A Look Back and A Way Forward: Actuarial Views on the Future of the Employment Insurance System

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EXECUTIVE SUMMARY

This report was prepared by the Task Force on the Financing of Employment Insurance (Task Force) as a contribution to the public debate on Employment Insurance (EI) financing in Canada, a debate that began in the second half of the 1990s and has continued, to date.

Since its inception in 1940, the Employment Insurance system (originally known as unemployment) in Canada has always had a strong social insurance character, since its central function is to protect workers from the consequences of the realization of risk, namely the risk of becoming unemployed. This character was, indeed, incorporated into the Canadian Constitution at that time.

Another essential character of the Canadian Employment Insurance system since its beginning is the contributory principle. This principle implies that all of the premiums contributed to the program along with resulting surpluses belong to the EI program and remain available only for its purposes.

In substance, the Task Force recommends that, on the basis of insurance principles and in line with other social insurance programs (such as the Canada and Quebec Pension Plans or Workers’ Compensation programs), the financial aspects of the EI program should be managed at arm’s length from the federal government, by an autonomous and re-invigorated organization representing all stakeholders including the general public interest.

Specifically,

- Premium rates should be set independently by that body and a separate investment fund should be established and managed by it. The fund should be used solely for providing insurance benefits to the insureds.

- The strategy for setting premium rates and investing reserve funds should be the sole responsibility of that entity, guided by general parameters of fiscal integrity and relative premium rate stability and based on expert actuarial advice and any other required expertise.

- Full and regular reporting to Parliament should be part of the accountability framework.

- Benefit policies, operations and amendments would remain the responsibility of government.
# ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>AG</td>
<td>Auditor General of Canada.</td>
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<td>CGAP</td>
<td>Quebec Management Board for the Parental Insurance Plan (<em>Conseil de gestion de l’assurance parentale</em>)</td>
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<td>CPP/QPP</td>
<td>Canada/Quebec Pension Plans.</td>
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<td>EBSM</td>
<td>Employment Benefits and Support Measures (under Part II of the EI Act).</td>
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<td>EI</td>
<td>Employment Insurance, the designation of the unemployment insurance program since June 30, 1996.</td>
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<td>HRDC</td>
<td>Human Resources Development Canada, the department responsible for the UI/EI program up to December 2003.</td>
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<td>HRSDC</td>
<td>Human Resources and Skills Development Canada, the department responsible for the UI/EI program after 2003 and until February 2006, when it was renamed Human Resources and Social Development Canada.</td>
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<td>OSFI</td>
<td>Office of the Superintendent of Financial Institutions, Ottawa.</td>
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<td>PSAB</td>
<td>Public Sector Accounting Board of the Canadian Institute of Chartered Accountants</td>
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<tr>
<td>UI</td>
<td>The designation of the Unemployment Insurance program from 1940 to 1996.</td>
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<td>WCB</td>
<td>Workers’ Compensation Board</td>
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FOREWORD

The Canadian Institute of Actuaries, in consideration of the insurance nature of Employment Insurance (originally labelled as Unemployment Insurance), the constant involvement of actuaries with the Canadian UI/EI program since the 1930s and the recognized expertise of the actuarial profession in insurance matters, decided in early 2007 to establish the Task Force on Financing of Employment Insurance.

Two main factors have drawn the attention of the Institute: a) the prevailing ambiguity and confusion surrounding UI/EI financing and the rules for setting premium rates, and b) the fact that since 2005 an explicit but constrained role has been reserved in the legislation for the EI actuary.

The Task Force had three objectives:

1) to review the current rules for the setting of EI premium rates and for the handling of the accumulated surpluses in the EI Account;

2) to consider the potential role of surplus and/or counter-cyclical premium rates in mitigating the effects of economic downturns; and

3) to recommend a viable long-term approach to these matters which would be in agreement with broad insurance and actuarial principles, as they are adapted to the field of social insurance.

The Task Force considered existing and previous rules, the reports of the EI actuary, previous representations of the actuarial profession and other relevant material.

Through this task force, the Canadian Institute of Actuaries seeks to make a meaningful contribution to public policy, holding “the duty of the profession to the public above the needs of the profession and its members.”

The Canadian Institute of Actuaries thanks the members who volunteered to take part in this task force, namely Bruno Gagnon (Chairperson), Michel Bédard (principal researcher), William Moore, Bernard Potvin and Raymond Veilleux. The opinions expressed herein do not represent the views of any current or past employer of these persons.
1. INTRODUCTION

The Canadian Unemployment Insurance (UI) program was created in 1940 when the provincial governments, following the Depression of the 1930s, unanimously agreed to add two words – “unemployment insurance” – to the list of matters falling under exclusive federal jurisdiction. The Unemployment Insurance Act was adopted on August 7, 1940, with contributions starting on July 1, 1941 and benefits starting to be paid in 1942.

It was understood at the time that the UI program would operate as a distinct entity, as enunciated in the 1935 Employment and Social Insurance Act (found in 1937 to be ultra vires) as well as in the draft legislation submitted to the provinces in 1938 during discussions aimed at obtaining their consent to the above constitutional amendment. As an insurance program, the program was to be financed primarily by employer-employee premiums with additional financing from the federal government, its accounts being separate from other government business, its investments managed by a committee that included the Governor of the Bank of Canada and representatives of the Departments of Finance and of Labour.

Over time, many changes were made to the program’s benefit and financing rules but always respecting the principle that expenditures could only be charged to the Fund (or after 1971, to the Account) for the purposes authorized by the UI legislation, either to pay benefits or to cover related expenses such as administration and the National Employment Service. This remained so even after 1986, when, on the recommendation of the Auditor General (AG) of Canada, the UI Account was consolidated with the overall accounts of the federal government. This consolidation meant that annual UI surpluses or deficits would henceforth carry over into the government’s overall budgetary results.

Most of what is stated in the previous paragraph still applies in 2007, at least in principle, except that legislation adopted in 2005 removed any real meaning from the accumulated surpluses (in the amount of $54 billion at March 31, 2007), even though they are still reported upon and audited each year by Canada’s AG. This is because premium rates are now set on the principle that the accumulated surpluses cannot be used to offset the future cost of benefits (except in rare circumstances and to a limited degree), nor to reduce premiums.

2. HISTORY OF FINANCING AND OF RATE-SETTING RULES UNDER UI/EI

In broad terms, there have been three different eras in regards to the financing of the UI/EI system: 1) from 1941 to 1971, the UI Fund; 2) from 1972 to 1990, the UI Account with tripartite financing; and 3) since October 23, 1990, an employer-employee financed UI Account, later renamed the EI account.

2.1 Historical review

At its start in 1941, the UI program covered an estimated 42% of workers. Premium rates were part of the UI legislation itself, and could only be changed by Parliament. There were no specified criteria for setting premium rates, other than the implicit goal of keeping the system in financial equilibrium. For this purpose, the government relied mainly on a UI Advisory Committee and on the annual actuarial reports produced by the Department of Insurance.

Employer and employee premiums were differentiated by earnings range (employers paying more than employees at low earnings but less at high earnings) but calculated to be equal in aggregate,
to which was added a government contribution of 20% of the employer-employee premiums. The government also paid for administration (separately, outside the UI Fund).

The program was managed apart from other government operations by the Unemployment Insurance Commission, a tripartite body with representation from employers and from labour, its chairperson representing the government. UI revenues were deposited into the UI Fund to pay for unemployment benefits, the Bank of Canada acting as fiscal agent. Any positive balance in the UI Fund was invested in interest-bearing special-issue government bonds, under the guidance of an Investment Committee that included the Governor of the Bank of Canada; any negative balance would be covered by interest-bearing loans.

In 1972, the UI Account replaced the UI Fund on the basis that neither reserves nor a Fund would be needed under new arrangements. The federal government would act as a reinsurer, supporting most of the cost fluctuations in unemployment benefits, defined as those attributed to an unemployment rate higher than 4%. Coverage was extended to virtually all paid workers.

Combined employer-employee premiums would cover basic program costs including costs of administration, employers having to pay 1.4 times employee premiums (in anticipation of an experience-rating system that was never implemented). As noted, the government was to pay for benefit costs attributed to “high” unemployment, but the definition of “high” unemployment was eroded over time to reduce the government’s share of program costs.

Premium rates were to be set annually by the UI Commission, subject to government approval. The Commission’s actuary continued to provide analysis and advice, without any legal requirement for that role. The Act required that premium rates be aligned with the average cost ratio for private sector costs over the last three years, such ratio to be adjusted to reduce any cumulative surplus or deficit that it would otherwise produce at the end of the next year.

Any positive balance in the account was to be credited with interest at the rates authorized by the Minister of Finance, which were set at 90% of 3-month Treasury Bill yields. Negative balances would be covered by advances under conditions specified by the Minister of Finance, which were the same as those for comparable loans to crown corporations, and were evidenced by written instruments specifying their rates and duration.

The commission had remained a distinct body in 1972, but in 1977 it was brought under the authority of the minister of Manpower and Immigration, the department’s deputy minister automatically becoming its chairperson (with the associate deputy minister serving as substitute). This marked a crucial step in the erosion of the commission’s independence.

The UI Account operated until 1986 as a separate non-consolidated (or off-budget) account within the accounts of the federal government but became a consolidated account in 1986, as recommended in 1983 by the Auditor General of Canada. This was done in order to present an integrated view of all of the activities for which government was responsible in substance.

Government contributions were terminated on October 23, 1990, UI since then being financed exclusively by employer-employee premiums, with the continuing possibility of refundable government loans. Premium rates were set annually by the UI Commission under the same rules as before. The government nevertheless set premium rates by itself from 1990 to 1992 (in 1992, by issuing a directive to the Commission) and again for 1995 and 1996, first to deal with the recession and fiscal crisis of the early 1990s then while planning for EI Reform in 1996.

After 1996, with the program renamed Employment Insurance, the legislation required the EI Commission to aim for relative stability over a business cycle by adopting rates that would “to the extent possible: a) ensure that there will be enough revenue over a business cycle to pay the amounts authorized to be charged to the Employment Insurance Account; and b) maintain relatively stable rate levels throughout the business cycle.” (Section 66 of the 1996 EI Act)
The Commission set premium rates under that authority for the years 1997 to 2001. However, from 1998 to 2001, the rates that were set always exceeded those proposed by the EI Chief Actuary, as the Commission effectively agreed to the government’s fiscal objectives, instead of adopting what would otherwise have been a steeper and more rapid reduction in premium rates.

From 2002 to 2005, facing repeated observations from the AG concerning excessive surpluses, negative public sentiment and looming court challenges, the government discontinued long-term actuarial forecasting and set the premium rates on its own. In 2003, it held consultations on a new rate-setting process. In June 2005, Parliament adopted legislation to set future EI premium rates on a one-year forward looking basis, based on an actuarial determination that must exclude existing surpluses and future interest credits. As of March 31, 2007, the cumulative EI surplus stood at $54.1 billion (as compared to an estimated maximum needed reserve in the order of $15 billion).¹

### 2.2 Current Status of EI Account and of Surpluses

The real status and meaning of the EI Account has become a source of confusion for many observers. In 1998 and 1999, two Quebec unions (Syndicat national des employés de l’aluminium d’Arvida and Confédération des syndicats nationaux) entered legal challenges against the federal government concerning its use of EI surpluses and its jurisdiction over so-called “active” measures, launching court cases which were joined and heard, first, by the Quebec Superior Court in 2003 then in 2006 on appeal to the Quebec Court of Appeal. Although those cases were both decided in favour of the federal government, the Supreme Court of Canada in 2007 agreed to again hear the matters on appeal. On one hand, the Account was said to have an “independent” existence by the Quebec Superior Court in 2003, as well as by the Quebec Court of Appeal in 2006²:

> “Furthermore, although the amounts collected under the Act are paid into the Consolidated Revenue Fund, the Account nonetheless has an [TRANSLATION] “independent existence”, as the Act even allows it to receive interest from the Consolidated Revenue Fund when its balance is positive.”

According to the Courts, the Consolidated Revenue Fund has an obligation to the Account and might eventually have to make good on it:

> “However, within the government’s [TRANSLATION] “reporting environment” itself, it is clear that the Consolidated Revenue Fund, through the Receiver General for Canada, is liable to the Employment Insurance Account to cover all the debits that the Act authorizes, up to the amount of the accumulated surpluses.” …

> “Hence, on the one hand, current political choices enable the federal government to now have substantial surpluses in its fiscal years and major reductions in its deficit, thanks in particular to high surpluses and the high accumulated surpluses in the Employment Insurance Account. On the other hand, tomorrow the same choices could, however, become the Achilles’ heel of Canada’s future financial statements, when future political choices demand that accumulated surpluses that are too high must be reduced.”

¹ The maximum needed reserve that was last estimated by the EI Chief Actuary was from $10 to $15 billion, an estimate that was produced in the fall of 2000. That range is here tentatively adjusted upwards by 20%, approximately in line with increases in aggregate insured earnings, to produce a $12 to $18 billion range of which $15 billion is the mid-point. We have independently confirmed this order of magnitude by analyzing the variability of unemployment rates since 1950, combined with the duration between peaks or troughs.

² Judgments rendered by the Quebec Superior Court on November 5, 2003 and by the Quebec Court of Appeal on November 15, 2006, are available in French at [http://www.jugements.qc.ca/](http://www.jugements.qc.ca/).
Finally, the Quebec Superior Court concluded that the EI Account belongs to the government, which, however, cannot remove the EI surpluses without changing the legislation:

“Thus, one cannot conclude that the premiums or the surpluses they generate belong to the people who pay into the plan, as suggested by the Arvida union and the CSN. In fact, if these monies «belong» to anyone, they belong to the «Consolidated Revenue Fund» into which they are paid, to «Her Majesty», who has a claim over the amounts collected under the Act, or to «Canada», to which the public funds that make up the Consolidated Revenue Fund belong. [unofficial translation]

That said, it therefore follows that the federal government can not do what it wants with those amounts. The Act is explicit in that regard. Debits that can be charged to the otherwise positive balance of the Employment Insurance Account are simply those provided for in section 77. For example, as the Act now stands, the Government of Canada could not eliminate the positive balance of the Employment Insurance Account by paying amounts out of the Consolidated Revenue Fund for purposes other than those provided for in that section.”

Those statements were made before the most recent changes to the Act. Since 2005, the accumulated surpluses that are shown in the EI Account can no longer even be used (in the sense of “used up” or diminished) for the purposes of the EI legislation, barring new legislation or use of ministerial override authority – as will be explained later in this report, in section 5.1.

2.3 The Consultations for the 2005 Amendments

The 2005 amendments came after consultations conducted by the Department of Finance in 2003, consultations that had been first announced in 2001 (as will be noted on page 17) and were based on the 1999 recommendations of the Standing Committee on Finance, namely that after a transition period EI premium rates should be set on a forward-looking basis. The Standing Committee held that accumulated surpluses were irrelevant to the maintenance of an effective and efficient EI program, even suggesting that the EI Account could be eliminated.

As worded, the principles for the 2003 consultations were similar to those that had applied since 1972 and had been reinforced at the time of EI Reform, in 1996: “premium rates should be set transparently; premium rates should be set on the basis of independent expert advice; expected premium revenues should correspond to expected program costs; premium rate setting should mitigate the impact on the business cycle; and premium rates should be relatively stable over time.” Other government statements indicated that the accumulated surpluses would in the future be omitted when determining premium rates.

The general consensus of the consultations was that the EI program should be administered as a separate, arm’s length entity with a strengthened role, its accounts separated from those of government. Most participants agreed that reserves were needed to achieve premium rate stability over a business cycle as well as with the desirability of relying on expert advice, projections and consultations, rather than by using any automatic formula. The Auditor General, for her part, indicated in 2004 to the Subcommittee on EI Funds her concern that the above principles “do not address the $46 billion surplus that has accumulated.”

In spite of such consensus, the amendments proposed by the government went ahead without any substantial modification.


4 Details on the Department of Finance’s website, at http://www.fin.gc.ca/consultresp/Summaries/eiratesSum_e.html.
3. CURRENT RULES ON EI FINANCING AND PREMIUM RATE-SETTING

A complete picture of EI financing involves:

1. the source of revenues used to finance the EI program;
2. the program expenditures that fall under the EI program;
3. the accounting framework used to consolidate and to report EI revenues and spending;
4. the general governance of the EI system; and
5. the rules for setting EI premium rates.

3.1 Source of Revenues

After October 23, 1990, the EI program was entirely financed by employee-employer premiums, with employers paying 1.4 times the employee premiums. The only government assistance may come from loans (repayable with interest at market rates) to cover temporary deficits.

Premiums are charged on employment earnings up to an annual limit of $40,000 for 2007, indexed annually to average wages. Workers earning less than $2,000 in a year get a premium refund at year end, through the tax system. Any employee contributing based on more than $40,000 in a year also gets a refund (for example, someone holding more than one job).

3.2 Program Expenditures

Expenditures are: i) benefits to claimants as partial income replacement while out of work ($12.1 billion in 2006-2007, for regular unemployment, sickness, maternity/parental, compassionate care, self-employed fishing), ii) employment benefits and support measures (EBSM) to facilitate return to work ($2.1 billion), and iii) administration costs ($1.6 billion) for the delivery of EI benefits and EBSM, and to support the National Employment Service.

Other significant program expenditures, but in the nature of lost revenue, are due to premium reductions for private wage-loss replacement plans in cases of illness ($600 million), as well as for provincial maternity/parental programs replacing the similar EI benefits that would otherwise be paid ($800 million in Quebec, the only province to adopt such a regime to date).

3.3 Accounting Framework

The EI Account has been established in the Accounts of Canada to record all transactions under the EI Act. Only the revenue and spending authorized under the EI Act can be credited or charged to the Account. It is also charged or credited with interest on EI deficits or surpluses at the rates authorized by the Minister of Finance. The rate for the advances made to cover deficits has been the same as for lending to Crown corporations, and for surpluses has for many years been 90% of the 3-month Treasury Bill rate.

5 Deficits from 1991 to 1995 peaked at $5.9 billion and were covered by loans from the federal government, repaid with interest totaling $1.1 billion from 1991 to 1995. Interest on surpluses has since that time risen to $1 billion in 2004-2005, to $1.9 billion in 2006-2007 and to an expected $2 billion in 2007-2008.
Since 1986, the EI Account is consolidated with the accounts of the federal government, so that any annual EI surplus or deficit carries over to the government’s budgetary balance. However, that effect is not fully proportional since EI premiums, like CPP/QPP contributions, give rise to tax deductions for corporate income tax purposes and to tax credits for personal income tax purposes – producing a “tax loss” at the federal level\(^6\) of about 14% on employee premiums\(^7\) and of 15% or 20% on employer premiums. For employers, the estimate depends on whether one chooses the ratio of federal corporate income tax collections to profits for all of Canada (about 15%), or the Department of Finance’s tax expenditure benchmark, which assumes that employer premiums would otherwise be included in employees’ income (20%).

Additional effects from consolidation are: (i) the interest credited to the EI Account is from the federal government’s perspective a notional (or costless) transaction, because the government, as owner of the EI Account, is paying interest to itself; and (ii) a similar reasoning applies to the federal government’s EI contribution as an employer (of about $350 million per year), which is also a notional transaction for the federal government.

### 3.4 Governance

The EI Commission is a tripartite body established pursuant to the *Department of Human Resources and Skills Development Act*, which reports to the Minister of Human Resources and Social Development (HRSDC). Charged with various duties related to the *EI Act*, it has four members, one representing employers, one for workers and two representing the government. The department’s deputy minister is automatically chairperson for the commission. The vice-chairperson, who is the associate deputy minister, can replace the chairperson but cannot vote if the chairperson is present.

The EI Commission has no employees of its own, all staff being departmental employees. The Commission must follow any directions given to it by the Minister, as occurred when premium rates were set for 1992. The 2005 amendments have also provided that, by exception, the EI actuary is under the direction of the EI Commission in regards to the functions associated with the premium rate-setting exercise.

### 3.5 Setting EI Premium Rates

Since 2005, the *EI Act* requires the Commission to set EI premium rates on a single year break-even basis, setting aside existing surpluses and future interest credits. Calculations are made by the EI actuary, using the economic assumptions provided by the Minister of Finance. This system was used to set EI premium rates for 2006 and 2007.

Two additional clauses apply: a) a limit of 0.15% on annual premium rate changes; and b) a possible override by government in the “public interest” (subject to the 0.15% limit but not to the break-even principle). The break-even approach was also applied (by special legislation) for 2004 and 2005, although it was then done unilaterally by the federal government and did not involve the EI Commission nor the EI actuary.

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\(^6\) Similar losses occur at the level of the provincial governments.

\(^7\) Own calculations, based in part on “Tax Expenditures and Evaluations 2006”, Department of Finance, Ottawa.
A description of the process and players involved is provided below in tabular form. The legislative texts are in Appendix B.

<table>
<thead>
<tr>
<th>Table 1 - Process for EI Premium Rate-Setting</th>
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<tr>
<td><strong>Item</strong></td>
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<tr>
<td>1. The Minister of Finance must provide the economic assumptions for the next year to the EI actuary.</td>
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</table>
| 2. The Minister of Human Resources and Social Development must advise the EI actuary of any benefit amendments to be included in the calculations. | October 14  | - Amendments must have been “announced.”  
- There is no provision to adjust for changes that could affect premium revenues. |
| 3. The EI actuary must determine the premium rate needed to just cover the expected program costs for the next year, without taking into account the existing balance in the EI Account nor any future interest thereon. | October 14  | - This is referred to as the break-even principle.  
- The EI actuary is under the direction of the EI Commission in respect to these functions. |
| 4. The EI Commission must make the EI actuary’s report public. | As soon as possible after receiving the actuary’s report. | | |
| 5. The EI Commission must set the premium rate based on: (i) the break-even principle; (ii) the actuary’s report; and (iii) any public input. | November 14 | - The premium rate cannot vary by more than 0.15% from year to year (interpreted as the subtraction of one rate from another). |
| 6. The Ministers of HRSDC and Finance may substitute any other premium rate “in the public interest.” | November 30 | - Subject to the same 0.15% limit as above.  
- Not constrained by the break-even principle. |

Notes: (i) The Minister of Finance can override the rate-setting provisions through a Budget motion.  
(ii) The EI Commission must follow any direction given to it by the Minister of HRSDC.
4. THE BUILDUP IN THE EI ACCOUNT

4.1 Financial History

To understand the recent build-up of surpluses in the UI/EI Account, it is necessary to review its financial experience since 1990. The data are shown in Table 2 on the following page. Earlier experience need not be considered since the high premium rates that later led to large surpluses were first initiated in July 1991, after the recession of 1991-92 and the cessation of government contributions in October 1990.

That recession, though not as severe as that suffered in the early 1980s, nevertheless saw unemployment rates rise to double digit levels during four consecutive years, from 1991 to 1994. The UI Account saw a cumulative surplus of $2.2 billion at the end of 1990 turn into a cumulative deficit of almost $6 billion by the end of 1993. A turnaround started in 1994, with annual surpluses in that year and in 1995 wiping out the cumulative deficit by the end of 1995.

This was due both to higher premium rates (rising to 3.07% of insured earnings in 1994 for employees, compared to 2.25% in 1990) and to lower program spending. Table 2 shows, however, that in spite of a significant drop in program costs to below $15 billion annually after 1994, total revenues (premiums plus interest) were thereafter maintained at an annual level of about $19 billion even up to the present. The premium rates themselves fell slowly during the period, offset by wage gains, labour force growth and interest credits.

High premium rates from 1995 to 1997 were intended to build a rainy day reserve in the EI Account, to avoid having to raise premiums again during a recession, as occurred during the early 1990s and during the early 1980s. The Minister of Finance noted in the February 1995 Budget: “With no increase in premium rates, the cumulative surplus in the Unemployment Insurance Account will be allowed to rise above $5 billion through to the end of 1996. This surplus will be maintained and will serve as a buffer to mitigate unemployment insurance premium rate increases during periods of slowing economic growth.”

These intentions echoed statements made in 1994 in an official document produced by Human Resource Development Canada, as a guide for EI Reform: “… during a prolonged recession, the UI premium rate often rises to stabilize the UI Account, which partly offsets the anti-recessionary effects of UI benefit payments. The premium-setting formula should be examined to find ways of avoiding such untimely rate increases. One approach that merits consideration would be to allow the UI Account to build up a substantial surplus during periods of economic growth. This surplus would provide a cushion in the next economic downturn against the need to raise premium rates, so that premiums can be maintained at a lower, relatively steady rate.”

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### Table 2 – Status of the EI Account from 1990 to 2007

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<thead>
<tr>
<th></th>
<th>Annual rate of unemployment (%)</th>
<th>Employee premium rate (%)</th>
<th>Costs in $ millions</th>
<th>Revenues in $ millions</th>
<th>Surplus (deficit)</th>
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<td></td>
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<td>Benefits</td>
<td>Administra-</td>
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<td>tion, etc.</td>
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**Sources:**

**Notes:**
- Employers pay 1.4 times employee premiums.
- Calendar year data to 2003, fiscal year data thereafter in regards to costs, revenues and surplus.
The House of Commons debates similarly had the minister of Human Resources Development stating on November 28, 1997 that: “A reserve is necessary because it reduces the need to increase premiums in a full-blown recession.”

During 1997, the balance in the EI Account reached $12 billion, which fell within the $10 to $15 billion maximum safety range recommended by its chief actuary. Actuarial reports from 1998 to 2001 proposed significant premium rate reductions, tending towards 2.00% or less by 2001 but the rates actually set were always higher and still stood at 2.25% for 2001. As a result, EI surpluses continued to accumulate at a rate of about $7 billion per year from 1998 to 2001, producing a cumulative balance of $39 billion by the end of 2001.

Such levels could no longer be rationalized as a cushion against future cost increases nor, given their repetitive nature, could they be attributed to favourable economic developments. They could only be explained as part of the government’s overall budgetary policy. On October 3, 2001, for example, the Minister of Finance explained the situation as follows: “Mr. Speaker, first of all, as the honourable member is well aware, the surplus in the EI fund is being used for health, for infrastructure programs, and for job creation.” (House of Commons debates). This was repeated in similar terms on December 12, 2001: “Mr. Speaker, what we are doing is following the Auditor General’s 1986 recommendation that we include the revenue from EI premiums in our consolidated revenue fund. That is what we did. This money is then invested in health, education, and job creation, sectors Canadians view as priorities.”

For 2002 to 2005, the government set premium rates through special legislation, without requiring further actuarial reports. For 2004 and 2005, the government stated that it was setting premium rates in accordance with the principle that they were expected to raise only enough revenues to cover program costs. The cumulative surplus rose again, to about $50 billion by the end of 2005 (an approximate value as calendar year surpluses are not published after 2003). The new system for setting premium rates was written into the EI Act in 2005 and first applied for 2006. The cumulative EI surplus then rose to $54.1 billion at March 31, 2007.

4.2 Views of the Auditor General

The Auditor General of Canada has had two important concerns for the EI Account: first, that given its present nature and structure, it had to be consolidated in the accounts of the government of Canada, and second that EI premium rates and surpluses had to be managed in accordance with the intent of the legislation.

Before 1986, the UI Account was treated as a non-consolidated account. In 1983 the AG advised that (along with certain other accounts) it should be included in the government’s accounts. The government accepted that view and implemented the consolidation for the fiscal year 1985-86. It indicated at the time that this would not affect the operations of the UI program: “The consolidation of the Unemployment Insurance Account…for purposes of financial reporting in no way alters [its] operations…”

The reasons for consolidation, as reiterated by the AG in 2004, were that “employment insurance is considered to be a government program: government determines the rates of premiums, eligibility

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9 The Auditor General had attached the following reservation to his audit opinion on the government’s financial statements for 1982-83: “In my view, the transactions of the UIA [UI Account] should be consolidated in the Government’s financial statements, with employee and employer contributions included in reported revenues, and benefits and administrative expenditures included in reported expenditures.”

criteria and benefits.” With regard to the EI Account, the AG stated: “We have used terms like “notional account” and “tracking account” to describe the [EI] balance as it does not represent funds held in a separate bank account.”

The criteria for the consolidation of public entities are those of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants: “PSAB uses the concept of "control" to determine when an organization should be included in the government’s financial statements. Control is defined as having the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss accruing to the government from the other organization’s activities.”

As will be seen further on in section 6, most social insurance programs in Canada are in fact substantially independent from government and are thus not consolidated, as their management has the authority to administer the scheme in its essential aspects, notably on the financial side. This could also be done for the EI program, and in our opinion, should be done but will require changes in its governance structure.

With regard to EI premium rates and EI cumulative surpluses, these started to attract public criticism in 1997 and 1998. In November 1999, the AG stated: “At the end of fiscal year 1999, the cumulative surplus in the Employment Insurance (EI) Account stood at $21 billion, a level much higher than the Chief Actuary of Human Resources Development Canada considers sufficient for purposes of the EI Act.” In formulating this opinion, the AG also relied on an independent external review of the chief actuary’s work.

From 1999 to 2004, the reports of the Auditor General questioned the setting of EI premium rates, seeking at first clarification and disclosure (in 1999 and 2000), then expressing doubt about whether the intent of the legislation was being respected (in 2001 and 2002), finally asserting (in 2003 and 2004) that “the Government did not observe the intent of the EI Act.”

In 2004, with regard to the premium rate-setting system that was then being discussed and that had been first proposed in 1999 by the Finance Committee of the House of Commons (see section 4.3 following), the Auditor General stated that its “principles may ensure that the surplus does not grow significantly once a new rate-setting process is in place. However, they do not address the $46 billion surplus that has accumulated.” The government’s plan was nevertheless adopted without modification in June 2005.

The AG has since then given an unqualified approval to EI financial statements, stating on November 24, 2005 to the Standing Committee on Public Accounts that: “Recent changes to the act mean the premium rate will be set on the principle that it will generate just enough revenue to cover the costs of the program each year, without considering the accumulated surplus. As a result, the issue of compliance with the intent of the act no longer applies.”

4.3 Views of Parliamentary Committees

In December 1999, the House of Commons Standing Committee on Finance recommended that EI premiums be set on a “forward-looking” and “cyclical break-even” basis, but that the government

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11 No vember 4, 20 04, Opening Statement by t he Auditor Ge neral o f Canada, t o t he Su bcommittee o n Employment Insurance Funds of the Standing Committee on Human Resources, Skills Development, Social Development Canada and the Status of Persons with Disabilities.

12 Noted on the PSAB’s website (at http://psab-ccsp.ca), in “PSAB – What it is and What it does”.

13 19 99 Re port of t he Auditor General o f C anada, at Ch apter 33, Ot her Au dit Observations, released November 30, 1999.
should move only gradually towards that goal. These recommendations were part of a wide-ranging review of the fiscal and economic environment (encompassing some sixty recommendations). The committee held that, since payroll taxes in Canada were below those of most OECD countries, the government should prioritize other tax cuts and programs. At the time, the EI surplus reached $26 billion (at December 31, 1999).

The committee’s plan was that EI premium rates should ultimately be set to consider only the next year’s costs, but not take into account past surpluses nor future interest credits. However, this should not be done immediately, to avoid an immediate “budgetary hit of over $3 billion per year” that might use up “most of the budgetary planning surplus.” Even though the ensuing budgetary surpluses turned out to be much larger than $3 billion per year and much larger than government forecasts, EI premium rates were only reduced slowly, to reach the expected break-even premium rate in 2004.

In the meantime, the Minister of HRDC had announced on May 2, 2001 to a Senate Committee that it was the government’s intention to consult on the “forward-looking” proposal, which consultation was planned for the fall but was deferred to 2003 and followed by legislation in 2005. Noting the estimated surplus of $35 billion at March 31, 2001, that Senate Committee reported to the House of Commons that: “the committee believes that the size of the reserve today – and it follows the premium rate – is excessive in terms of that required to satisfy the intent of the act.”

Following the Speech from the Throne on October 5, 2004, a subcommittee of the House of Commons was charged with reviewing the use of EI funds. After hearing from government officials as well as from labour and employers, it submitted its report in February 2005, with 28 recommendations. The first six, dealing with the financing of the EI program, are listed in Appendix D and can be summarized as follows: to establish an autonomous EI organization operating independently from government, to which the existing surpluses would be gradually turned over, and which would set premium rates on the basis of actuarial advice. A rate stabilization reserve would be created along with a target for stable premium rates over a five-to seven-year horizon. The new organization’s decisions on premium rates could only be overridden if approved by a vote in the House of Commons.

4.4 Views of Employers and Labour

While agreeing on the desirability of creating an independent EI fund, organized labour and employers have had conflicting objectives with regard to EI premium rates and surpluses, labour

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15 The fiscal year surpluses recorded by the federal government were $14.3 billion in 1999-2000, $19.9 billion in 2000-01, $9.0 billion in 2001-02, $6.6 billion in 2002-03, $9.1 billion in 2003-04, $1.5 billion in 2004-05 and $13.2 billion in 2005-06 (Department of Finance, Fiscal Reference Tables, September 2006).


18 Consultation results can be found at http://www.fin.gc.ca/activty/consult/eirates_e.html.

seeking to apply EI surpluses and premiums to improve benefits and employers wanting lower premiums. Those opposing positions were described as follows in February 2005 by the above-mentioned Subcommittee on EI funds:

“Many of those who appeared before the Subcommittee want future premium rates to increase or decrease in order to achieve objectives beyond those associated with the rate-setting process itself. For example, most of the witnesses representing employees recommended that the current premium rate be maintained or even increased so as to help finance, in conjunction with a reduction in the cumulative balance in the EI Account, numerous program enhancements. Groups representing employers, on the other hand, sought a continued reduction in EI premiums via a reduction in the cumulative balance in the EI Account, a rebalancing of employer/employee cost sharing, and higher premium refunds. It was also proposed that the new rate-setting process incorporate experience rating, a feature that would result in higher premium rates being charged to companies that generate above-average program liabilities compared to companies that tend to have relatively greater employment stability.

We think the premium rate should be increased. If we want to improve the employment insurance system, as we wish, the premium rate absolutely must be approximately $2.20 per $100. (René Roy, Fédération des travailleurs et travailleuses du Québec)

Given that employers and employees have already paid in over $47 billion in extra premiums to the government for the sole purpose of achieving rate stability, CFIB recommends that the government continue to lower the rates beyond 2004 and take the responsibility for future unexpected program shortfalls associated with the business cycle. (Garth Whyte, Canadian Federation of Independent Business)”

That divergence remained in 2007, with labour representatives arguing that premium rates should not be reduced from their 2006 level but that benefits should be improved, while employer groups asked for larger rate reductions. Both groups did, however, remain united on the necessity of creating an independent EI fund.

5. AN ASSESSMENT OF THE CURRENT RATE-SETTING PROVISIONS

The 2005 EI rate-setting provisions did not address the issue of the existing cumulative surpluses nor will they prevent further surpluses from arising. Future interest credits, although still correctly imputed to the EI Account, are no longer taken into account for rate-setting purposes. However, better than forecast results over recent years underscore the difficulty of correctly predicting benefit payments and premium revenues on an annual basis.

5.1 Detailed Analysis of the Rate-Setting Rules

The 2005 amendments gave a formal role to the EI Chief Actuary for premium rate-setting, instead of the previous arrangement that had only provided a de facto role. However, the new role is a very constrained one. The EI Commission’s rate-setting authority was also restored, but within strict limits that leave little discretion. Finally, the ministers (of HRSDC and Finance) were allowed to override this process if they so choose “in the public interest.”

The Chief Actuary’s role is to calculate for the next year a break-even premium rate based on three parameters: 1) the economic assumptions given by the Minister of Finance; 2) any anticipated amendments to program costs announced by the Minister of HRSDC; and 3) the rules specified in

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20 There seems to be no provision to adjust for any changes that might affect premium revenues.
the legislation (i.e., considering current costs only, excluding past surpluses as well as future interest credits).

These rules carry over to the EI Commission, to which the actuary must report his calculations, such report to be made public as soon as possible. The Commission must then reach a decision on EI premium rates for the next year, based on three factors: 1) the aforementioned principle that premiums should just cover the costs of the program, excluding existing surplus and future interest credits; 2) public input; and 3) the Chief Actuary’s report. A limit is set, namely that the premium rate cannot vary by more than 0.15% from one year to the next (which approximately corresponds to a revenue flow of $1.5 billion and is just more than enough to cover a 1% increase or reduction in the unemployment rate, estimated at $1.4 billion).

Three other provisions are noteworthy, all of them being contained in the legislation governing the department’s organization (rather than in the EI Act): 1) the Commission may hire outside experts to assist it in setting premium rates; 2) the Chief Actuary in these duties is under the direction of the Commission; and 3) the Commission must in all matters comply with any directions given to it by the minister (a provision introduced in 1977).

A number of comments may be made. First, the effect of allowing for public input in the decision process is unclear. For example, could compelling public input partly affect the prescription to set premium rates on a break-even basis? One thinks that it could, since the provision for public input must otherwise remain academic and cosmetic in nature.

Second, given the Commission’s capacity to hire experts, it could seek external advice on any of the factors used to determine the break-even premium rate. A recommended approach in this regard, to enhance governance and accountability, would be to seek an external peer review of the EI actuary’s report. Such peer review would be in accord with the Canadian Institute of Actuaries’s General Standards of Practice (section 1640) and with OSFI’s guidance for insurance company appointed actuaries. Examples of such a process are found in the Canada Pension Plan, in most of the provincial Workers’ Compensation plans and in private industry, both for pension plans and for insurance companies.

A peer review process would also be congruent with the International Social Security Association guidelines for social security actuaries, namely: “If the actuary is an employee of the government ministry overseeing the social security scheme, or of the governing body or the entity administering the scheme, the work of the actuary should be subject to independent peer review or actuarial audit.”

Third, the actuary’s independence is in part assured by direct reporting to the EI Commission for the rate-setting exercise, and by publication of the actuarial report. These are reasonable measures, as the Commission is the body having to set EI premium rates. However, the actuary’s professional autonomy is unnecessarily limited by the imposition of economic assumptions by the Minister of Finance. While it is reasonable to take those assumptions under close advisement, the actuary ought to be free to choose these or any others on his own, based on appropriate consultations and on a review of trends.

Fourth, there are numerous possibilities for ministers to intervene in the rate-setting process, the whole of which can only detract from its transparency and credibility. This refers firstly to the general override authority given to the ministers of HRSDC and Finance, but also to the imposition of economic assumptions by the Minister of Finance and to the general authority of the Minister of HRSDC to direct the Commission, at least as it applies to premium rate-setting. Legislation should

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limit such interventions to exceptional circumstances.

Fifth, in the event of a recession causing a significant increase in program costs or even in the case of a small upward fluctuation in program costs, the existing reserves in the UI Account would make it difficult to justify, on insurance grounds, any increase in premium rates.

Sixth, by current rules, premium rates must be set as a multiple of 0.01% (under section 66.4 of the EI Act). This conveys an unwarranted air of precision that is not justified by the margins of error. Premium rates should at least be multiples of 0.05%. Trivial or erratic fluctuations give false signals and should be avoided. This is another instance in which the existence and use of cumulative surpluses for stabilization would serve a desirable purpose.

Seventh, the maximum variation of 0.15% in employee premium rates (and thus of 0.21% in employer premium rates) does seem desirable to prevent abrupt increases in premium rates. However, two caveats apply: first, this limit is significantly higher than the 0.10% limit for the CPP, especially for employers, and second, there might be less of a reason to apply this limit to reductions, in the same way that the 0.10% limit does not apply to eventual reductions in CPP contributions.

Keeping to the 0.15% limit as it is now specified, what might be its impact? Looking at annual unemployment rates since 1946, we find 7 out of 60 years in which this rule could have applied on the upside (in years of increasing unemployment), and only 4 where it might have applied on the downside (falling unemployment). Thus, if history was to repeat itself, this 0.15% limit might apply in just over 10% of years on the upside, and in one of every 15 years on the downside. Supporting data are found in Appendices C(A) and C(B).

In financial terms, we find that existing EI surpluses might be reduced in total by only about $9 billion (in 2007 dollars) over the next 60 years, an amount found by adding up all of the excess costs for the seven upside years (namely the costs that would have exceeded the 0.15% premium increase). The downside years would have little or no financial impact, with excess premiums (as would occur in this case) for the four years in question coming to just $600 million. Thus, the likelihood of actually reducing the existing cumulative EI reserves in any significant way under this limitation is for all intents and purposes zero. (Ministers of HRSDC and Finance could, however, maintain premium rates constant to counter rising unemployment, under the “public interest” override provision. In that case, the EI surplus might be affected more significantly, though to an unknown extent.)

This analysis is based on historical rather than on forecasted unemployment rates that would apply in the actual rate-setting environment. However, it still indicates that, under the 2005 procedures for setting EI premium rates, the cumulative EI surpluses will never be reduced and will, in fact, continue to grow indefinitely due to interest revenues.

5.2 Some of the Principles Involved

The effective forfeiture of EI surpluses implied in the 2005 amendments runs against actuarial and insurance principles. Program participants, namely employee-employer contributors, ought to maintain effective ownership over the funds that they have contributed as insurance premiums. As stated in the Beveridge Report of 1942 for the United Kingdom, “The scheme is described as a scheme of insurance, because it preserves the contributory principle.” In insurance terms, the contributory principle can be defined as protection granted in return for premiums paid, with equivalency between the two, not necessarily over the short run nor even for any individual, but in an aggregate or collective manner over a reasonable period.

22 Given that employers pay 1.4 times employee premiums for EI.
The Canadian Institute of Actuaries had already expressed the view in 1986\textsuperscript{23} that “the existence of a fund, or account, for a social insurance plan is essential if some degree of discipline is to be maintained”, adding that a social insurance plan should have as one of its characteristics “premiums established on actuarial principles such that income and outgo of the plan will be kept generally in balance.”

The role of actuarial reserves would be:

“(i) as a financial protection against the occurrence of unforeseen contingencies;
(ii) as a device for smoothing out income and outgo over time; and
(iii) as a measure of the direction in which the overall finances of the plan are moving.”

The unfolding of events over the last decade accentuates the necessity of implementing a sound financial framework. In 1994, the Canadian Institute of Actuaries specifically argued for increased financial autonomy of the program, noting for example: “Since the UI program is entirely self-financing, the current mechanism distorts the government budgetary results.”\textsuperscript{24} The Canadian Institute of Actuaries’ concern at the time was the foreseeable impact of keeping the UI Account consolidated with the government’s accounts, a situation that was likely to jeopardize the financial management of the UI system.

Treating part of EI revenues as general taxes would indeed run counter to the insurance notion of premiums paid in return for benefits of equivalent value, or of a quid pro quo. The insurance character of EI premiums rests on the fact that they are only charged on insured persons (and their employers), excluding for example the self-employed or persons who receive investment or pension income, as well as the fact that they are capped at a level, currently $40,000 annually, which corresponds to the maximum level on which benefits are based (in the absence of the insurance relationship, this would otherwise be considered a regressive tax). An additional observation is that EI contributions are logically distinguished from taxes by the fact that they themselves provide income tax deductions or credits. To treat any part of EI premiums as general taxes would finally go against the insurance contract established in 1940 between the federal government and insured persons, as agreed to at the time by provincial governments.

Further insight into these issues was provided by the Technical Committee on Business Taxation\textsuperscript{25} (the Mintz Report) in 1998, which agreed with the notion of earmarked premiums based on payrolls to finance social insurance schemes such as EI, CPP/QPP or Workers’ Compensation (pages 8.1 and 8.2 of its report):

“We see little merit in using payroll taxes as a general revenue source…

The Committee does see potential merit in employer payroll taxes (coupled with employee contributions) when used to finance income-replacement social insurance programs, where eligibility for benefits is linked to employment and the size of potential benefits is linked to earnings subject to contribution. At the federal level, such an approach is used to finance EI; it is also used for the Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) which, as well as covering employees, cover the self-employed who contribute at a rate equal to the sum of the employer and employee contribution rates.

\textsuperscript{23} “A Submission by the Canadian Institute of Actuaries to the Commission of Inquiry on Unemployment Insurance”, Canadian Institute of Actuaries, Ottawa (Jan. 17, 1986), in particular pages 4 and 5.

\textsuperscript{24} “Task Force on Unemployment Insurance”, Canadian Institute of Actuaries, Ottawa (Sept. 1994).

At the provincial level, workers’ compensation programs are financed through employer contributions.”

That committee also agreed with the need for a stabilization reserve for EI, which it described on page 8.8 as:

“a substantial reserve account that would allow economy-wide average premium rates to be maintained at stable levels intended to cover the cost of benefits over a full economic cycle.”

although it did defer to the government on fiscal policy, by saying (on page 8.13, note 3):

“We recognize, however, that it is appropriate to build up a stabilization reserve, and that the pace at which contributions are reduced to bring them in line with the average level of benefits must give weight to considerations of overall fiscal policy.”

It is the view of the Task Force that EI premiums should be treated in the same way as are contributions for the Canada/Quebec Pension Plans or for provincial insurance schemes such as Workers’ Compensation, namely as dedicated funds to be kept and managed for the single purpose of financing the program. The argument is as strong for UI as for any program, as its insurance nature is a constitutional requirement that has been confirmed from time to time by the Supreme Court of Canada.

The parallel with Workers’ Compensation is a particularly interesting one, since the provincial Workers’ Compensation plans, which like EI have dual objectives of income replacement and re-employment assistance, are funded as separate entities on an off-budget basis. As noted by the Auditor General of Canada in 2006, they are in effect considered as insurance companies, under strict governance and financial rules – even if they are legislated by and report to provincial governments.

From an actuarial perspective, a program such as EI should not be financed on an annual pay-as-you-go basis but by relatively stable premium rates made possible by adequate reserves. Economic studies, in Canada and abroad, have indicated that raising premiums at the onset of a recession can only make things worse. From a micro or individual perspective, it would be a mistake at that time to either reduce benefits to unemployed persons or the take-home pay of workers, or to raise employer premiums. From the angle of macro-economic stabilization, keeping the UI program on an even keel in such circumstances is the best approach to sustain spending and investment and to help stabilize the economy.

A final but important point should be made regarding interest revenues, which are excluded from consideration under the terms of the 2005 legislation. The time value of money is a basic actuarial, accounting and economic concept which, on grounds of intergenerational equity, should not be overridden by legislative decision. It is also implied that the funds held by the EI Account should be managed to ensure an adequate return on investment, while paying close consideration to investment risks and liquidity needs.

5.3 Results to Date

As noted in the preceding section 4, based on Table 2, the cumulative EI surplus has grown by another $9.2 billion since the single-year approach was first applied in 2004. Of this amount, $5.3 billion was due to interest revenues and $3.9 billion to better than expected program experience.

The EI actuary’s 2007 report noted that positive and negative forecasting differences are inevitable but that they should “converge to zero over an extended period, such as one or more business cycles.”

26 See the 2006 Report of the Auditor General of Canada on the Workers’ Compensation Board of the Northwest Territories and Nunavut.
This comment was primarily concerned with the break-even premium rate, but should also apply to financial results. Yet the implicit deferral of accountability to as long as one or more business cycles, or up to 10 or 20 years, is much too long. Of course, this matter only becomes an issue if, as under current rules, there is no cumulative adjustment system to incorporate and correct past deviations.

The EI actuary’s report has indicated another source of forecasting differences, namely the fact that accurate data on premium revenues are only available a full year after the end of any calendar year (a general situation that was also noted in the O’Neill report of 2005, mentioned below). Neither data nor analysis are provided on the potential errors that this introduces but this fact does again provide good reason for an effective cumulative accounting system to correct past errors.

The economic assumptions for 2006 and 2007 were described by the EI actuary as representing “the most recent averages of forecasts from the quarterly survey of private sector forecasts conducted by the Department of Finance.” The process used to derive this forecast was described in a 2005 study sponsored by the Department of Finance, the resulting forecast itself being indicated as generally sound.27

Notwithstanding those expectations, results to date already show significant deviations in program experience in little more than three years, from January 1, 2004 to March 31, 2007. This does not suggest that any of the assumptions made or even their combination was biased, nor even that they were not the best and most realistic possible. Nevertheless, explicit efforts should be made to produce EI assumptions and forecasts on a fully neutral “best estimate” basis. Forecasters, in general, have a natural leaning towards prudent or conservative estimates, which under the current rules would be particularly inappropriate.

The potential for significant and recurring forecasting errors can also be seen by comparing the annual EI benefits paid with the forecasts made before each year (based on Budget documents and the Annual Financial Reports of the Government of Canada, see Appendix E): such errors cumulated to almost $9 billion in the 10 years ended March 31, 2007. Similar errors can also occur when making estimates for program changes, such as in 2003 when EI compassionate care benefits were projected to cost $221 million per year, but actually cost $8 million per year.

6. LOOKING FOR MODELS

6.1 An Overview

What are the usual characteristics of social insurance programs, of their governance and accountability structure as well as for their general financial management? What could be learned or adapted from other systems? Given the potential scope of such an investigation, we will limit ourselves to a few examples that we consider to be of interest. On the international scene, we will thus only evoke a few of the UI systems that exist worldwide.28

The main social insurance programs in Canada are the Canada and Quebec Pension Plans, the Employment Insurance program and the provincial Workers’ Compensation programs. The Quebec


28 There are about 70 countries with unemployment compensation systems of some kind, most of them unemployment insurance schemes (Vroman and Brusentsev, “Unemployment Compensation Throughout the World”, W.E. Upjohn Institute, Chicago (2005)).
Parental Insurance Plan, launched in 2006, is also of interest as it replaced the EI system in that province with regard to maternity and parental benefits. Health insurance will not be included here, mainly because it has no comprehensive financing basis.

Other potential references are the State UI programs in the US, which like the Canadian system were launched towards the end of the 1930s (actually a few years before Canada’s UI) and are also fully financed by the private sector (in the US case, by employers with the exception of three States that also have employee premiums).

Relevant opinions have also been expressed by the International Labour Office (ILO) and the International Social Security Association (ISSA). In 2002, the International Labour Office published a treatise on “Actuarial Practice in Social Security,” which included a chapter on Unemployment Insurance methodologies and principles.29

6.2 Some Examples

Most social insurance schemes in Canada are managed as autonomous or semi-autonomous entities with specific parameters to guide their overall management, actuarial guidance for the setting of contribution rates and independent management of assets. These programs have earmarked payroll contributions as a primary or sole source of funding. If governments are involved in the rate-setting process, their authority is to be exercised within set parameters.

The assets of these programs are segregated from government funds, leaving the programs generally free of external budgetary pressures. Governments still control their legislation and policy design, and program administrators are accountable to them and to the general public for their overall performance, in terms of service to clients, efficiency and financial results.

The Canada Pension Plan, for example, operates on a decentralized model of collaboration between multiple federal departments. Benefit administration is done by HRSDC’s service arm, Service Canada, while contributions are collected by the Canada Revenue Agency, in both cases transiting through the government’s Consolidated Revenue Fund. Spending is limited to the plan’s net assets. All of the excess funds not needed for immediate operations are transferred to the independent CPP Investment Board. Actuarial services are provided by a government Chief Actuary housed in the Office of the Superintendent of Financial Institutions. Other departments provide a variety of other services.

The CPP Investment Board operates at arm’s length from the federal government, setting investment policy independently with “a view to achieving a maximum rate of return without undue risk of loss, having regard to the factors that may affect the funding of the CPP and the ability of the CPP to meet its financial obligations on any given business day.” It is, however, “accountable to the public, Parliament (through the federal Minister of Finance), and the provinces.30 It provides regular reports of its activities and of the results achieved.”31

The contribution rates for the CPP are reviewed every three years by federal and provincial ministers, based on regular actuarial evaluations. The role of the actuary is embedded in the CPP Act, and the


30 The joint federal-provincial guardianship of the Canada Pension Plan is no doubt a reflection of the fact that any province may choose to implement its own plan, pursuant to section 94A of the Canadian Constitution.

CPP Chief Actuary has had peer evaluations conducted for the last three evaluations. Federal and provincial ministers (and ultimately the governments representing 2/3rds of the provinces with 2/3rds of the population) are charged with setting contribution rates so as to achieve the long-term stability of contribution rates and a steady ratio of assets to expenditures at specified dates. If no action is taken, contribution rates are set or continued according to default provisions in the CPP Act, based on those same objectives.

Workers’ Compensation Boards (WCB) offer another model of public governance in Canada. The WCBs are autonomous bodies that operate at arm’s length from, yet are still accountable to, provincial governments, as well as to the citizenry. As in the case of the CPP, there is a separation of accounts and of financial operations from those of government. At the same time, provincial governments maintain full legislative authority over the programs’ policy directions. All of these Boards rely on independent actuarial advice for annual actuarial valuations, with external peer reviews when an internal actuary has done the initial valuation.

The Alberta WCB,32 to illustrate, has established clear rules for the setting of contribution rates, based on four principles:

1) minimize the risk of being unfunded;
2) minimize cost volatility for employers;
3) minimize the total cost charged to employers by ensuring the funded position is appropriate in relation to financial needs; and
4) ensure today’s employers pay for today’s accidents.

There are limits on maximum reserves, which in recent years have generated large dividend refunds to contributors. Replenishment levies could be charged if reserves went below a minimum level, but would be managed to minimize annual increases. Annual actuarial valuations are conducted in-house and subject to external peer review. The management of assets is done autonomously, based on the organization’s evaluation of goals and risks.

The neighbouring province of British Columbia has similar rules for WCB33 which, though different in their details, also ensure the program’s financial stability. An interesting feature is that its Board of Directors includes not only employer and employee delegates but also public interest members, a health professional and an actuarial nominee, all of whom bring varied expertise to the oversight function, to help reconcile traditional tensions between stakeholders.

The Quebec Parental Insurance Program was created in 2006, when the Quebec government assumed responsibility for maternity and parental claims previously covered by EI. The plan is managed by an autonomous board (the Conseil de gestion de l’assurance parentale, CGAP) which acts as trustee of the independent and self-financing fund.34 CGAP is responsible for overall management, funding and investment as well as strategic plans and annual reports. It also advises the responsible minister on policy. Other provincial bodies deliver benefits, collect premiums and manage investments, under contractual service agreements with CGAP.

CGAP’s Board of Directors has members from all insured and contributor groups, unionized workers, employers, self-employed, non-organized workers, plus a government appointee. This is a new

34 Made possible through the EI program’s 1972 opting-out provisions for maternity, parental or sickness benefits, if provinces set up their own schemes (equal to or better than the federal program) and collect their own premiums, workers paying lower EI premiums as an offset.
scheme whose funding policy has to date been to build sufficient reserves to meet costs, including stabilization reserves. But it has yet to be developed in full and tested against mature program experience. Actuarial reports and five-year projections are to be conducted annually by an in-house actuary and tabled in the legislature.

In the United States, there are fifty-three\textsuperscript{35} individual unemployment insurance programs in operation. Though diverse, the schemes all include the experience-rating of employer premiums (only three states also have employee premiums), a condition for receiving a credit against federal unemployment taxes. That credit is normally 5.4\% of taxable wages, which are wages up to a maximum of $7,000 per year. The remaining federal tax of 0.8\% is used to cover administrative and related costs (federal and state), the federal half of extended benefits triggered by high unemployment rates and for loans to States. Each state program is self-financed, the only federal subsidy being the 50\% financing of extended benefits. State trust funds are held in the federal trust account, where they receive interest based on a market basket of Treasury securities.

The recommended benchmark for the State unemployment insurance programs state that during periods of economic growth they should accumulate enough reserves to carry them through at least twelve months of recession-level benefit costs (defined as the average of the three worst years over the last twenty years or the most recent three recessions, whichever period is longer). At the end of 2006, about half of the States met this threshold.\textsuperscript{36}

During a recession, an unemployment insurance trust fund with low balances may have to make adjustments to avoid insolvency\textsuperscript{37} and to maintain its ability to pay benefits. Individual states have four main avenues for handling such a situation: borrowing from the federal government, issuing state bonds, augmenting premiums or reducing benefits.\textsuperscript{38} The two latter recourses (changing premiums or benefits) are in some states activated automatically when trust fund balances fall below specified levels, or in other states have been done on an ad hoc basis.

The general stance for many (though not all) of these programs seems to have been to manage on the edge, with low reserves, and to react when necessary. However, as (politely) noted in a 2005 study prepared for the New York Federal Reserve Bank: “Imposing added economic burdens on the parties during a recession, that is, reduced benefits and higher taxes, seems an inappropriate action to many.” Borrowing at such times should be the better choice, at least from a macro-economic perspective, but still rates behind having built adequate reserves to begin with.

Chile adopted a new unemployment insurance scheme in 2002. The scheme took the form of individual savings accounts complemented by a solidarity fund. While the scheme has been criticized for its low benefits and inadequate re-employment component, its governance is fully above board. It features a private sole-purpose firm managing all operations of the scheme, premium collections, benefit applications and payments, investment of funds, under a 10-year contract with the Chilean government. A consultative group of employers and labour, headed by a distinguished individual from the academic world, publishes an annual report on the operations of the scheme and on potential changes.

Performance, standards of service and conformity with legal rules and with administrative procedure are controlled by the government’s social security agency. Actuarial valuations are mandated every two years and are to make long-term projections but the two done so far have not been made public.

35 One in each of the 50 US states plus in the District of Columbia, the Virgin Islands and Puerto Rico.
37 Most of what follows is from Wayne Vroman’s 2005 study for the New York Federal Reserve Bank.
38 One state, Pennsylvania, in 2004 borrowed from another state fund (the Motor License Fund).
There is monthly publication of program statistics, as well as regular publication of the private administrator’s financial statements.

In France, the unemployment insurance system is managed by the social partners on a joint basis. These partners comprise all the large employer and labour associations. Every three years, they must agree on the level of employer-employee contributions as well as on the benefit eligibility rules. Created in 1958, the French system has faced mixed financial fortunes over the years, in line with the rise and fall of unemployment rates.

By the end of 2006, the system had a cumulated deficit of close to six months of benefit spending, which is expected to be cut in half by the end of 2008. Those deficits are covered by external borrowing. Since 1985, the system has shown a positive balance only one-third of the time, and is instead seen to operate usually with a small negative balance (equivalent to about three months of payments). The consequential borrowing costs represent an ongoing and undesirable financial burden for the system.

The International Labour Organization (ILO) has two conventions relating to unemployment insurance, Convention 102 of 1952 and Convention 168 of 1988. Though neither of them has been ratified by Canada, they still provide an international perspective on such issues. The relevant sections of these conventions that apply to governance are attached as Appendices F and G. The remainder and larger part of the conventions are concerned with the types of benefits and the circumstances under which they are payable.

The gist of these conventions is that governments should ensure the sound operations of social insurance programs, their open and transparent administration, the participation of stakeholders and financial soundness, including the provision of necessary actuarial studies and reports. As stated by the ILO in 2002: “Public confidence in social security systems is a key factor for their success. For confidence to exist, good governance is essential.”

In a 2002 publication of the ILO, reference is made (i) to the need for stabilization reserves, (ii) to the desirability of keeping unemployment insurance accounts separate from those of government, and (iii) to inherent risks of building reserves that could be too large. Relevant paragraphs are quoted below:

“A UI programme should be financed in such a way as to contribute to a counter-cyclical stabilization of the economy. Namely, its revenue requirements should remain as stable as possible over time and especially not be increased with the onset of a recession, as this would only make the recession worse. Clearly, this implies the need for some form of dedicated financing that can be used to establish and maintain rainy day reserves. Such reserves are, in one sense, of the same type that exist for life insurance policies in that they are established to stabilize premiums against a contingency that occurs with very volatile probabilities. For life insurance, the variation is generally one of a steady growth in the probability of dying (though not necessarily so, if one considers the sharp rise in mortality rates for youths around the age of 20.) For UI, the variation is one of successive ups and downs in the probability of becoming unemployed, following economic cycles.” (page 292)

“In that regard, it might be preferable for the finances of the UI programme to be operated at arm’s length from the State’s budgetary results, in order that UI funds remain fully committed to the programme….If not, there could be strong incentives for the government to intervene in

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the affairs of the UI system, for reasons having little or nothing to do with its proper administration and continuance.” (page 303)

“Economic studies have shown that abrupt changes in premium rate are detrimental to job creation and maintenance, and so should be avoided during a recession. This leads to the necessity of establishing sufficient rainy day reserves to allow premium rates to remain level when economic downturns occur. However, the size of such reserves can become very contentious. Groups who would want to liberalize benefits may see large reserves as justification for pressing their demands, while some public authorities may see large UI reserves as a convenient source of funds for other projects.” (page 306)

6.3 Lessons learned

From all of the preceding examples as well as from the views expressed in the international literature, it emerges that the issue of setting premium rates for a social insurance plan such as EI goes beyond simple technical calculations and formulas: it also involves broad matters of governance and accountability.

For EI, the principle that financing should rest on stable premiums, backed up by reserves as protection against economic fluctuations, seems an inescapable conclusion, both from an actuarial viewpoint and from an economic perspective. An equally strong conclusion is that the program’s fiscal integrity will be best assured if its accounts are fully segregated and independent from those of government, as can be seen from numerous examples in Canada and elsewhere.

Further conditions for achieving financial stability are that the setting of EI premium rates should be carried out in such a way as to avoid abrupt changes as well as trivial or erratic fluctuations, that cumulative surpluses not be allowed to grow beyond what is needed, and that deficits be avoided as much as possible, all of these principles being grounded in sound business practice as well as on insurance rationale.

From a governance perspective, an autonomous body is needed to carry out those functions: first, to set EI premium rates in a fully objective and independent manner, and second, to act as trustee and manager of the EI Fund. That autonomous body should be constituted with a clear mandate for sound financial management, with a broad membership for its Board of Directors. Policy or political issues should not enter into those decisions. A more integrated approach could also see that autonomous body responsible for the entire EI program, contracting with government agencies and units as needed to guarantee performance standards, standards of service and efficient management.

It would also be important to provide for regular actuarial valuations and forecasts to assist the rate-setting process and the management of reserve levels. A peer review of the work done by an in-house actuary is also considered advisable actuarial practice. Actuarial reports, indeed all of the decisions, strategies and proceedings of the EI autonomous body, need to be made public. This last point is especially true in the present instance, when the rules for the setting of EI premium rates and for the management of EI surpluses have led to a great deal of acrimony and confusion.
7. RECOMMENDATIONS

From an overall perspective, the Employment Insurance program should have three fundamental policies:

1) A Benefits Policy;
2) A Funding Policy; and
3) Investment and Borrowing Policies.

The Benefits Policy should be set by the Government of Canada, based on its assessment of the needs of Canadian workers and employers, the outlook for the Canadian labour market and economy, and an overall view of what the program should achieve and cost over the long-term.

The other two policies should fall under the control of a governance council. The constitution of that council should seek to achieve even broader representation of worker and employer groups than the current commission, as well as include government and public interest representatives and an actuarial nominee. The government should not intervene in the council’s decisions (but will always retain its right to amend the legislation, in the same way that provincial governments can amend their Workers’ Compensation plans).

With regard to funding, the parameters guiding the actions of this council would be part of the legislation but would leave it with considerable leeway to adjust premium rates as necessary to achieve two fundamental objectives: 1) the relative stability of premium rates, and 2) the fiscal integrity of the EI program. It should be left to the council to flesh out how it would pursue those objectives, but this should presumably include consideration of maximum reserve balances and the general desirability of avoiding deficits.

The new fund would be constituted as an autonomous fund managed according to sound business practices, at arm’s length and independently of the government of the day, under the trusteeship of the governance council. Its investment and borrowing policies would be set by the council, with due regard to liquidity needs and investment yield. In the event that the reserve was completely depleted, a borrowing policy would also be anticipated.

The application of the funding policy, that of the investment and borrowing policies, the specific strategies and plans adopted to implement those policies, and the results achieved would be duly reported to and monitored by Parliament. Regular actuarial valuations would be part of such reporting, including the impact of any program changes.

The preceding changes in the EI system’s governance structure ought to be sufficient to achieve the de-consolidation of EI accounts from those of the federal government. Such de-consolidation is in our view essential to establishing a sustainable insurance-based financial framework, and expert advice from the accounting profession should be obtained as necessary to ensure that this objective is attained.

A crucial issue remains, namely the existing reserve of $54 billion in the EI Account. Its significance is seen in the fact that it represents over three years worth of EI premiums, or about $3,400 per insured person (assuming about 16 million individual contributors). This amount represents insurance premiums that were collected over about 10 years from employee and employer contributors (plus accumulated interest), and cannot in our opinion be removed, frozen or otherwise diverted from the EI program on the basis of insurance principles.

There could be many ways in which to recognize this obligation to EI contributors. The federal government could, for instance, issue special government bonds that would mature during the next ten years or so, in order to spread out the financial and cash flow impact over many years while
recognizing its full liability up front.

In any event, it would then be up to the governance council to set appropriate premium rates for the EI program, determining a path that would avoid a “cliff” or an abrupt increase in premium rates at the time the total reserves would have fallen to the levels desired for stabilization purposes, depending also on future developments and prospects for unemployment rates and on any program amendments in the meantime.

8. CONCLUSIONS

The setting of EI premium rates and the management of the EI Account are matters that are seen to go beyond projection methods, reserve levels or the definition and duration of a business cycle. They raise fundamental issues of governance and accountability, issues that are at the heart of insurance principles.

We consider the insurance character of EI to be a given, because it has been embedded since 1940 in the Canadian Constitution. Governments of the day, federal and provincial, chose at that time to establish and to manage the Unemployment Insurance scheme as a social insurance program.

While social insurance principles have to be adjusted over time and to keep up with new social realities, we consider that the use of these funds for purposes entirely unrelated to EI can never be interpreted as a form of advancement. Governance of the EI program was clearly affected by the consolidation of its accounts with those of the Government of Canada. Accountability dictates that, in accordance with the contributory principle, EI premiums and surpluses belong and must eventually revert to insured persons and their employers.

An alternative model is available, and has shown its value for social insurance programs such as the Canada and Quebec Pension Plans as well as for the Workers’ Compensation programs in the provinces. That approach is to establish rules that assure the fiscal autonomy of the program as regards its rate-setting and investments, so that its financial management becomes substantially independent from the government and aligned with insurance and business principles. International experience has also validated such an approach.

Under such an arrangement, the government retains full legislative control over the program’s benefit rules and their application, and can thus ensure that it will continue to fulfil its social mandate and to evolve over time. However, the government thereby also insulates itself from the fiscal fortunes of the scheme and from annual fluctuations in its financial operations. This is the type of arrangement that, in our opinion, should be applied to the EI program.
BIBLIOGRAPHY AND REFERENCE MATERIAL

Canadian Institute of Actuaries, “A Submission by the Canadian Institute of Actuaries to the Commission of Inquiry on Unemployment Insurance”, Ottawa (January 17, 1986).

Canadian Institute of Actuaries, “Task Force on Unemployment Insurance”, Ottawa (September 1994).


# APPENDIX A

## RULES FOR EI RATE-SETTING

Extracts from the *Employment Insurance Act*

<table>
<thead>
<tr>
<th><strong>PREMIUMS AND OTHER FINANCIAL MATTERS</strong></th>
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<td><strong>Premiums</strong></td>
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<td><strong>Chief actuary</strong></td>
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<td><strong>Changes to payments</strong></td>
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<td><strong>Report to the Commission</strong></td>
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<td><strong>Annual premium rate setting</strong></td>
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<td><strong>Difference year to year</strong></td>
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<td><strong>Time limit</strong></td>
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<td><strong>Cap on rate</strong></td>
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<tr>
<td><strong>Forecast values</strong></td>
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</table>
Governor in Council  
66.3 Subject to subsection 66(2) and section 66.1, on the joint recommendation of the Minister and the Minister of Finance, the Governor in Council may, on or before November 30 in a year, substitute a premium rate for the following year that is different from the one set by the Commission under subsection 66(1), if the Governor in Council considers it to be in the public interest.

Rounding percentage rates  
66.4 If the calculation of a premium rate under section 65.3, 66 or 66.3 results in a rate that includes a fraction of one per cent, the resulting percentage is to be rounded to the nearest one-hundredth of one per cent or, if the resulting percentage is equidistant from two one-hundredths of one percent, to the higher of them.

Statutory Instruments Act  
66.5 The Statutory Instruments Act does not apply in respect of a premium rate set under section 66 or 66.3 or the premiums determined under sections 67 and 68. However, the premium rates must, as soon as possible, be published by the Commission in Part I of the Canada Gazette.

User Fees Act  
66.6 For greater certainty, the User Fees Act does not apply in respect of the premium rate set under section 66 or 66.3 or the premiums determined under sections 67 and 68.

Charges to the Account  
77. (1) There shall be paid out of the Consolidated Revenue Fund and charged to the Employment Insurance Account  
(a) all amounts paid as or on account of benefits under this Act;  
(b) all amounts paid under section 61 for employment benefits and support measures authorized by Part I;  
(c) all amounts paid under paragraph 63(a); and  
(d) the costs of administering this Act, including administration fees or costs paid under section 62 or paragraph 63(b).

2) Extracts from the Human Resources and Skills Development Act

Directions to Commission  
24. (3) The Commission shall comply with any directions given to it from time to time by the Minister respecting the exercise of its powers or the performance of its duties and functions.

Staff  
28. (1) The officers and employees necessary for the proper conduct of the business of the Commission shall be employees of the Department.

Chief actuary  
28. (1.1) The employee or officer who holds the position of chief actuary shall be under the direction of the Commission in the performance of the chief actuary’s functions under section 65.3 of the Employment Insurance Act.

Persons who have specialized knowledge  
28.1 Despite section 28, the Commission may, as it considers necessary for the purpose of assisting it in setting the premium rate under section 66 of the Employment Insurance Act, contract for the services of persons who have specialized knowledge and may fix and pay the remuneration and expenses of those persons.
APPENDIX B

ACTUARIAL INVOLVEMENT WITH UI IN CANADA SINCE THE 1930S

The Canadian UI system was established in 1940 after all of the provincial governments had agreed to a constitutional amendment adding “unemployment insurance” to the list of items falling under exclusive federal jurisdiction (section 91, paragraph 2A of the British North America Act). From the outset, the “insurance” specification was significant, as indicated by Prime Minister Mackenzie King’s refusal to seek federal jurisdiction over the additional matter of “unemployment assistance”.

It is not surprising then that the design and costing of the first UI scheme (adopted in 1935, found to be ultra vires but reintroduced in 1940 with minor changes, after amendment of the BNA Act) was done by the actuaries at the federal Department of Insurance (mainly Andrew D. Watson, its Chief Actuary from 1926 to 1947). Actuarial expertise to the UI program and the EI Advisory Committee was continued by the federal Department of Insurance up to 1971, and after 1971 by an in-house Actuarial Services Branch at the UI Commission (now the Canada Employment Insurance Commission).

The first fundamental review of the design and operations of the UI system was conducted in 1961-62 by the Gill Committee (named after its President, Ernest C. Gill, a Fellow of the Society of Actuaries, President of the Canada Life Assurance Company). The Committee’s Director of Research was the Department of Insurance’s Chief Actuary, Richard Humphrys.

As actuarial advisers for the 1971 UI Act and for its later development, actuaries were particularly involved in advising the UIC, and later the CEIC, in respect to financial parameters (annual premium rates, maximum insured earnings, the premium reduction program in respect of wage-loss insurance plans), as well as in respect to insurance principles and to actuarial implications of various legislative changes. Those duties have continued to date, with the EI Chief Actuary having also assumed responsibility for the review of EI boundaries in 2000. In the early 2000s, the actuary’s reports were repeatedly quoted by the Auditor General of Canada in drawing attention to excessive EI surpluses.

Over the years, the Canadian Institute of Actuaries has submitted its views on UI to the federal government on two occasions: first in 1986, to the Forget Commission of Inquiry on UI, then again in 1994 in the lead-up to the EI Reform of 1996.

One author took note and perhaps exception to the “actuarial ideology” that the Canadian UI system has followed since its inception. Nevertheless, for all of its merits or faults, such “ideology” is a reflection of the Canadian Constitution. The social insurance character of UI has been affirmed repeatedly by the Supreme Court of Canada – along with comments that the interpretation of insurance principles in this context has to be broad and forward-looking and constantly adjusted to changing socio-economic circumstances.
## APPENDIX C(A)

**UNEMPLOYMENT VARIATIONS FROM 1946 TO 2006**

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Unemployment Rate</th>
<th>Year-over-year change</th>
<th>Increase (decrease) of 1% or more</th>
<th>Year</th>
<th>Annual Unemployment Rate</th>
<th>Year-over-year change</th>
<th>Increase (decrease) of 1% or more</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946</td>
<td>3.4%</td>
<td></td>
<td></td>
<td>1977</td>
<td>8.0%</td>
<td>1.0%</td>
<td></td>
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<tr>
<td>1947</td>
<td>2.2%</td>
<td>-1.2%</td>
<td>-1.2%</td>
<td>1978</td>
<td>8.3%</td>
<td>0.3%</td>
<td></td>
</tr>
<tr>
<td>1948</td>
<td>2.3%</td>
<td>0.1%</td>
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APPENDIX C(B)

“EXCESS COSTS” DUE TO UNEMPLOYMENT RATE VARIATIONS

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1) Associated costs: the regular benefit costs (expressed in 2007 dollars) associated with a year-over-year variation of more than one percentage point in the unemployment rate (for the years shown in Appendix C(a)), estimated as $1.4 billion per percentage point change in the unemployment rate (source of the $1.4 billion: EI Actuary’s 2007 Report on EI Premium Rates).

2) Excess costs: the annual costs estimated in (1) less $1.5 billion, representing the share that would be covered by a 0.15% change in premium rates (source of the $1.5 billion: EI Actuary’s 2007 Report on EI Premium Rates).
APPENDIX D

ALL-PARTY RECOMMENDATIONS IN THE FEBRUARY 2005 REPORT:
“RESTORING FINANCIAL GOVERNANCE AND ACCESSIBILITY IN THE
EMPLOYMENT INSURANCE PROGRAM”

Produced by the Subcommittee on Employment Insurance Funds of the House of Commons
Standing Committee on Human Resources, Skills Development, Social Development and the
Status of Persons with Disabilities.


Note: the complete report had 28 recommendations, but only the first six addressed the financial
governance of the EI Account and are shown below. Those recommendations received unanimous all
party support.

“Recommendation 1

The Committee recommends that, in 2005, legislation be tabled in Parliament that would create a new
entity called the Employment Insurance Commission. The proposed Employment Insurance
Commission would be given the statutory authority to manage and invest employment insurance
revenues in the proposed Employment Insurance Fund Account and to transfer these revenues, as
required by law, to the Consolidated Revenue Fund in order to cover the cost of employment
insurance. This new Crown corporate entity should be governed by commissioners who broadly and
equally represent employees and employers. The government should also be represented in the
proposed Employment Insurance Commission. The chair and vice-chair of the Commission should
rotate between employer and employee representatives after serving a two-year term. Commissioners
would be appointed by the Governor in Council following consultations with groups representing
employment insurance contributors. The operations of the Commission and the funds under its
management must be fully accounted for and reported in accordance with generally accepted public
sector accounting standards. The Commission should have the authority to make recommendations to
the government.

Recommendation 2

The committee recommends that, in conjunction with the legislation referred to in Recommendation 1,
statutory authority be given to establish a new reserve, called the Employment Insurance Fund
Account. The Employment Insurance Fund Account, perhaps modeled after the Exchange Fund
Account1, would exist outside of the Consolidated Revenue Fund and act as a depository for all
employment insurance premiums and other transfers from the Consolidated Revenue Fund as required
by law. Funds transferred from the Employment Insurance Fund Account to the Consolidated Revenue
Fund would by law be used exclusively to cover employment insurance costs.

1 The operation of the Exchange Fund Account is governed by the provisions of Part II of the Currency
Act. This Account, administered by the Bank of Canada, represents financial claims and obligations of the
Government of Canada as a result of foreign exchange operations. Investment income from foreign
exchange transactions and net gains and losses are recorded in foreign exchange revenues on the
Statement of Operations and Accumulated Deficit.

Recommendation 3

The committee recommends that, beginning in 2005-2006, the federal government transfer amounts
from the Consolidated Revenue Fund to the proposed Employment Insurance Fund Account. This
transfer must occur over a period of time, taking into consideration the year-to-year fiscal position and
expected outlook of the federal government. The minimum amount to be transferred to the fund each
year must be no less than one half of the amount remaining in the Contingency Reserve at year’s end. These transfers would continue until the cumulative balance that existed in the Employment Insurance Account as of 31 March 2004 has been fully transferred to the Employment Insurance Fund Account. When the cumulative balance in the Employment Insurance Account reaches zero, all references to this account in the Employment Insurance Act should be repealed.

2 The Bloc Québécois recommends that at least $1.5 billion a year be refunded to the Employment Insurance Fund. It also recommends, if needed to cover one full year of contribution, a guaranteed payment of $15 billion. If this guaranteed payment is not used, it should be refunded at the rate of $1.5 billion after the payment of the initial $31 billion.

Recommendation 4
The committee recommends that a premium rate stabilization reserve be created and maintained within the proposed Employment Insurance Fund Account. This reserve should be estimated by the Chief Actuary of the proposed Employment Insurance Commission and re-estimated every five years. It should be managed prudently, provide the required liquidity needed to maintain premium rate stability over a five-year period, and should never exceed 10% of the most recent estimated premium rate stabilization reserve requirement.

Recommendation 5
The committee recommends that starting in 2005:

i) the Chief Actuary of the proposed Employment Insurance Commission utilize independent expert advice to estimate annually a break-even premium rate that would ensure program solvency and premium rate stability over a five-year, look-forward period;

ii) the Chief Actuary utilize independent expert advice to estimate quinquennially the size of premium rate stabilization reserve that would insure program solvency and premium rate stability over a five-year period; and

iii) the proposed Employment Insurance Commission publish its recommended break-even premium rate and underlying analysis by 30 September in the year prior to the year for which the recommended rate applies.

Recommendation 6
The Committee recommends that if the rate recommended by the proposed Employment Insurance Commission is, for some extraordinary reason, different from that which the Governor in Council wishes to approve, then the government must, in setting a different rate, amend the Employment Insurance Act by establishing a statutory premium rate for a period not exceeding one year. This proposed legislative change must be subject to a vote in the House of Commons.”
## APPENDIX E

### COMPARISON OF FORECASTED AND ACTUAL BENEFITS UNDER THE EI PROGRAM

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<th>Actual amounts¹</th>
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10 year total of differences : 8,748

2. Source : Federal budget for each year
APPENDIX F

ILO CONVENTION 102 OF 1952, ARTICLES ON GOVERNANCE

Article 71

1. The cost of the benefits provided in compliance with this Convention and the cost of the administration of such benefits shall be borne collectively by way of insurance contributions or taxation or both in a manner which avoids hardship to persons of small means and takes into account the economic situation of the Member and of the classes of persons protected.

2. The total of the insurance contributions borne by the employees protected shall not exceed 50 per cent. of the total of the financial resources allocated to the protection of employees and their wives and children. For the purpose of ascertaining whether this condition is fulfilled, all the benefits provided by the Member in compliance with this Convention, except family benefit and, if provided by a special branch, employment injury benefit, may be taken together.

3. The Member shall accept general responsibility for the due provision of the benefits provided in compliance with this Convention, and shall take all measures required for this purpose; it shall ensure, where appropriate, that the necessary actuarial studies and calculations concerning financial equilibrium are made periodically and, in any event, prior to any change in benefits, the rate of insurance contributions, or the taxes allocated to covering the contingencies in question.

Article 72

1. Where the administration is not entrusted to an institution regulated by the public authorities or to a Government department responsible to a legislature, representatives of the persons protected shall participate in the management, or be associated therewith in a consultative capacity, under prescribed conditions; national laws or regulations may likewise decide as to the participation of representatives of employers and of the public authorities.

2. The Member shall accept general responsibility for the proper administration of the institutions and services concerned in the application of the Convention.
APPENDIX G

ILO CONVENTION 168 OF 1988, ARTICLES ON GOVERNANCE

Article 28

Each Member shall assume general responsibility for the sound administration of the institutions and services entrusted with the application of the Convention.

Article 29

1. When the administration is directly entrusted to a government department responsible to Parliament, representatives of the protected persons and of the employers shall be associated in the administration in an advisory capacity, under prescribed conditions.

2. When the administration is not entrusted to a government department responsible to Parliament -

(a) representatives of the protected persons shall participate in the administration or be associated therewith in an advisory capacity under prescribed conditions;

(b) national laws or regulations may also provide for the participation of employers’ representatives;

(c) the laws or regulations may further provide for the participation of representatives of the public authorities.