



# Pennsylvania Compensation Rating Bureau

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April 8, 2015

## PCRB CIRCULAR NO. 1639

To All Members of the PCRB:

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

Prior PCRB circulars, most recently PCRB Circular No. 1626, 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 approved by the Insurance Commissioner effective April 1, 2015 was a decrease of 5.99 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 - 2015

<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
April 1, 2006	-8.58
April 1, 2007	+2.95
April 1, 2008	-10.22
April 1, 2009	-3.00
April 1, 2010	+0.68
April 1, 2011	+0.87
April 1, 2012	-5.66
April 1, 2013	-4.01
April 1, 2014	-5.15
April 1, 2015	-5.99

The PCRB'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 PCRB believes that claim frequency trends will continue to be an important factor in determining future loss cost indications in the Commonwealth. Approved April 1, 2015 loss costs contemplate that claim frequency will continue to show declines through the end of 2015.

Prior to the adoption of a competitive rating system, PCRB rate filings were a substantial determinant of carrier prices. Some carriers used uniform percentage deviations from PCRB 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 PCRB 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 PCRB 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 features of the pricing system produced very significant changes in the Pennsylvania workers compensation market. As a result, carrier rates and prices are now determined considering many diverse factors, of which PCRB filings are just one. Consider the following:

- PCRB loss costs decreased approximately 54 percent beginning with the December 1, 1993 loss cost revision through the April 1, 2013 loss cost revision.
- Workers compensation earned premiums decreased nine percent from \$2.82 billion for Calendar Year 1993 to \$2.57 billion for Calendar Year 2013.
- Effective insured payrolls (as discussed below) are now estimated to have increased approximately 82 percent from 1993 to 2013.

With regard to insured payroll and premium trends noted above, some shift in exposures away from such activities as manufacturing 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 prior years, the PCRB has also noted that the volume of business insured under large deductible plans has fluctuated over time in Pennsylvania and that these factors should be considered in reviewing exposure and premium data and the implications of such data for price levels.

Regarding large deductible business, actual payrolls for those policies is captured, but the premiums collected are significantly reduced relative to full first dollar coverage premiums, with the reductions from first dollar premiums averaging approximately 83 percent. The PCRB has adjusted the actual payrolls on large deductible policies to be more consistent with the premium contributions of those same policies. Thus, while actual payrolls grew 120 percent from 1993 to 2013, "effective" payrolls increased just 82 percent during that same period.

In order for premiums to decrease nine percent while the effective insured exposure base increased 82 percent, carrier prices per unit of exposure had to decrease by approximately 50.0 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

$$\begin{aligned} \text{Factor to New Price per Unit of Exposure} &= \text{Factor to New Premium} / \text{Factor to New Exposure Base} \\ &= (1.00 - 0.09) / (1.00 + 0.82) \end{aligned}$$

$$\text{Factor to New Price per Unit of Exposure} = 0.500$$

And

$$\text{Change in Price per Unit of Exposure} = 0.500 - 1.000 = - 0.500$$

Financial data collected by the PCRB provides another way of looking at market pricing activity. Much of the PCRB'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 PCRB'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 PCRB loss costs. The following table is based on Annual Calls for Financial Data collected by the PCRB:

<u>Policy Year</u>	<u>Collectible Loss Costs at PCRB Level (\$M)</u>	<u>Net Earned Premium at Company Level (\$M)</u>	<u>Ratio</u>
1996	\$1,857	\$1,767	0.952
1997	\$1,544	\$1,327	0.859
1998	\$1,482	\$1,204	0.812
1999	\$1,494	\$1,201	0.804
2000	\$1,531	\$1,357	0.886
2001	\$1,646	\$1,619	0.984
2002	\$1,735	\$1,937	1.116
2003	\$1,807	\$2,182	1.208
2004	\$1,938	\$2,305	1.189
2005	\$2,109	\$2,426	1.150
2006	\$2,092	\$2,397	1.146
2007	\$2,260	\$2,458	1.088
2008	\$2,072	\$2,246	1.084
2009	\$1,873	\$2,073	1.107
2010	\$1,985	\$2,190	1.103
2011	\$2,090	\$2,320	1.110
2012	\$1,986	\$2,339	1.178
2013*	\$1,106	\$1,383	1.250

\* 2013 represents a partial policy year as of December 31, 2013. At this writing, data through December 31, 2014 is not yet available from our member companies.

The above table shows that prior to 2002 carriers had written business in Pennsylvania at levels below, and sometimes significantly below, PCRB loss costs. The ratio of carrier prices to PCRB loss costs reached a low point in 1999, peaked in 2003, dropped each year through 2008, and then continued slightly higher but relatively stable through 2011. Increases have since been seen such that the incomplete Policy Year 2013 shows the highest ratio in the table.

In light of the above noted changes in the Pennsylvania workers compensation market, PCRB 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 15 percent of losses, and other expenses have represented approximately 21 percent of premium. Using these relationships, if carriers wrote business at 125.0 percent of PCRB loss costs and, if PCRB loss costs equaled overall undiscounted loss experience on average, then the following results would be implied:

Indicated Pure Loss Ratio:	80	(100 / 1.250)
Indicated Loss and LAE Ratio:	92	( 80 x 1.15)
Indicated Combined Ratio:	113	( 92 + 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 PCRB circulars and further reinforced by the above narrative and information, PCRB 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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President

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