



Pennsylvania Compensation Rating Bureau

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April 20, 2017

PCRB CIRCULAR NO. 1680

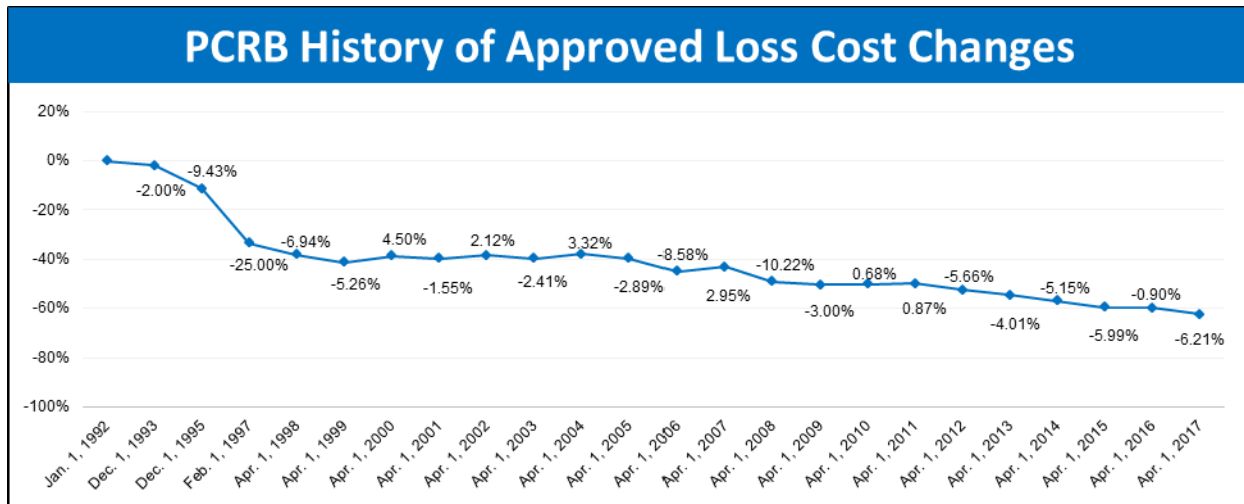
To All Members of the PCRB:

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

This circular highlights key elements of the Pennsylvania workers compensation system, including background and discussion regarding loss cost revisions, trends in claim costs, and several dynamics affecting the system. It is provided for the benefit of PCRB members and other interested parties, updates information provided in prior PCRB circulars, most recently PCRB Circular No. 1656 dated March 21, 2016, and presents the information in a new format.

Loss Cost Changes

The average change in collectible loss costs approved by the Insurance Commissioner, effective April 1, 2017, was a decrease of 6.21 percent. The system of filing loss costs was implemented as a result of Act 44 of 1993, with the first loss cost filing effective December 1 of that year. Act 44, along with Act 57 of 1996, introduced significant changes in the Pennsylvania workers compensation system. The following chart shows a history of loss cost changes in Pennsylvania since the inception of the present pricing system:

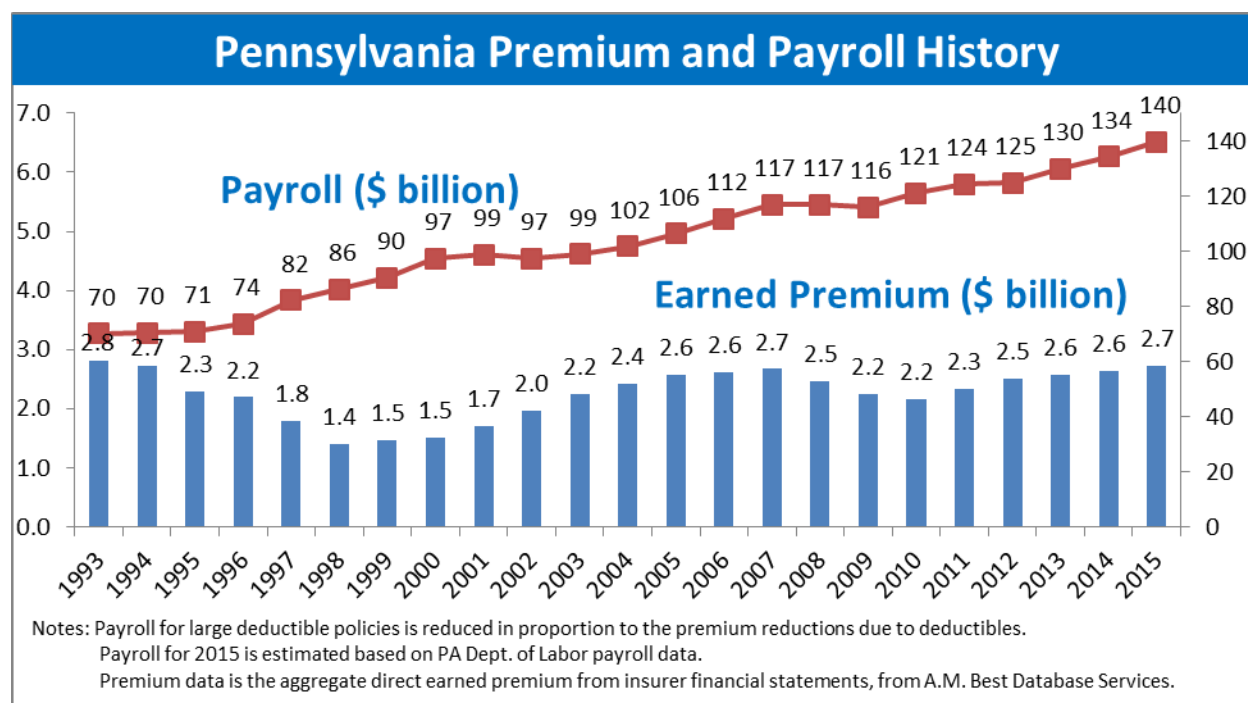


The primary favorable factor underlying loss costs in Pennsylvania has been improvement in claim frequency, which is decreasing by 4.8 percent annually. This downward trend is sufficient to counter the upward claim severity trend for indemnity and medical. The PCRB believes that claim frequency trends will continue to be an important factor in determining future loss cost indications in the Commonwealth. The approved April 1, 2017 loss costs contemplate that claim frequency will continue to show declines through the end of 2017.

Pennsylvania Claim Cost Trends			
	Frequency	Severity	Pure Premium
Indemnity	-4.8%	+2.0%	-2.9%
Medical		+4.1%	-0.9%

Premium and Payroll History

The size of the Pennsylvania market, as measured by Direct Earned Premium, has fluctuated over the last several decades: dropping from \$2.8 billion in 1993 to \$1.4 billion in 1998; then growing steadily to \$2.7 billion in 2007; dropping to \$2.2 billion by 2010; and rising since then to \$2.7 billion in 2015. In contrast, effective payroll¹ has almost doubled over the same time frame. The chart below illustrates the different growth patterns. The pattern of premium growth and decline displayed for Pennsylvania is similar to patterns seen in broader, multi-state studies.



The difference in growth rates for payroll and premium appears to result from several dynamics in Pennsylvania, some of which are similar to trends across the country.

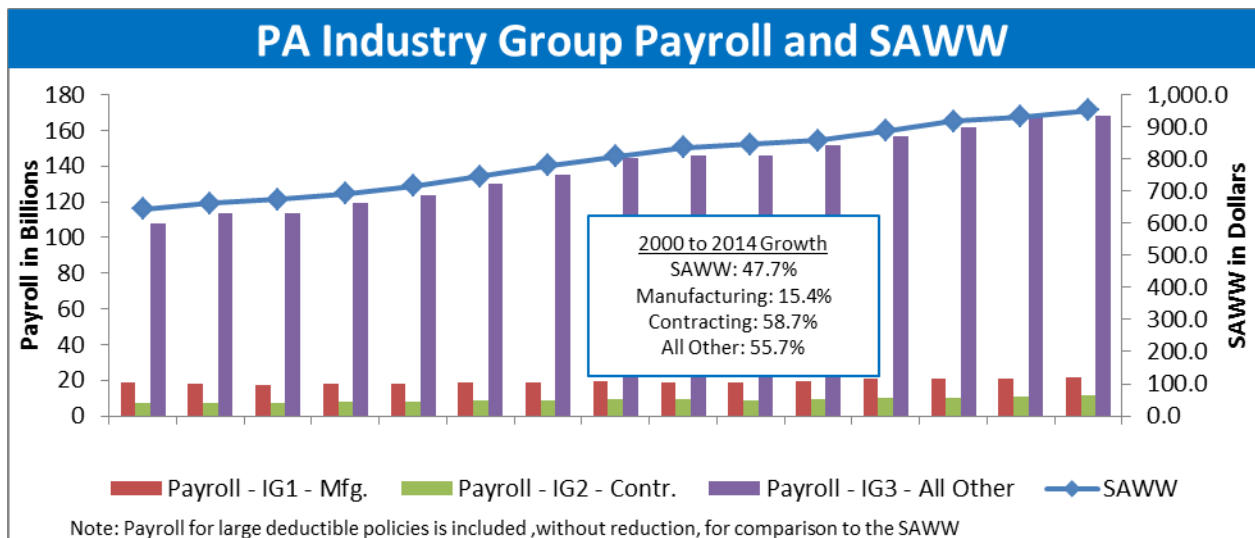
First, total payroll reported by insurers to the PCRB, adjusted to reflect large deductible policies, has risen every year except 2002, 2008 and 2009. The cumulative increase in effective payroll since 1993 is 99.2 percent.

Second, as shown in the first chart above, loss costs have generally declined since they were first implemented in 1993. The cumulative loss cost change since then is a decrease of 62.3 percent.

¹ Payroll in this chart is adjusted to an “effective” level by subtracting an amount that reflects the retained exposure, measured by the premium discount on deductible policies. This provides a better comparison to earned premium in company financial statements, which is net of deductible credits.

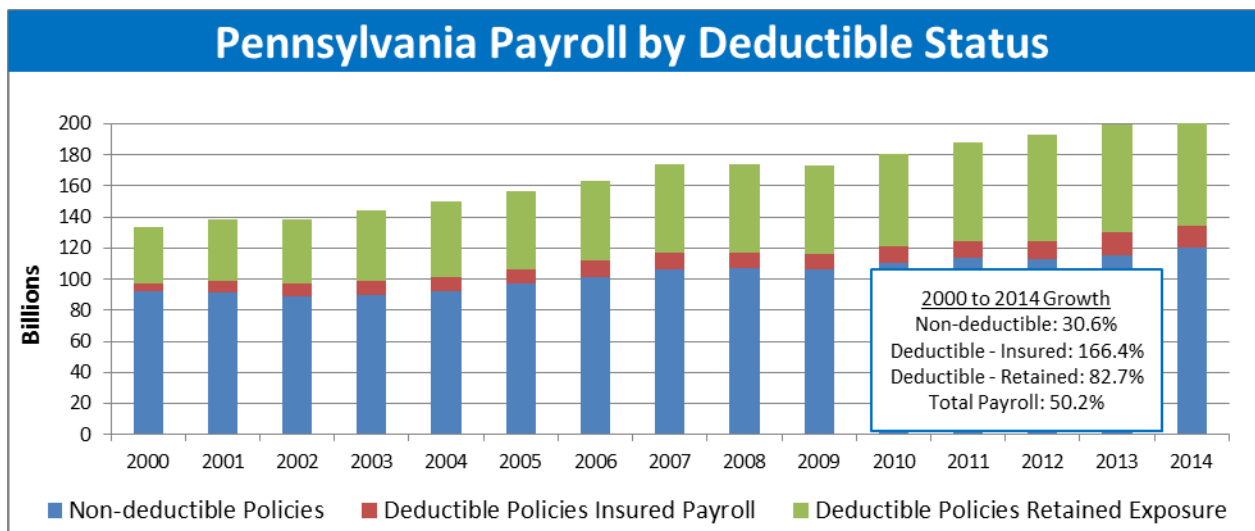
Third, payroll growth differs among the three industry groups tracked by the PCRB, with manufacturing payroll lagging the other sectors which have kept pace with the growth in the Statewide Average Weekly Wage (SAWW). In the next chart, payroll is included at its full value for deductible policies (i.e., not at the “effective” level), to be comparable to the wage data. The chart shows SAWW growth from 2000 to 2014 of 47.7 percent.

For the three PCRB industry groups, the growth over that same period varies. For Industry Group 1 – Manufacturing, payroll rose from \$18.7 billion to \$21.6 billion, or by 15.4 percent. For Industry Group 2 – Contracting, payroll grew from \$7.1 billion to \$11.2 billion, or by 58.7 percent. For Industry Group 3 – All Other, payroll grew from \$108.0 billion to \$168.2 billion, an increase of 55.7 percent. The growth rate for Manufacturing is well below that of the other industry groups and the SAWW.



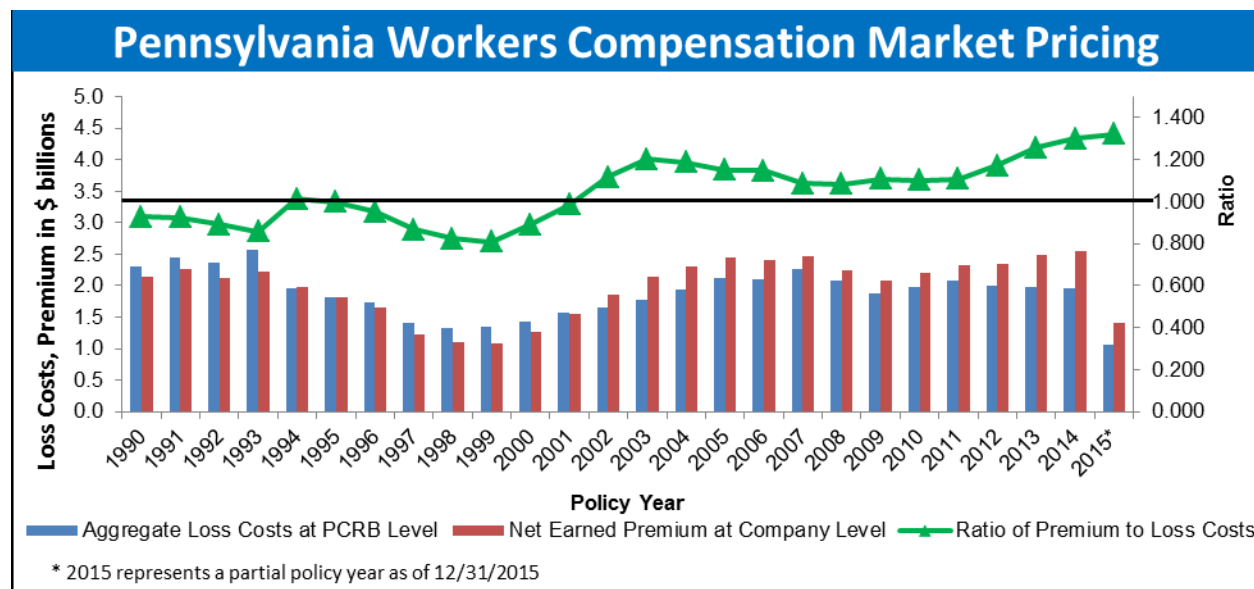
Growth in Use of Large Deductible Policies

A fourth dynamic is the growth in the use of large deductible policies. In 2014, 40 percent of payroll was reported on large deductible policies, where the average portion of risk retained by policyholders is over 80 percent. The next chart shows the history from 2000 to 2014.



Loss Costs and Industry Earned Premium

Another factor to consider is the pricing strategy across the industry in Pennsylvania and the country. Pricing strategy is impacted by market cycles, competitiveness, investment performance, and many other factors. The chart below shows the relationship between aggregate loss costs at PCRB level and net earned premium at company level by policy year from 1990 through a portion of 2015. Prior to 2002, carriers wrote 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 at 0.809, peaked in 2003 at 1.203, dropped each year through 2008 to 1.085, continued slightly higher but relatively stable through 2011 reaching 1.109, and has increased since then such that the incomplete Policy Year 2015 shows the highest ratio of 1.322.



PCRB loss cost filings, which address only the provision for claim payment, represent the projected average cost for each classification. They do not provide indications of either past or prospective price trends. Insurance carriers must independently evaluate information and factors beyond PCRB filings to determine the rates they will use in the Pennsylvania market, subject to regulatory approval.

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.

Questions regarding the information in this circular should be directed to John Pedrick, Vice President – Actuarial Services, at extension 4429, or jpdrick@pcrb.com, or Ken Creighton, Chief Actuary, at extension 4924, or kcreighton@pcrb.com.

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