



Pennsylvania Compensation Rating Bureau

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February 16, 2005

BUREAU CIRCULAR NO. 1493

To All Members of the Bureau:

Re: **BUREAU FILINGS AND THE PENNSYLVANIA WORKERS COMPENSATION PRICING SYSTEM**

Bureau Circulars No. 1419, 1434, 1459 and 1477 provided background discussion and explanation about loss cost revisions and the Pennsylvania workers compensation pricing system as a whole for the benefit of members and other potentially interested parties. Those circulars also presented historical parameters about the Pennsylvania workers compensation pricing system. This circular will update the information previously provided with the most current data presently available.

The average change in collectible loss costs filed by the Bureau and approved by the Insurance Commissioner effective April 1, 2005 was a decrease of 2.89 percent. The following table shows a history of loss cost changes in Pennsylvania since the inception of the present pricing system in 1993:

History of Approved Loss Cost Changes – 1993 - 2005

<u>Effective Date</u>	<u>Average % Change in Loss Costs</u>
December 1, 1993	-2.00
December 1, 1995	-9.43
February 1, 1997	-25.00
April 1, 1998	-6.94
April 1, 1999	-5.26
April 1, 2000	+4.50
April 1, 2001	-1.55
April 1, 2002	+2.12
April 1, 2003	-2.41
April 1, 2004	+3.32
April 1, 2005	-2.89

The Bureau's analysis continues to indicate that, in addition to the significant impacts of legislative enactments in 1993 and 1996, the primary favorable factor underlying loss costs under the competitive pricing system in Pennsylvania has been improvement in claim frequency. The Bureau believes that claim frequency trends will continue to be an important factor in determining future loss cost indications in the Commonwealth and expects that claim frequency will continue to show declines through the end of 2005.

Prior to the adoption of a competitive rating system, Bureau rate filings were a substantial determinant of carrier prices. Some carriers used uniform percentage deviations from Bureau rates, but once a deviation was in effect for a given company it was common for that deviation to remain in effect for years. As a result, carrier rates and prices changed in relatively close alignment with Bureau rates as approved by the Insurance Department.

With the enactment of Act 44 of 1993 and Act 57 of 1996, several important new dynamics were introduced into the Pennsylvania workers compensation pricing system. Carriers now file their own independent and competitive "loss cost multipliers" as a means of incorporating expense provisions in rates. Companies may modify Bureau loss costs, or they may file independent loss costs across all classifications or for selected classifications. Carriers may adopt their own variations on the uniform classification plan by using "subclassifications." Schedule rating (adjustment of premium based on evaluation of characteristics of individual risks in accordance with specified criteria and within specified limits) can substantially alter prices otherwise based on the "published" or approved rates of any carrier.

Collectively, these relatively recently authorized features of the pricing system have produced very significant changes in the Pennsylvania workers compensation market. As a result, carrier rates and prices are determined considering many diverse factors, of which Bureau filings are just one. Consider the following:

- Bureau loss costs decreased 40 percent beginning with the December 1, 1993 loss cost revision through the April 1, 2003 loss cost revision.
- Workers compensation earned premiums decreased 20 percent from \$2.8 billion for Calendar Year 1993 to \$2.2 billion for Calendar Year 2003.
- Insured payrolls are now estimated to have increased approximately 65 percent from 1993 to 2003.

In order for premiums to decrease 20 percent while the insured exposure base increased 65 percent, carrier prices per unit of exposure had to decrease by approximately 51.5 percent over this same period of time, as illustrated below:

$$\text{Price per Unit of Exposure} \times \text{Exposure Base} = \text{Premium}$$

Or

$$\text{Price per Unit of Exposure} = \text{Premium} / \text{Exposure Base}$$

So

$$\begin{aligned} \text{Factor to New Price per Unit of Exposure} &= \text{Factor to New Premium} / \text{Factor to New Exposure Base} \\ &= (1.00 - 0.20) / (1.00 + 0.65) \end{aligned}$$

$$\text{Factor to New Price per Unit of Exposure} = 0.485$$

And

$$\text{Change in Price per Unit of Exposure} = 0.485 - 1.000 = - 0.515$$

Some shift in exposures away from such activities as manufacturing and construction and into services and technology has occurred and continues to occur in Pennsylvania, and such shifts would account for a part of the observed premium reductions over time. In addition, the volume of business insured under

large deductible plans has fluctuated over time in Pennsylvania. These factors should be considered in reviewing exposure and premium data and the implications of such data for price levels.

Financial data collected by the Bureau provides another way of looking at market pricing activity. Much of the Bureau's record keeping and analysis is prepared and presented on a policy-year basis. This accounting construct matches premium earnings, loss and expense payments and/or reserves to the year in which the policies giving rise to those transactions were first effective. The Bureau's experience on this basis reveals some key relationships pertaining to the Pennsylvania workers compensation marketplace. The first of these relationships is a comparison of carrier prices to Bureau loss costs. The following table is based on Annual Calls for Financial Data collected by the Bureau:

<u>Policy Year</u>	<u>Collectible Loss Costs at Bureau Level (\$M)</u>	<u>Net Earned Premium at Company Level (\$M)</u>	<u>Ratio</u>
1996	\$2,091	\$1,998	0.956
1997	\$1,719	\$1,492	0.868
1998	\$1,632	\$1,331	0.816
1999	\$1,651	\$1,338	0.810
2000	\$1,704	\$1,506	0.884
2001	\$1,791	\$1,750	0.977
2002	\$1,789	\$2,043	1.142
2003*	\$1,071	\$1,267	1.183

* 2003 represents a partial policy year as of December 31, 2003. At this writing, data through December 31, 2004 is not yet available from our member companies.

The above table shows that carriers had historically written business in Pennsylvania at levels significantly below Bureau loss costs. The differences between carrier prices and Bureau loss costs increased through 1999 and then began narrowing in 2000. By 2002, carrier prices exceeded Bureau loss costs.

In light of the above noted changes in the Pennsylvania workers compensation market, Bureau loss cost filings, which address only the provision for claim payment, clearly do not and cannot provide indications of either past or prospective price trends. Participants in this market must, therefore, independently and carefully evaluate information and factors beyond those filings in order to make informed competitive decisions.

Available aggregate data of potential interest in this regard might include loss adjustment and other expense experience in Pennsylvania. Recently, loss adjustment expenses (LAE) have represented approximately 12 percent of losses, and other expenses have represented approximately 21 percent of premium. Using these relationships, if carriers wrote business at 118 percent of Bureau loss costs and if Bureau loss costs equaled overall undiscounted loss experience on average, then the following results would be implied:

Indicated Pure Loss Ratio:	85	(100 / 1.18)
Indicated Loss and LAE Ratio:	95	(85 x 1.12)
Indicated Combined Ratio:	116	(95 + 21)

Considerations not reflected in the above data (for example, the effect of investment income on results) are necessary additional components needed to evaluate past results or to plan prospective strategies. In addition, departures from average results for individual carriers and/or for specific coverage terms (for example, deductible or other loss-sensitive pricing plans) can be substantial and would need to be assessed.

As previously noted in Bureau Circulars No. 1419, 1434, 1459 and 1477, and as further reinforced by the above narrative and information, Bureau rating values can serve as meaningful benchmarks within an overall pricing approach. However, numerous other very important factors must also be carefully accounted for on an ongoing basis in each carrier's pricing analysis.

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