Yukon *Workers' Compensation Act* Subsection 105.(1) Research Series:

Effect of Retirement on Entitlement

Commissioned by the Yukon Workers' Compensation Health and Safety Board of Directors in preparation for the 2003 *Workers' Compensation Act* Review

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1.0 Introduction

The Yukon Workers' Compensation Health and Safety Board is responsible for the administration of the *Workers' Compensation Act*. Subsection 105.(1) of the *Workers' Compensation Act* requires that a review of selected concepts embodied in the *Act* be initiated no later than January 1, 2003. The concepts identified for consideration include:

(a) expansion of disability, within the meaning of the Act
(b) the effectiveness and appropriateness of the board administering both the *Workers' Compensation Act* and the *Occupational Health and Safety Act*
(c) the use of deeming
(d) the effect of retirement on entitlement
(e) the role and use of indexing of benefits
(f) the method and limitations on calculating the maximum wage rate
(g) the role and effectiveness of the workers' advocate
(h) the adequacy of the system for spouses

This paper presents the results of the review undertaken by Vector Research in respect of concept (d), the effect of retirement on entitlement.

The main methodology employed in the study was a document review. Since many workers' compensation research issues are decades old, research efforts included the review of selected reports prepared by task forces and review committees in other jurisdictions over the last 20 years. The review of those reports was undertaken during a November 2002 visit to the British Columbia Workers' Compensation Library.

The analysis contained in this paper is fundamentally from a public finance perspective; the absence of discussion about the psychological and sociological impacts of worker injury and disability is not intended to diminish the importance of those impacts to workers, employers and their families.

The remainder of this research paper consists of five sections. The next section (2.0) looks at the underlying rationale for why annuity payments are made by workers' compensation boards. Section 3.0 describes the Yukon workers' compensation annuity calculation and section 4.0 contains a discussion of workers' compensation annuities from an interjurisdictional point of view. The issue of the impact of Canada Pension Plan disability benefit offsets is highlighted briefly in section 5.0. The paper concludes in section 6.0 with the identification of some key issues thought to warrant further discussion by the Board.

2.0 Compensation Benefit Conversion to Annuity at Age 65

Prior to the introduction of a dual award approach, compensation benefits paid to Yukon workers who suffered permanent work-related injuries were based on a pension-for-life approach. An injured worker's degree of permanent medical impairment was assessed according to a published rating schedule. The amount of compensation was calculated by applying the degree of impairment to a measure of the worker's earnings prior to injury. Payment of the pension continued for the life of the worker. Changes in the worker's employment status or earnings history did not serve to alter the value or duration of the pension payments.

Under a dual award system, workers who suffer permanent impairment are eligible for a one-time payment based on the degree of permanent impairment as well as wage loss benefits.[1] A key change which accompanied the recasting of the Yukon *Workers' Compensation Act* in 1983 was the introduction of a limit on the duration wage loss benefit payments. For workers injured or disabled after December 31, 1982, wage loss benefits generally became payable only until the worker reaches the age of 65.[2]

The introduction of a limit on the duration of compensation payments was consistent with the underlying philosophy of the wage loss approach. By definition, workers cease to receive income in the form of wages upon retirement. Thus, it would be inconsistent with the wage loss approach to make payments to replace wages that are no longer being paid. In recognition of this potential inconsistency, the 1983 Act also introduced the Yukon to the concept of compensating workers for the loss of pension benefits.

Disabled workers who experience a reduction in earning capacity can also experience a reduction in pension benefits. A reduction in pension benefits is experienced if a worker loses partial or complete access to a pension scheme to which they were contributor prior to disability. Access is reduced or lost only for those pension schemes which are based on the amount of wages earned by an employee and for which continued employment is a requirement for ongoing contributions to the pension plan.[3] Two such pension schemes are common in Canada.

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[1] The phrase "wage loss benefits" refers to the same concept described by the phrase "loss of earnings benefits" used in the Yukon *Workers' Compensation Act*. Both phrases are used interchangeably in this paper and throughout the Subsection 105.(1) Research Series.
[2] The age 65 limitation is modified if a work related disability occurs when a worker is older than 63 years and younger than 65 years. Subsection 3.(2) of the Yukon *Workers' Compensation Act* allows that wage loss benefits may be paid in such a circumstance for a period of up to 24 months.
[3] Some pension schemes, such as federal Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) programs are not directly based on an individual's work history. The key eligibility factors for the OAS and GIS are age (65 years of age or older) and current income level.

The first such pension scheme is the Canada Pension Plan, a federally administered pay-as-you-go program which applies to all workers in all industries. Since workers' compensation benefit payments are not subject to income tax, they do not qualify as pensionable earnings for the purposes of the Canada Pension Plan. As a result, to the extent that their pensionable earnings have been reduced as the result of a disability, workers are excluded from making additional CPP contributions. Because the value of a worker's CPP retirement benefit is based on their Canada Pension Plan contribution history, the value of their retirement benefits will necessarily be lower.

The second type of pension scheme common in Canada based on earned wages and which requires continued employment is the employer-sponsored pension plan. In contrast to the Canada Pension Plan, employer-sponsored plans are not universal. Whether or not an employee can make contributions to an employer-sponsored plan is dependent upon the employer registering a plan with the appropriate federal and provincial agencies.

Complete access to an employer-sponsored pension plan can be lost if a worker ceases to be employed after suffering a disability. Note that loss of contributory access does not necessarily mean that the worker will not receive <u>any</u> pension benefits from the plan upon reaching retirement age. Similar to the Canada Pension Plan, loss of access does mean, however, that the value of pension payments cannot be further increased by employer and employee contributions.

Disabled workers who return to employment but at a reduced earning capacity may also experience a loss in the value of employer-sponsored pension benefits. The loss in value results from lower contributions made by employers under the terms of pension plans in which the employer contribution to the plan is calculated by multiplying the employee contribution by a given factor. Pension benefit values can be further diminished for workers contributing to a defined benefit plan since benefits paid under such plans are typically based in part on a measure of earnings over some number of the employee's highest income years.[4]

In summary, a disability may reduce a worker's ability to accumulate retirement savings through employment-based pension schemes. In recognition of this, several jurisdictions, including the Yukon, compensate workers for the impact of

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[4] A <u>defined benefit plan</u> promises a defined pension benefit, specified by a formula, which the employee will receive upon retirement. Employees contribute to the plan according to a fixed rate. The employer contributes whatever amount is required to achieve the benefit promised by the formula. With a <u>defined contribution plan</u>, also known as a *money purchase plan,* the employer and employees contribute to the plan at a fixed rate. Contributions to the plan are invested and the contributions and investment returns are allocated to individual employee accounts. Because the value of an employee's pension benefit is dependent on investment returns an employee cannot determine exactly before they retire what the value of their pension benefits will be.

disability on forgone Canada Pension Plan and employer-sponsored pension plan benefits. The next section of this paper looks at the mechanics of the Yukon approach to compensating workers for pension losses which result from permanent impairment.

3.0 Calculation of Compensation Annuities in the Yukon

Beginning in 1983, workers in the Yukon became eligible for a loss of earnings annuity if they had received compensation in respect of the same disability for at least 24 months.[5] The amount of the annuity is calculated as 10 percent of the amount of loss of earnings benefits paid during the period of disability. The 10 percent amount is paid in addition to any loss of earnings benefits paid to the worker.[6]

Note that the YWCHSB does not actually administer the annuity upon the worker's attainment of age 65. Rather, under provisions of YWCHSB Policy FN-06 (1994), the accumulated capital and accrued interest is used to purchase an annuity in the name of the worker from an investment firm. The total earnings loss annuity accumulated by age 65 (including interest) must exceed a minimum amount specified by the YWCHSB; amounts below the specified minimum are paid out (including interest) to the worker in the form of a lump sum.

All interest which accrues in respect of the 10 percent set-aside amount and/or a permanent impairment lump sum is to be included with the annuity amount paid to the investment firm on behalf of the worker. The Yukon *Workers' Compensation Act* does not specify a rate of interest to be used in the calculation but does require that the funds be set aside in the reserves of the YWCHSB. In practice, the YWCHSB pays interest equivalent to the overall rate of return earned by compensation fund investments in a given year.

The Act does not permit a worker to match or partially match the contributions made by the YWCHSB to their annuity fund. Under authority of section 26 of the Act, the Board may prescribe by order a minimum amount of compensation in respect of a worker who has suffered a total disability. If a workers' retirement income, including workers' compensation annuity payments, is less than the amount prescribed in section 26, the Board may increase the amount of annuity payments. Annuity

[5] After 1982 and before 1993 compensation benefits must have been received for 24 consecutive months. After 1992 compensation benefits must have been received for 24 cumulative months.
[6] While not intended to compensate workers for forgone retirement savings opportunities, current Yukon legislation allows workers eligible to receive a lump sum payment in respect of a permanent work-related impairment to elect to receive payment in the form of an annuity rather than a lump sum. The lump sum capital and interest accrued in respect of the lump sum are to be used to purchase an annuity for the worker upon election by the worker or when the worker reaches the age of 65.

payments may not be increased by the Board beyond the level which would cause the workers' retirement income to exceed the amount prescribed in section 26.

Under provisions of YWCHSB Policy FN-06 (1994), all monies set aside on behalf of a worker for a loss of earnings annuity become payable to the worker's dependents (including their spouse) upon death of the worker. In addition to the accumulated capital, the lump sum payment is also to include accrued interest. Note that the death of the worker need not necessarily be work-related; the key determinant for payment of the lump sum is whether or not annuity amounts had been set aside on behalf of the worker.

The workers' compensation loss of earnings annuity is only one of many types of pensions potentially available to retirement age Yukoners. Pension program benefits are stackable by design which means that the receipt of benefits under the provisions of one program of does not necessarily disqualify an individual from receiving benefits from another program. A summary of selected pension programs available in the Yukon is presented in Table 9 below.

Table 1: Key Features of Selected Pension Programs*

Old Age Security (OAS)	• universal entitlement at age 65 • subject to clawback based on income in current year (clawback begins at income of $57,879) • maximum monthly benefit of $436.36**
Guaranteed Income Supplement (GIS)	• universal entitlement at age 65 • subject to income in previous year (reduction begins at income of $12,396; benefit reduced to $0 at income of $31,344) • maximum monthly benefit of $538.80 (single individual)**
Canada Pension Plan (CPP) Retirement Benefit	• non-universal entitlement at age 65 (may receive reduced benefits as early as age 60) • eligibility/benefits calculated according to contribution history • maximum monthly benefit of $801.25**
Employer-sponsored Pension Plan	• non-universal entitlement • must have worked for employer who sponsored a pension plan • benefits calculated according to contribution history • retirement age defined by pension plan
Yukon Workers' Compensation Loss of Earnings Annuity	• non-universal entitlement at age 65 • must have been paid wage loss benefits in respect of the same work-related disability for at least 24 months

* the program list above is not an exhaustive inventory of programs available to individuals of retirement age. Other programs include the Pioneer Utility Grant, the Seniors Supplement to the Homeowners Grant and First Nation Elders Payments.
** monthly maximums are for the period January 2003 to March 2003

3.1 Scale of Annuity Payments in the Yukon

Relatively few individuals have had annuity contributions made on their behalf by the YWCHSB. Information supplied by the YWCHSB indicates that between 1983 and 2002 approximately 170 individuals have had annuity contributions set aside. Fewer than 20 of those 170 individuals have had their annuity account balances paid out for the purchase of an annuity from an investment firm.

In terms of the value of annuity contributions, approximately $2.5 million dollars had been set aside on behalf of workers since the Yukon *Workers' Compensation Act* was recast in 1992 to the end of 2002. With interest, the accumulated annuity account balances stood at approximately $3.3 million at the end of 2002. Of the approximately $3.3 million, some $260,000 has been paid out for the purchase of annuity upon a worker reaching the age of 65.

4.0 Interjurisdictional Comparisons: Retirement

With the exception of the Northwest Territories/Nunavut, all jurisdictions in Canada cease making wage loss benefit payments upon a worker reaching the normal retirement age of 65.[7] Similarly, all jurisdictions except for the Northwest Territories/Nunavut pay some form of a post-retirement benefit intended to compensate workers with a permanent impairment for their reduced ability to accumulate retirement benefits. Four distinct approaches are used to calculate the post-retirement benefit by the 11 jurisdictions which pay post-retirement benefits. Each approach is described below and the specific approaches used in each jurisdiction are summarized in Table 10.

Set-aside of Additional Amount

Seven jurisdictions set aside a specified percentage of a worker's wage loss benefit after the worker has been in receipt of a wage loss benefit for a specified period of time. The amount set aside is in addition to any wage loss benefits to which the worker is entitled. Of the seven jurisdictions, five (British Columbia, Manitoba, New Brunswick, Nova Scotia and Ontario) set aside five percent of the wage loss earnings paid to the worker. Two jurisdictions (Saskatchewan and the Yukon) set aside ten percent of the wage loss earnings paid to the worker. Three jurisdictions (British Columbia, Manitoba and Ontario) also allow the worker to voluntarily contribute a percentage of their wage loss benefits to the amount set aside.

Demonstrated Pension Benefit Loss

Two jurisdictions (Newfoundland and Prince Edward Island) will now only pay a retirement benefit to workers who can demonstrate the value of retirement benefits lost as a result of a work-related disability. The loss must be from either the Canada Pension Plan or an employer-sponsored pension plan and must be in respect of a disability for which they are receiving compensation benefits.

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[7] Except, as described in footnote 1, in the circumstance where a worker is disabled after the age of 63 and wage loss benefits can be continued for up to two years from the date of disability.

Table 2: Interjurisdictional Comparison of Annuity Provisions

Alberta	• retirement benefit is calculated using a formula similar in structure to formula used to calculate defined benefit pension plan benefits • formula is: (average annual compensation) x [number of years of compensable benefits (max. 35) x 2 %] where average annual compensation is based on wage loss benefit payments over last 5 years • payable at age 65
British Columbia	• additional amount of 5% • worker must have received permanent total/partial disability wage loss payments • worker may make voluntary contributions of between 1% and 5% of wage loss benefits • payable at age 65
Manitoba	• additional amount of 5% less any amount contributed by a workers employer • wage loss benefits must have been paid for 24 cumulative months • worker may make voluntary contributions up to percentage being contributed by Workers' Compensation Board. • payable at age 65 or as early as age 55 if demonstrated that the worker has retired from the workforce
New Brunswick	• additional amount of 5% • wage loss benefits must have been paid for 24 continuous months • at age 65, the aggregate amount which has been set aside by the Commission is used to purchase an annuity from an external carrier • term of annuity purchased may be 5 years/10 years/life
Newfoundland and Labrador	• at age 65 workers are paid the equivalent of demonstrated loss of CPP retirement benefits or registered employer sponsored pension plan benefits • worker must demonstrate that pension benefits were lost as a result of an injury for which he or she is receiving compensation under the Newfoundland Workplace Health, Safety and Compensation Act
NWT/Nunavut	• injured workers paid a life pension based on degree of permanent impairment
Nova Scotia	• additional amount of 5% • requires worker to be entitled to an extended earnings replacement benefit • payable at age 65
Ontario	• additional amount of 5% • wage loss benefits must have been paid for 12 continuous months • workers may make contributions of up to an additional 5% deducted from wage loss benefits • payable at age 65
Prince Edward Island	• at age 65 workers are paid the equivalent of demonstrated loss of CPP retirement benefits or registered employer sponsored pension plan benefits • worker must demonstrate that pension benefits were lost as a result of an injury for which he or she is receiving compensation under the Prince Edward Island Workers' Compensation Act
Quebec	• wage loss benefit is reduced by 25% upon reaching 65 years of age • reduced by 50% at age 66, by 75% at age 67 and by 100% at age 68
Saskatchewan	• additional amount of 10% • wage loss benefits must have been paid for 24 months • payable at age 65
Yukon	• additional amount of 10% • wage loss benefits must have been paid in respect of same injury for 24 months • payable at age 65

Sources:
(1) *Comparison of Workers' Compensation Legislation in Canada 2002,* Association of Workers' Compensation Boards of Canada, 2002, pages 101 and 102.
(2) *Core Services Review of the Workers' Compensation Board,* report prepared for the Government of British Columbia by Alan Winter, March 2002.
(3) Workers' compensation legislation in various jurisdictions.

Defined Benefit Calculation

One jurisdiction, Alberta, uses an approach to the calculation of a retirement benefit which is similar to that used to calculate defined benefit pension plan values. As with all defined benefit pension schemes, a key feature of the Alberta approach is the high degree of certainty and transparency afforded the recipient with regard to the value of their monthly retirement benefit.

Straight Line Extinguishment

One jurisdiction, Quebec, uses an approach which is unique in that it defines the maximum length of time any worker can be paid a retirement annuity. Wage loss benefits are reduced on a straight line basis over four years beginning on the workers 65th birthday. Benefits are reduced at that time by 25% for the next year and are further reduced in 25% increments upon subsequent birthdays until reduced to zero on the worker's sixty-eight birthday.[8]

5.0 Canada Pension Plan Disability Benefit Offsets

In addition to retirement benefits, the Canada Pension Plan (CPP) also makes payments to working Yukoners who suffer earnings loss due to disabilities that prevents them from working at any job. The scope of the CPP disability program is broader than workers' compensation in that while the disability must be "severe and prolonged", it need not be work-related.[9] Disability benefits paid by the Canada Pension Plan cease at age 65 at which time the worker begins to receive regular CPP retirement benefits.

In all jurisdictions in Canada it is possible for the same worker to qualify for both workers' compensation wage loss benefits and CPP (or Quebec Pension Plan) disability benefits in respect of the same disability. In order to reduce the possibility of overcompensation, most jurisdictions offset the amount of wage loss benefits they pay by all or some of the CPP/QPP disability benefits received by the disabled worker.[10]

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[8] Workers who suffer an employment disability when older than 64 years of age have their benefits reduced according to the first anniversary date of their disability rather than their 65th birthday.

[9] The CPP disability benefit consists of a flat rate portion plus an earnings related portion. As of January 1, 2003 the flat rate monthly amount was $370.32. The current maximum monthly benefit for both portions is $971.26. As with other CPP benefits, disability benefit payments are considered taxable for income tax purposes. Note also that in contrast to the workers' compensation approach, the burden of proof that a disability is "severe and prolonged" weighs heavier on the worker under the CPP disability benefit approach.

[10] Only Alberta, Northwest Territories/Nunavut and the Yukon do not currently offset any amount of Canada Pension Plan (or Quebec Pension Plan) disability benefit payments. British Columbia offsets one half of CPP disability benefits from wage loss payments but calculates a worker's annuity on the basis of the pre-offset wage loss amount.

One impact of a CPP/QPP disability benefit offset is that in jurisdictions which calculate the retirement annuity as a percentage of loss of wage loss benefits paid, the offset serves to reduce the value of the annuity. The reduction occurs as the fixed annuity percentage is applied against a smaller amount of wage loss benefits. A reduction in an individuals workers' compensation annuity as a result of a receiving a CPP disability benefit is not currently possible in the Yukon. While CPP disability benefits were offset from wage loss benefits in the Yukon during the 1983 to 1992 period, the 1993 version of the *Workers' Compensation Act* contains no such requirement.

6.0 Issue Identification: Retirement

> "The intent of a post-retirement benefit is to provide compensation for that portion of the retirement earnings that the worker has lost due to the work-related disability."[11]

While the intent of the post-retirement benefit may be described in simple terms, translating that intent into administrative practice which is seen to be fair by all is rather more complicated. The balance which administrative practice must try and achieve in order to fulfill that intent stated above can be described in terms of the concept of horizontal equity.

Horizontal equity refers to the idea that, all else being equal, a worker who suffers a permanent work-related disability should fare no worse (or better) financially upon reaching retirement age than another worker employed at a similar rate of pay who does not suffer a permanent work-related disability. In order for horizontal equity to be achieved, the annuity calculation must reasonably reflect the value of retirement benefits which are forgone by each disabled worker.

One method of ensuring that the annuity calculation is an accurate reflection of forgone benefits is to perform the calculation on an individual basis. This is, in fact, the approach used in Newfoundland and Prince Edward Island where workers must demonstrate the value of pension benefits which they have personally forgone. Note that the gain in equity which results from an individualized annuity calculation must be balanced against the higher administrative costs which could potentially result.

A second method of ensuring that the annuity calculation is an accurate reflection of forgone benefits is to determine and implement a set-aside rate which is, on average, equitable for all concerned. This is the intent of the approach used by the seven

[11] From a briefing paper prepared by the Workers' Compensation Board of British Columbia, as referenced in *Core Services Review of the Workers' Compensation Board* prepared by Alan Winter for the Government of British Columbia, March 2002, page 206.

jurisdictions, including the Yukon, which calculate a workers retirement benefit by setting aside an additional percentage of a worker's wage loss earnings.

The current version of the Yukon's worker's compensation statute specifies a set-aside rate of 10 percent and is the same as the rate introduced in the 1983 recasting of the legislation. The reasons for choosing a set-aside rate of 10 percent in the early 1980s are not known to the writer. What is known is that certain characteristics of the labour market and income tax law which defines many of the rules for employer sponsored pension plans have changed significantly since that time. Thus, it is not immediately clear if the 10 percent set-aside rate results in annuity calculations which accurately reflect the value of retirement benefits forgone by workers who suffer permanent work-related disabilities.

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