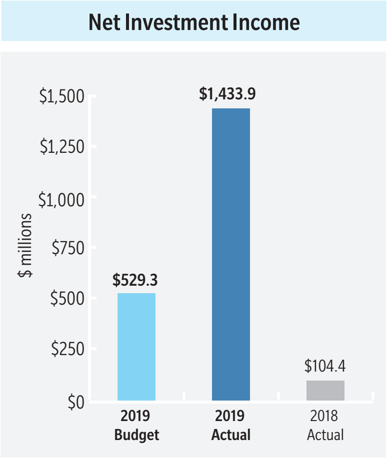
The portfolio is prudently managed within a robust ALM framework, which involves an integrated risk-based approach to managing the fund's assets within the context of the claim benefit obligations they are expected to safeguard. Financial risks are modeled and studied on a regular basis, to confirm that the portfolio can deliver on its requirement to pay for the obligations of the fund well into the future. Volatility in investment markets and the economic environment makes this a complex and challenging exercise. However, strong risk management practices supported by modeling software provide a systematic and consistent platform for monitoring the emerging risk profile of the assets and liabilities. Throughout the year, risk metrics confirmed that the Accident Fund was operating within an acceptable level of risk.

INVESTMENTS

Net Investment income

- **$904.6 million (170.9%) over budget**
- **$1,329.5 million (1,273.5%) higher than prior year**

Net investment income was higher than budget and the prior year as returns across all asset classes significantly exceeded expectations and prior year returns.



The portfolio earned a total rate of return of 13.7% in 2019 (0.4% above the policy benchmark) and 8.2% for the four-year period ending December 31, 2019 (1.7% above the policy benchmark). While the return in 2019 was unusually strong as all invested asset classes performed well, the long-term return is consistent with the expected level of risk set in the Investment Policy and by the ALM framework. The primary goal of the investment portfolio is to earn a long-term rate of return that meets or exceeds the actuarial nominal rate of return (referred to as the actuarial discount rate). On this basis, the portfolio's rate of return for 2019 of 13.7% significantly exceeded the actuarial nominal required rate of 4.6%, and has comfortably surpassed this objective over both four (8.2%) and ten year (8.6%) periods.

Investment returns play a pivotal role in WCB's financial results. The following provides an overview of the economic and market forces that had a direct impact on WCB's investment portfolio and returns.

Capital markets overview

2019 was an impressive year as every major asset class had a positive return for the year. Global equity markets recorded their best year in a decade, shrugging off trade tensions and warnings of slowing growth in major economies. Government bonds, which tend to fall when risk assets perform well, also gained in 2019. Oil, gold and corporate bonds all generated double-digit returns. Bonds produced strong returns as the US Federal Reserve pivoted from its tightening interest rate policy stance and cut interest rates three times out of concern that trade tensions between the US and China and a global growth slowdown would negatively impact the US economy.

Real assets, such as real estate and infrastructure, continue to attract investors due to their defensiveness when volatility rises, as well as their ability to provide moderate but predictable earnings growth. In today's low yield environment, they offer an above-average yield, low return correlation to more traditional asset classes such as equities and bonds, and steady forecastable cash flows. Within real estate, core income generating assets, particularly in British Columbia and Ontario, provided stable income and capital appreciation. Downtown office assets in Vancouver and Toronto experienced appraisal gains due to increased market rents and strong fundamentals. Valuation gains were also prevalent within the industrial and multi-family portfolios due to rental rate growth and cap rate compression. Infrastructure assets continued to deliver strong total returns supported by cash flow growth and improved valuations.

CLAIM BENEFIT LIABILITIES

At the end of each fiscal year, WCB determines its claim benefit liabilities for all injuries that have occurred on or prior to that date, as well as for past exposures that may result in future occupational disease claims. These liabilities represent the actuarial present value of all future benefits and related administration costs, excluding costs attributable to self-insured employers. As at December 31, 2019, those future payments totalled $21.8 billion and, when discounted using a nominal rate of return assumption of 4.6% per annum, resulted in claim benefit liabilities of $10.0 billion—an increase of $0.9 billion over 2018.

Effect of discounting

The difference between the future payments and the present value highlights the significant effect of discounting, as shown in the table below.

($ billions)	Years 1 to 5	Years 6 to 15	Years 16 & beyond	**Total**
Timing of future payments	$ 3.2	$ 5.1	$ 13.5	$ 21.8
Effect of discounting	(0.3)	(1.8)	(9.7)	(11.8)
Claim benefit liabilities				$ 10.0

Benefit obligations extend well into the future. The table above illustrates that over 85% of future payments are expected to occur in year 6 and beyond. More than 50% of these payments are expected to be funded by future investment income.

Significant changes in liabilities

The overall $925.1 million increase in claim benefit liabilities was attributable to the following:

($ millions)		2019 changes
Customer Operations related		
Provision for future costs of current-year injuries and exposures*	$	932.9
Benefit payments for prior years' injuries		(884.8)
		48.1
Asset Liability Management related		
Interest expense on the liability		394.8
Changes in actuarial methods and assumptions		347.6
Claim experience loss		131.8
Other		2.8
		877.0
	$	925.1

** Provision for future costs of current-year injuries and exposures are included as part of claim benefit expense on page 29.*

Actuarial methods and assumptions

The following actuarial methods and assumptions changes resulted in an increase to claim benefit liabilities of $347.6 million:

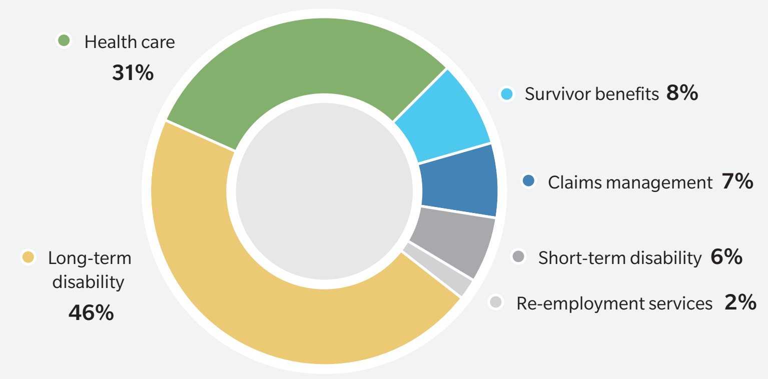
- Updates to the methods and assumptions used for valuing home maintenance and housekeeping allowances ($479.3 million increase).
- Updates to mortality assumptions ($145.8 million decrease).
- Updates to other assumptions ($14.1 million increase).

Claim experience

Differences between actual experience and what was expected in the prior valuation result in experience gains (which decrease the liability) or losses (which increase the liability). These differences resulted in an overall experience loss of $131.8 million for 2019. Claim costs were higher than expected in most benefit categories, most notably in health care (increased the liability by $78.5 million), short term disability (increased the liability by $56.1 million), and re-employment services (increased the liability by $50.3 million), while wage growth and inflation were lower than expected (decreased the liability by $45.3 million).

The following chart shows the breakdown of the claim benefit liabilities as at December 31, 2019, by benefit type:

Claim Benefit Liabilities, December 31, 2019



Funding

FUNDING POLICY

The Funding Policy is the primary instrument through which WCB manages its capital or fund structure and provides direction for setting premium rates and optimum funding level. Effective January 1, 2019 the Occupational Disease Reserve (ODR) was transferred to the Fund Balance and is no longer a separate reserve due to changes to the funding policy. Details of the Funding Policy may be found in the Policy and Legislation section of WCB's website. Discussion is also included in Note 4 *Funding*, in the accompanying consolidated financial statements and notes.

Funding principles and objectives

The strategic aim of funding and investment policies is to strive for balance between financial risk (i.e., volatility), investment returns and funding sustainability. Specifically, the Funding Policy embodies these financial objectives:

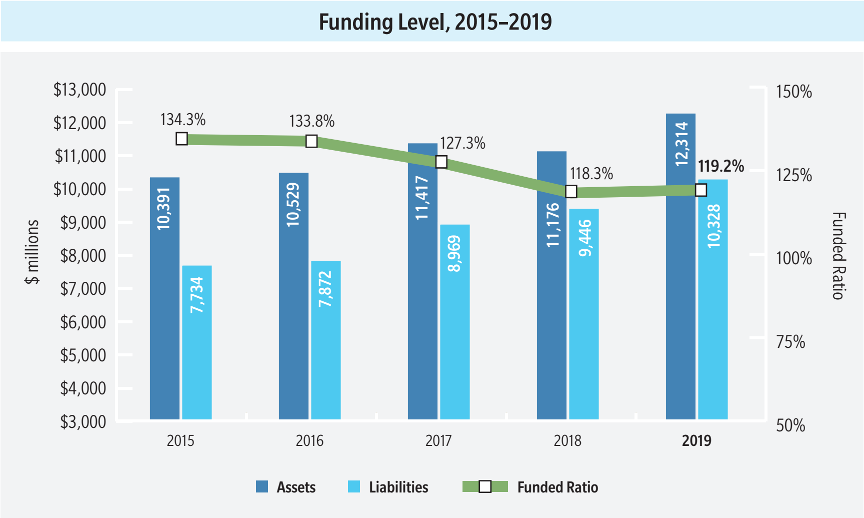
- Minimize the risk of becoming unfunded.
- Minimize cost volatility to employers.
- Ensure a link exists between current premiums and the cost of current year injuries.

The funding mechanisms that evolve from these objectives address those risks that may affect the financial sustainability of WCB—primarily investment volatility. Funding Policy rules are in place to minimize these risks, with ongoing monitoring and evaluation to ensure they continue to respond effectively to changing economic conditions.

FUNDING LEVEL

The Funded Ratio (total assets to total liabilities), as at December 31, 2019, is 119.2%, (2018 - 118.3%). Viewed from another perspective, WCB has total assets of $12.3 billion to cover the discounted present value of its total estimated liabilities of $10.3 billion. The Funded Ratio is within the target range recommended in the Funding Policy.

The chart below presents the funding level from 2015 through 2019.



Enterprise Risk Management

OVERSIGHT

Under WCB's corporate governance structure, the Board of Directors is responsible for overall risk management. The executive team, which has a mandate to identify and manage enterprise-level risk, is assisted by the Planning & Priorities Committee, composed of a group of senior managers with responsibility for risk identification, assessment and mitigation at the operating level.

RISK ASSESSMENT

WCB has three primary processes for managing risk. First, risk management is integral to the day-to-day business. Major projects and changes to business processes must go through a documented risk analysis to assess risk and identify mitigation plans and controls to lessen the likelihood or impact of these risks. The second process is to complete a systematic and comprehensive risk assessment of emerging corporate risks as they develop throughout the year. Finally, WCB also completes corporate risk assessments during the year that engage departmental management teams and senior managers to develop a comprehensive organizational risk register. The executive team prioritizes those risks with the highest potential residual impact to WCB and selects some for comprehensive risk assessment and mitigation.

SIGNIFICANT RISKS

WCB has identified the following risk exposures that could have significant impact on the organization and its operations.

Benefit cost risk
Many of WCB's claim-related benefits are subject to external factors that have potentially significant impacts on the amount and duration of related benefit costs. These risks and uncertainties are driven largely by economic conditions such as health care inflation and utilization, as well as employment and wage growth. Other factors may also arise through administrative precedents established through the appeals process, legislative changes or from new medical findings for occupational disease. All of these factors add significant uncertainty to WCB's cost structure and may impose, over time, pressures on the funding level.

Fraud-related risk
Every year, WCB collects approximately one billion dollars in premium revenue to cover current and future costs arising from compensable injuries and exposures to occupational diseases occurring in the year, as well as the future costs to administer these claims. The magnitude of these costs and the number of individuals and companies involved in these processes—over 159,000 employers, 178,000 injured workers and thousands of service providers—creates inherent risk for fraud. WCB employs an extensive audit program to monitor the organization's ability to protect against fraud and implements additional controls, as required, to strengthen WCB's management of fraud risk.

Funding risk
Managing the components of WCB's overall funding level is a complex process that involves forecasting, liability projection, investment management and operational performance. Although processes are within management's influence or control, many of the assumptions used in forecasting involve significant uncertainty regarding the future. Asset liability management continues to be enhanced to provide better tools, processes and information to enhance forecasting, financial planning and decision-making processes within WCB.

Investment risk
In its investment portfolio, WCB is exposed to financial risk, which includes market and portfolio risk, among others. Market risk is the risk that the fair value of investments and/or associated cash flows may change because of changing general economic conditions or events that broadly affect capital markets. Portfolio risk relates to specific composition and management of WCB's portfolio. Details of financial risks related to investments are discussed in Note 7 *Investment Risk Management*, in the accompanying consolidated financial statements and notes.

Premium risk
WCB has exposure to premium risk, which is the risk that premiums set for the coming fiscal period will not be sufficient to cover the operating costs in that year. This risk is largely driven by provincial economic conditions such as employment growth and wage escalation. To manage premium risk, WCB has instituted a comprehensive forecasting program that leverages widely accepted economic-forecasting sources such as the Conference Board of Canada.

Technology risk
To support its core business processes, WCB uses a number of information systems for processing transactions and maintaining injured worker and employer information. If these systems were to fail or were compromised, significant disruption to business processes and customer service could result. To mitigate technology risk, WCB maintains a business continuity plan, system controls and backup systems to address processing failures and provides extensive training to develop internal system expertise.

Implications of Accounting Policies and Estimates

Preparation of consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) requires management to make judgments, assumptions, and estimates that could materially affect the results of operations and financial condition of WCB. The following discusses those significant accounting policies that entail significant use of judgment and estimates. For further discussion of accounting impacts, please refer to the accompanying consolidated financial statements and notes.

Investments
WCB must apply judgment to determine whether it has control or significant influence with respect to the activities of its investees, which will affect whether consolidation or equity accounting for an investee is required. Additional details are found in Note 5 *Investments*, in the section *Interests in unconsolidated structured entities*.

WCB's investment assets are financial instruments measured at fair value at each reporting date. Fair value measurement, which reflects realizable market value, could lead to significant volatility in the statement of financial position during periods of economic and market instability. For those investments whose fair value is not based on observable market inputs, judgment must be applied in selecting and/or developing appropriate valuation techniques, assumptions, risk factors and input data. Due to the nature of the market for such assets, their estimated fair value may differ from their realized value depending on prevailing market conditions.

The fair value of a derivative contract is its change in value with respect to the change in the underlying security or reference index to which the contract is linked. In addition, the fair value of derivative contracts must reflect potential counterparty default risk, which is mitigated by transacting only with those counterparties whose credit risk is insignificant. Because such fair value changes are recognized in income in the periods in which they arise, investment income for those periods may be volatile. When the closing positions of derivative contracts represent material gains and losses, their settlement may result in large unanticipated cash inflows and/or outflows, respectively.

Details of investment assets and their inherent risks are in Note 5 *Investments* and Note 7 *Investment Risk Management* in the accompanying consolidated financial statements and notes.

Valuation of employee benefit liabilities
WCB has applied defined benefit accounting for employee post-employment plans, which requires an actuarial determination of employee benefit obligations extending well into the future. The actuarial valuation process projects benefit cost streams into the future and discounts them to present value using a discount rate linked to market yields on high quality corporate bonds with similar risk and cash flow characteristics as the liabilities. Measurement uncertainty is high because judgments and assumptions regarding the estimated amount, timing and duration of benefit commitments many years in the future are inherently difficult to predict reliably and also subject to external factors outside management's control. Since these judgments and assumptions may change in response to current and future economic conditions, liability remeasurement arising from changes in judgments and assumptions in any given period, may also result in material changes to the related liabilities.

Details of WCB's multi-employer and sponsored defined benefit plans are in Note 12 *Employee Benefits* in the accompanying consolidated financial statements and notes.

Valuation of claim benefit liabilities

WCB has significant obligations for benefits to injured workers extending well into the future. In order to estimate these future obligations, WCB applies the actuarial present-value methodology for its claim benefit liabilities. The actuarial process projects benefit payment streams into the future and discounts them to present value using a discount rate linked to the long-term return on investment assets funding those liabilities. Measurement uncertainty is high because the assumptions regarding the amount, timing and duration of the benefit commitments and future return on assets are difficult to forecast and are influenced by risk factors that are inherently unpredictable. Consequently, the selection of one valuation assumption or technique over another in estimating claim benefit liabilities could have a material impact on the liability valuation.

Details of the valuation, along with sensitivity of the associated risks are in Note 13 *Claim Benefit Liabilities* and Note 15 *Claim Benefit Risks* in the accompanying consolidated financial statements and notes.

Premiums

The reported premium revenue at year end includes an estimate of premium adjustments, as well as an estimate for safety rebates earned by participating employers that have met performance criteria for workplace safety. Generation of these estimates requires use of judgment in developing the methodology as well as the relevant economic assumptions. As such, actual premiums and safety rebates may differ in periods of economic uncertainty.

Details of these estimates are in Note 16 *Premium Revenue* in the accompanying consolidated financial statements and notes.

Governance and Compliance

Legislative authority

Under the authority of the Act, WCB is a provincial board-governed organization that operates independently while reporting to the Minister of Labour and Immigration.

Internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (ICOFR) to provide reasonable assurance regarding the reliability of the entity's financial reporting and the preparation of its consolidated financial statements in accordance with IFRS. WCB has developed a framework and plan for the overall ICOFR program, which is based on best practices under the COSO[i] and COBIT[ii] frameworks. The ICOFR program is assisted by WCB's Management Audit Services group and program results are shared with the Office of the Auditor General.

Business planning

An important aspect of financial planning and budgeting is linkage to WCB's strategic plan and the resulting corporate objectives developed each year in support of the strategic plan. These objectives and the related performance indicators set the direction for the organization and identify the significant areas of focus for the coming year. The annual budget establishes the foundation for appropriate resource allocation for achieving the corporate objectives.

[i] *Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013 Framework), which developed a governance framework for internal control.*

[ii] *Control Objectives for Information and Related Technology, a collection of best practices for IT governance, control and assurance.*

Emerging Standards

WCB conducts continuous environmental scanning of the financial reporting and actuarial standard-setting landscape. Important developments in recognition and measurement of critical financial statement items may have significant implications for funded position and financial performance in the current and future reporting periods. Once standards are officially issued, WCB analyzes their key requirements to ensure that any major impacts on the organization are well understood, thus facilitating timely planning and effective implementation of accounting processes and systems that will result in high-quality financial reporting.

IFRS 17 INSURANCE CONTRACTS

Released in May 2017, IFRS 17 introduces a new measurement model for insurance contracts featuring important new concepts, definitions, recognition and measurement approaches for claim benefit liabilities and insurance service revenue, reflected in new and enhanced financial statement presentation and disclosure. Ancillary changes in actuarial standards will also affect how the new requirements will be applied for the valuation of WCB's claim benefit liabilities, particularly with the determination of assumptions, methodologies, and data requirements.

Some important changes for WCB arising from adoption of IFRS 17 include:

Discount rate
The interest rate used to discount future cash flows arising from its claim obligations could change materially. The prescribed approach involves the development of a yield curve using observable market data for an actual or a reference portfolio of fixed income assets with similar cash flow characteristics as the comparable liability portfolios. This new methodology could potentially introduce material increases or decreases in claim benefit liabilities, as well as volatility in subsequent measurements.

Risk adjustment
IFRS 17 prescribes inclusion of an explicit risk adjustment to the estimate of future cash flows to reflect the compensation an entity requires for bearing the uncertainty inherent in insurance contracts. This approach represents a major departure from current practice, where uncertainties and risks are reflected through an implicit margin in the discount rate. IFRS 17 does not prescribe a particular technique for quantifying the risk adjustment, but allows judgment in how it is developed and applied.

Deferral of effective date
An important amendment to IFRS 17, with expected endorsement later in 2020, will allow an entity to defer the effective date for mandatory application to January 1, 2023, with early adoption of January 1, 2021 still permitted.

Implementation activities are well under way as outlined in a multi-year implementation strategy and plan. WCB has completed the technical analysis and impact assessment phases and is finalizing its accounting and actuarial positions as well as implementation approaches on all elements of the IFRS 17 general measurement model. For further discussion on the application of IFRS 17, see the section in Note 3 *Accounting Policy Changes* for standards issued but not yet effective, in the accompanying consolidated financial statements and notes.

Looking Ahead

BUSINESS OUTLOOK

Customer operations

WCB is an organization that recognizes the client experience is as important as the outcome. It is our goal that every worker, employer and health care provider will know WCB is willing to listen and aims to help and deliver support through avenues that educate, engage, inform and demonstrate care. This focus remains our number one priority during both the COVID-19 pandemic and the recovery that will follow.

In 2020, WCB's strategic plan maintains the organization's commitment to continuously improving the overall customer experience, while generating better outcomes for all stakeholders and the workers' compensation system.

Shared service journey

Collaboration with workers, employers and service providers to achieve positive recovery and return-to-work outcomes remains a priority. WCB will look at different worker and employer engagement strategies to develop a greater understanding of their needs and the best ways to support them. Through collaborative care planning the goal is to achieve successful recovery and return to work.

The changing nature of claims

Psychological injuries are one of the fastest-growing workplace injuries impacting all partners in the system. Education, new tools, engagement and collaboration will help lead the way to reducing the impact of psychological injury and increasing the likelihood of successful return to work.

The changing nature of work

WCB will focus on increasing successful outcomes for workers who need help moving to a new career or new way of living. Their personal success translates into success for the system. The organization will identify creative solutions for permanently injured workers to find job opportunities and, for its most seriously injured workers, to improve independence and quality of life after a workplace injury.

Technology modernization

WCB's strategy relies on having the tools to successfully deliver on its strategic commitments. Through process re-engineering and automation, WCB will take non-value-added tasks out of the system, allowing employees to focus on the customers who need help.

OUTLOOK FOR FINANCIAL CONDITION

The 2020 financial outlook for WCB requires caution in the premium rate-setting approach as Alberta manages through the challenges brought about by the COVID-19 pandemic and collapse of oil prices. While some decline in the volume of lost-time claims is expected, the fully-funded cost of those claims is expected to grow given the changing nature of claims, the changing nature of work and the lack of quality employment opportunities that will exist should a recession take hold. Assessable earnings typically drop meaningfully during recessionary times; if this pattern holds true, it would lead to a widening of the existing premium rate-setting gap. With this in mind, WCB will continue to manage its business with a solid focus on financial sustainability in the face of great economic uncertainty. WCB's business priorities are focused on building on operational and financial strengths that have contributed to its organizational success and efficient customer service.

2020 premium rate

For 2020, the average collected premium rate is set at $1.14 per $100.00 of assessable earnings based on assumptions made in the third quarter of 2019. Assessable earnings were expected to grow by 4.6% to $108.7 billion. At this level of earnings, a rate of $1.33 would be required in order to collect premiums sufficient to cover the fully-funded cost of claims (i.e., the full cost of injuries that take place in the rate-setting year, which includes a provision for the future costs that are expected to be incurred for those injuries). The lower collected rate set for 2020 recognizes that recovery of Alberta's economy remained fragile. The gap between the required and collected rates of $0.19 (2019 gap was $0.27), will be absorbed by the Accident Fund (see Note 4 *Funding*), which represents a short-term strategy to support economic recovery. Lost-time claim volume in 2020 was expected to dip slightly by 3.0% to 29,200, while fully-funded costs were expected to grow by 3.3%. Barring some combination of a significant increase in the growth rate of assessable earnings or an improved outlook regarding claims cost growth, there will be upward pressure on premium rates until the gap is closed.

Asset liability management

WCB's asset liability management activities are a critical component of the organization's long-term financial health and the sustainability of future payments to injured workers. WCB's independent actuaries have estimated that WCB's total obligation for injured worker benefits that will be paid in the future, related to past accidents, will total approximately $21.8 billion. WCB's asset liability management activities are focused on ensuring that WCB's $11.8 billion investment portfolio earns sufficient investment income in order to fully pay these obligations for decades into the future.

The total investment portfolio return for 2020 is budgeted at 5.2% which is slightly above the 4.6% actuarial return required to pay for the expected 2020 escalation of the claim benefit liability. The budgeted investment return is based on rigorously developed capital market and economic forecasts that are inherently susceptible to a significant level of volatility that may create investment surpluses or deficits.

The valuation of WCB's $10.0 billion claim benefit liabilities is an activity that involves significant assumptions, methods and claim data. Annually, a rigorous process is followed in order to determine the present value of all future claim payments related to past injuries that have occurred. Due to the significant uncertainty regarding claim experience from year to year, it is not possible to budget for claim experience gains or losses in advance of the valuation. Any actuarial experience gains or losses arising from claim experience, changes to policies during 2020 or changes to assumptions/methods during the 2020 valuation process, will be recorded in the financial statements as they arise.

The combination of investment surpluses/deficits and actuarial experience gains/losses arising during 2020 may have a material effect on WCB's funded ratio.

Funding level

WCB's broad-based risk management framework includes a targeted funded ratio between 114-128%. At the end of 2019, WCB's funded ratio was 119.2% (assets over liabilities). While budget expectations for 2020 are for the funded ratio to be close to the target range, given the uncertainty surrounding what continues to be recessionary outlook for the provincial economy, coupled with the volatility of investment returns, it is difficult to determine, with any certainty, WCB's future funding level. Despite these uncertainties, WCB's broad-based risk management framework, of which a long-term view is essential, is designed to mitigate, where possible, this economic and capital market volatility.

FACING THE FUTURE

Investment Portfolio Transfer

On November 22, 2019, the Government of Alberta passed legislation that requires WCB to transfer management of its investment portfolio to the government's investment manager, Alberta Investment Management Corporation (AIMCo), by December 31, 2021. Efforts are underway to carefully plan an orderly transfer of investment assets to AIMCo before the deadline. Transfer of these assets is not expected to impact the WCB's operations but will likely result in higher investment costs as compared to the internal investment management program. The financial impact of higher investment management costs is indeterminable at this time.

COVID-19 Pandemic

On March 11, 2020, the World Health Organization characterized the COVID-19 virus as a global pandemic. The organization has a Pandemic Business Continuity Plan that addresses the various stages of pandemic development and response thus ensuring capabilities to deliver core services are protected.

As a result of the COVID-19 pandemic, global financial markets have experienced significant volatility. In addition, the responses to the crisis have had negative impact on global economies, including in Alberta. On March 23, 2020, the Government of Alberta announced financial support measures to address the economic impacts of the COVID-19 pandemic. These included premium relief for private sector employers covered by WCB, effectively deferring payment of all 2020 private sector employer premiums to 2021. Businesses of a certain size will also have 50% of their WCB premiums paid by the Government of Alberta.

The crisis, as well as the Government of Alberta announcement, does not affect the 2019 financial results but will require careful management of the investment portfolio in 2020 to ensure adequate liquidity is available to meet regular operating cash requirements. WCB has an available standby line of credit of up to $20 million, with provision for it to increase to $100 million for 6 months during the year. Management is also closely monitoring cash flow requirements and updating forecasts in light of heightened volatility in financial markets. Given the extent and rapidly changing nature of the crisis, it is difficult to estimate the ultimate impact or duration of the volatility on the investment portfolio of WCB, as well as the impact to premium revenues and claim benefit expenses.

Against the backdrop of a global pandemic, 2020 will still be a year of engagement, innovation and collaboration. It is also a year we expect new legislation and policy change, impacting employees and stakeholders. Through its many partnerships, the organization will work to implement changes effectively and will maintain its commitment to act fairly, consistently, thoughtfully and respectfully.

The financial sustainability of the workers' compensation system will be protected. WCB is committed to ensuring injured workers receive the benefits they deserve, while employers who fund the system benefit from a cost effective system and pricing programs that promote safety and disability management.