



## Pennsylvania Compensation Rating Bureau

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December 17, 2004

### VIA HAND DELIVERY

The Honorable M. Diane Koken  
Insurance Commissioner  
Commonwealth of Pennsylvania  
Insurance Department  
1311 Strawberry Square  
Harrisburg, PA 17120

Attention: Chester J. Szczepanski

RE: Proposal C-348 - April 1, 2005 Loss Cost Filing

Dear Commissioner Koken:

On behalf of the members of the Pennsylvania Compensation Rating Bureau (PCR B), I am filing herewith workers compensation loss costs, rating values and rules proposed to be **effective 12:01 a.m., April 1, 2005** with respect to new and renewal policies having normal anniversary rating dates on or after that date.

This filing proposes an overall average reduction in loss costs (prior to application of the assessment for the Office of the Small Business Advocate, Pennsylvania Construction Classification Premium Adjustment Program loadings, Merit Rating Plan off-balance and Certified Safety Committee loadings) of 2.89 percent effective April 1, 2005.

In the course of preparing this filing, as was the case for its three most recent previous loss cost filings, the PCR B has again given consideration to the question of whether, how and to what extent PCR B loss cost filings can and should include a separate and specific provision for extraordinary catastrophes. While this consideration is clearly not limited only to terrorist attacks, the potential for loss events in historically unprecedented amounts, possibly arising from any of a variety of causes, was clearly demonstrated by the events of September 11, 2001. More recently, most jurisdictions have entertained rating organization filings recognizing domestic terrorism, natural disasters and/or catastrophic industrial accidents.

The PCR B implemented a loss cost rating value specific to terrorism as addressed under the provisions of the Terrorism Risk Insurance Act of 2002 (TRIA) effective April 1, 2003. This filing does not propose to change that existing loss cost rating value. However, the PCR B continues to actively explore issues of foreign terrorism, domestic terrorism, natural disasters and/or catastrophic industrial accidents and appropriate recognition thereof in Pennsylvania loss costs.

The PCRB hereby reiterates its prior specific reservations of the right to amend this filing during the period it remains pending before the Insurance Commissioner and/or to submit another separate filing or filings at any time, proposing approaches and/or pricing parameters responsive to those contingencies.

This letter and its attachments present a discussion and explanation of the filing's supporting analysis and conclusions based thereon and are presented in the following topical sequence:

- Summary
- Principal Findings and Conclusions
- Recognition of Effects of Prior Legislation
- Loss Development
- Trend
- Indicated Change in Loss Costs
- Employer Assessment Factor and Loss Cost Loadings
- Experience Rating Plan Procedures and Parameters
- Optional Retrospective Loss Development Factors
- Classification Loss Cost Relativities
- Hepatitis C Loss Cost Surcharges
- Manual Language Revisions
- Excess Loss (Pure Premium) Factors, State and Hazard Group Relativities and Loss Elimination Ratios

## **SUMMARY**

In preparing and reviewing supporting information for this filing, the Bureau has attempted to identify and estimate the relative contributions to the filed overall loss cost indication arising from several factors. The resulting attribution of effects upon the overall loss cost indication is set forth below:

|  |          |
|--|----------|
| 1) Changes in indemnity loss experience from provisions in approved April 1, 2004 loss costs                               | 0.996271 |
| 2) Changes in medical loss experience from provisions in approved April 1, 2004 loss costs                                 | 0.995107 |
| 3) Changes in indemnity trend rate and period from provisions in approved April 1, 2004 loss costs                         | 0.993572 |
| 4) Changes in medical trend rate and period from provisions in approved April 1, 2004 loss costs                           | 0.985952 |
| 5) Changes in estimated effects of Act 44 of 1993 on indemnity losses from provisions in approved April 1, 2004 loss costs | 0.999911 |
| 6) Indicated change in loss costs effective April 1, 2005<br>(1) x (2) x (3) x (4) x (5)                                   | 0.9711   |

Line 6) above combines the separate effects described in Lines 1) through 5) by compounding the individual increases or reductions in loss cost indications, resulting in the proposed loss cost reduction of 2.89 percent ( $0.9711 - 1.0000 = -0.0289$ ).

## **PRINCIPAL FINDINGS AND CONCLUSIONS**

The following comments summarize the most important considerations and concepts pertinent to each of the specific factors contributing to the overall loss cost indication as set forth above.

### Changes in Indemnity Loss Experience from Provisions in Approved April 1, 2004 Loss Costs

The PCRB's analysis of the most recent available experience data for indemnity benefits produces estimates of loss costs nominally lower than the expectations underlying the current schedule of Bureau rating values. Consistent with the practice adopted for prior recent filings, the PCRB has again adjusted available historical data to be consistent with provisions of Act 57 of 1996 (Act 57) as part of the analysis supporting this filing. Certain provisions of Act 44 of 1993 (Act 44), which were susceptible to estimation, were also directly applicable to indemnity benefits. Those provisions have been accounted for in this filing, as they also have been in previous filings, by application of a "savings factor" to trended loss ratios estimated on a pre-Act 44 basis.

Besides statutory changes, indemnity experience is affected by a variety of additional factors. These include ongoing interpretation and administration of various provisions of the Workers Compensation Act. The initiation and/or continuation of various accident prevention and loss management programs by the Commonwealth, insurers and employers may affect loss experience. Economic conditions and fraud detection, prosecution and/or prevention initiatives have potential direct and indirect influences on the workers compensation system of the Commonwealth and its costs. Circumstances in the administrative system by means of which claims for work-related injuries and illnesses are processed and disputes pertaining thereto are resolved may alter system experiences and costs. These and other similar considerations are reflected in experience data and are thereby incorporated into the loss development analyses performed in conjunction with each PCRB loss cost filing.

The net effect of all factors that have affected indemnity loss experience in the current filing would be to reduce the overall loss cost indication by approximately 0.37 points.

### Changes in Medical Loss Experience from Provisions in Approved April 1, 2004 Loss Costs

Consistent with the approach adopted in prior recent filings, the PCRB has continued to state medical loss experience on a post-Act 44 basis. While the PCRB's analysis of medical loss experience suggests that the favorable effects of Act 44 of 1993 on workers compensation medical costs in Pennsylvania remain substantially in place, this approach precludes a separate analysis of the direct effects of that important legislation on current and prospective loss cost levels.

While certain specific provisions of the Workers Compensation Act and supporting administrative system are specific to medical benefits instead of indemnity benefits, medical losses are generally subject to influence by the same system considerations as enumerated above for indemnity losses. The PCRB's most recent evaluation of medical loss experience

shows a very small decrease in loss cost levels from those contemplated in the April 1, 2004 filing, resulting in an incremental reduction in the overall loss cost indication of approximately 0.49 points.

#### Changes in Indemnity Trend Rate and Period from Provisions in Approved April 1, 2004 Loss Costs

In the April 1, 2004 Loss Cost Filing the PCRB's trend provisions were based upon separate analyses of claim frequency and claim severity experience for the Pennsylvania workers compensation system.

Based on available data from internal sources, the PCRB had established loss ratio trends that projected observed claim frequency trends through January 1, 2002. The April 1, 2004 filing then anticipated that further improvement in claim frequency would continue at an annual trend rate of -6.0 percent, based on observed claim frequency trend over the policy year period 1996-2001 inclusive.

For this filing, the PCRB has updated the available information from internal sources pertaining to claim frequency that was used in previous filings and has applied the most recent available data to its trend analysis. Consistent with the collective indications of this supporting information, the PCRB has selected an annual claim frequency trend of -6.2 percent, based on observed claim frequency trend over the policy year period 1996-2002 inclusive.

Components of trend other than claim frequency, collectively referred to herein as "severity trend" for sake of brevity, have been reviewed using commonly accepted and applied trend models applied to the PCRB's estimated ultimate on-level loss ratios, adjusted for effects of previous changes in claim frequency. Testing done by the PCRB in regard to this trend analysis indicates that goodness-of-fit and predictive accuracy results are improved by virtue of the separation of trend into frequency and severity components instead of treating loss ratios alone.

The trend models thus produced show indemnity severity trends, which had increased sharply in the April 1, 2003 filing to reach a level of +8.1 percent per year and then risen nominally to +8.2 percent last year, are now slightly lower and again show an annual rate of change of approximately +8.1 percent.

On balance, the selected continuation of favorable claim frequency trend and the revised indemnity claim severity trend, applied in this filing to the mid-point of the proposed schedule of loss costs, account for approximately 0.64 points to the proposed reduction in loss costs from those approved effective April 1, 2004

#### Changes in Medical Trend Rate and Period from Provisions in Approved April 1, 2004 Loss Costs

The claim frequency trend discussed above with respect to indemnity benefits has also been applied for medical benefits. Medical severity ratios have been separately analyzed based on the same experience period used for indemnity benefits.

The severity trend model selected for this filing shows medical severity trends somewhat lower than those present in the information supporting the April 1, 2004 Loss Cost Filing, averaging approximately +7.2 percent per year as compared to the +7.7 percent used in the Bureau's previous loss cost filing.

On balance, the selected continuation of favorable claim frequency trend and upward medical claim severity trend applied in this filing to the mid-point of the proposed schedule of loss costs would reduce the proposed change in loss costs from those approved effective April 1, 2004 by approximately 1.40 points. This reduction occurs despite the fact that medical loss ratio trends have been and remain positive, because of the improvement in the expected level of medical severity trend used in this filing compared to that applied in the April 1, 2004 proposal.

#### Changes in Estimated Effects of Act 44 of 1993 on Indemnity Losses from Provisions in Approved April 1, 2004 Loss Costs

While Act 44 of 1993 primarily addressed issues of medical care for workers compensation, that law also included some limited features that affected indemnity benefits. These features were two-fold: first, the elimination of an absolute minimum indemnity benefit regardless of pre-injury wages; and, second, an increase in the allowable payment for burial expenses in death cases.

In combination, these law changes produced a reduction of slightly more than one-half of one percent in loss costs. In prior filings the PCRB has elected to adjust indemnity experience incurred after the effective date of Act 44 to a pre-Act 44 basis. Appropriate loss development and trend analyses were performed using the resulting, adjusted data. An Act 44 savings factor was finally applied to the resultant loss ratios prior to deriving annual loss cost change indications. This filing continues that approach and has not revised the savings factor itself. However, because the estimated proportion of total loss costs which are attributable to indemnity benefits has increased in this filing as compared to the April 1, 2004 revision, the Act 44 savings have a slightly larger (more favorable) impact on overall loss costs this year than was the case last year. For this filing, this factor produces an incremental decrease of approximately 0.01 percent in the overall loss cost indication.

#### **RECOGNITION OF EFFECTS OF PRIOR LEGISLATION**

The predominant legislative changes which must be recognized in preparing and reviewing this filing are Act 44 of 1993 (Act 44) and Act 57 of 1996 (Act 57).

Act 44 included the medical cost containment features listed below:

- Implementation of a reimbursement mechanism related to the Medicare system of compensating providers of medical goods and services.
- Authorization of administrative systems providing both utilization review and peer review of the necessity, appropriateness and reasonableness of fees for medical services.
- Authorization for coordinated care organizations intended to provide comprehensive medical services that recognize timely return to work for injured workers as a primary objective of the workers compensation system.

- Extension of the period of time within which employers may direct injured workers to use medical practitioners selected from a listing of qualified practitioners provided by the employer from 14 to 30 days.

In preparing its April 1, 1999 Loss Cost Filing, the PCRB first adopted an approach of stating experience incurred prior to the implementation of this law on an effective "post-Act 44" basis. Prior to adopting this approach, the PCRB had performed extensive testing of this approach and comparison of results obtained thereby to alternative methods incorporated in previous loss cost filings. This filing continues the procedures first implemented with the April 1, 1999 filing. This analytical approach precludes a new and independent evaluation of the continuing effects of Act 44 on loss costs for each filing. However, it also has many substantial benefits, including efficiency, tractability and the elimination of otherwise remaining requirements to "adjust" the most recent and critical calendar years' experience for effects of law changes occurring several years ago.

In its February 1, 1997 Loss Cost Filing, the PCRB had estimated effects of three key provisions of Act 57 on prospective loss costs. Those provisions were as follow:

- Section 204 - Allows for offsets to workers compensation indemnity benefits otherwise payable to recognize Social Security old age benefits, certain employer-funded pension benefits and/or severance benefits.
- Section 306 - Applies the American Medical Association Guides for the Evaluation of Permanent Impairment to determinations of which cases will be qualified for total disability benefits and, alternatively, which cases will be treated as permanent partial disability cases.
- Section 309 - Revises the procedures applicable to the establishment of workers' wages for purposes of determining indemnity benefit rates.

In each loss cost filing submitted subsequent to February 1, 1997, various technical updates and/or revisions to the original estimates of effects of this legislation have been incorporated as appropriate.

For reasons analogous to those supporting adjustment of prior medical experience to a post-Act 44 basis in preparing the April 1, 1999 Loss Cost Filing, the PCRB adopted a comparable approach for indemnity experience in the April 1, 2000 Loss Cost Filing as respects Act 57. As was the case in the transition for medical experience, the PCRB had previously extensively tested its adjustment of prior data. The PCRB had previously tested these adjustments for sensitivity and had verified the equivalence of this approach to the prior procedure. That prior procedure continued to adjust experience incurred after the effective date of the law to a pre-Act 57 basis, producing preliminary filing estimates and then applying savings factors to arrive at a final loss cost indication.

It should be understood that the transition of the PCRB's filing analyses from "pre-law" to "post-law" bases for Acts 44 and 57 does not remove or reduce the favorable impacts of these two important pieces of workers compensation legislation from the filing indications. Neither does this change signal deterioration in the PCRB's perspective about the magnitude of the effects that these laws have had and continue to have on Pennsylvania loss costs. Rather, these analytical changes simply allow the effects of these laws to be incorporated more directly and efficiently into ongoing loss cost filings' supporting information.

The Table I prepared from reported financial data in support of this filing and stated on a post-Act 44 basis for medical losses and a post-Act 57 basis for indemnity losses, as described above, is shown in Exhibit 5 of the enclosures to this filing. Details of adjustment of reported indemnity and medical data is provided in Exhibit 5.

As respects the small effects of Act 44 on indemnity losses, the PCRB has continued the procedure of applying adjustment factors to more recent experience to state all historical data on a pre-Act 44 basis and then has applied savings factors in the final derivation of loss cost indications. It is anticipated, however, that in future loss cost filings the PCRB will opt to include adjustment for the indemnity savings from Act 44 in the initial construction of Table I in a fashion comparable to the adjustments noted above for the more substantive provisions of Act 44 and Act 57, thereby eliminating the need for application of a subsequent savings factor.

## **LOSS DEVELOPMENT**

While the establishment of appropriate levels of loss costs is ultimately a prospective process, a great deal of the supporting analysis and information required in this endeavor pertains to the estimation of loss experience for PRIOR policy periods. Proper evaluation of previous loss experience establishes reference points from which projections of future loss cost requirements can be made and in the context of which such projections can be reviewed for reasonableness. In simple terms, future loss cost needs cannot reasonably be estimated without first establishing what prior loss cost experience has been.

In preparing this filing and particularly in regard to the estimation of policy year loss ratios, the PCRB has been mindful of numerous technical and analytical considerations. Among the pertinent processes and procedures applied to this filing are the standards set forth in the Casualty Actuarial Society's "Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves" (Principles). A discussion of those Principles as they pertain to analysis supporting this filing is included as a separate enclosure with this filing.

In previous loss cost filings the PCRB has applied various loss estimation approaches separately to indemnity and medical losses prior to selecting policy year ultimate losses for further use in those filings' analyses. The range of approaches that have been used included case-incurred loss development and a series of approaches combining paid and incurred loss development approaches. Those combined methods applied paid loss development for successively longer periods of time before converting paid losses to case-incurred amounts and then applied case-incurred loss development for the balance of the development period to ultimate.

The past practices described above have also been applied in support of this filing. In addition, as was the case for the April 1, 2002, April 1, 2003 and April 1, 2004 filings, the PCRB has included loss estimates derived by averaging results from a case-incurred loss development method and the longest term paid loss development method possible with available data in its analysis of loss development for this filing. This last approach is one alternative (and in some respects a particularly direct) way of balancing the potentially different results from case-incurred and paid loss development methods than the combined development approaches previously applied. Results of selected loss development methods applied in support of this filing are set forth in detail in Exhibits 6, 7 and 10 of the enclosures. This analysis and conclusions drawn there from are further described below:

**Indemnity Losses** - A relatively broad range of results was obtained from the application of the loss development approaches described above to indemnity losses. The case-incurred loss development method gave the lowest estimates of policy year losses of any method tested, while the approaches using paid loss development tended to produce higher results as the period over which paid loss development was included in the method increased (see Page 10.1, Exhibit 10 of this filing for a graph illustrating some of these differences). This pattern of loss development methods, producing higher estimated policy year loss ratios as successively more paid loss development experience is used, has been in evidence over many previous PCRB filings.

Based on information obtained in a previously-conducted series of surveys of large writers of workers compensation insurance in Pennsylvania, the most recent of which is summarized in a separate enclosure with this filing, the PCRB believes that compromise and release and/or other case settlement activity continue to be important factors within the most recent years' of available loss development experience. Of particular note with regard to this filing and the most recent carrier survey is the indication that, in many cases, compromise and release settlement amounts are being recorded either exclusively as indemnity amounts or with a disproportionately large allocation to indemnity, when compared to the anticipated future liabilities prior to the recognition and application of the compromise and release settlement. This bias appears to result from various system limitations and/or coding procedures in evidence for many (but not all) carriers. The PCRB expects that, as a result of this tendency, indemnity loss development may be artificially inflated, while medical loss development may be artificially deflated to an undeterminable extent.

For filings prior to the April 1, 2002 filing, the PCRB had used various selected loss development methods or averages of selected methods as the basis for its ultimate loss estimates. The basis for selecting the method(s) used in each filing were consistent from year-to-year; that is, the Bureau endeavored to base each annual filing's indications on a method or method from which results fell in the mid-range of all methods tested and considered.

In the 2002, 2003 and 2004 filings, the PCRB selected ultimate loss estimates derived by averaging the indications separately obtained from the case-incurred loss development method and the longest-term paid loss development method supported by available financial data (a paid-to-20th report method).

As the indications derived from supporting information for this filing using this averaging process fall, as would be expected, in the mid-range of estimates produced for each policy year, the PCRB has again selected these average indications as the basis for this filing's analysis of appropriate loss cost indications.

**Medical Losses** - As has been the case in other recent PCRB loss cost filings, the range of results produced when applying the loss estimation methods described above to medical losses is narrower than is the case for indemnity benefits. (See Page 10.2 of Exhibit 10 of the enclosures to this filing for a graph illustrating some of these differences.) Consistent with the above discussion of loss development for indemnity losses, the PCRB has also selected estimates of prior policy year medical losses, based on the average of a case-incurred loss development approach and the longest-term paid loss development method supported by currently available financial data (a paid-to-20th report method), for use in this filing.



## TREND

**Indemnity Trend** - Insurance experience available for analysis in promulgating loss costs is necessarily limited to policy periods previously completed. On the other hand, the loss costs being determined will apply to some future period. As can readily be seen in the preceding review of policy year loss ratios for this filing, insurance experience often reflects substantive changes over time in response to various economic, legal and social changes. As a result, the establishment of an appropriate overall loss cost change must recognize the time period that is interposed between the historical experience and the application of the new loss costs. This recognition is provided through "trend" analysis, a means of measuring any persistent, systemic changes in experience expected to occur in that interim period of time.

One commonly-applied method of establishing a provision for trend is to attempt to measure year-to-year changes occurring in historical information using mathematical techniques. Based on such measurements, a selected measure(s) is/are applied for the period of time required to connect the available prior experience to the prospective pricing period. The mathematical approaches most often used in this regard involve the fitting of selected curves through the observed historical data and basing the average change or trend rate on the characteristics of the curve(s) which best fit that prior experience.

Two curves usually considered in this type of analysis are a straight line (or "linear" model) and an "exponential" model. The linear model is based on a determination of the constant amount of change in loss ratios which best fits the observed historical data; the exponential model is based on a determination of the constant percentage change in loss ratios which best fits the observed historical data.

In preparing each of the last six Pennsylvania loss cost filings (beginning with April 1, 1999 and continuing through April 1, 2004), the PCRB has separated its trend analysis into two component parts: claim frequency and severity factors. Based on detailed analysis of both internal and outside data (when available) pertaining to these phenomena (and, in particular, pertaining to claim frequency), the PCRB has selected different methods and/or parameters to estimate trends for each of these component parts. This approach has sometimes allowed the PCRB to capitalize on available external data pertaining to injury and illness counts and claim frequency and ultimately provided a basis for selection of prospective loss ratio trends based on specific analysis and review of claim frequency data and experience.

The trend provisions incorporated into the April 1, 2004 filing were premised on claim frequency and severity trends as measured within historical PCRB data, effectively assuming that those trends would continue through the prospective rating period for both indemnity and medical losses.

Based on separate measures of policy year loss ratio trend and claim frequency trend, implied severity trends have been identified in the supporting information for this filing. An exponential trend model, based on the seven policy years from 1996 through 2002 inclusive, was selected for use in this filing as the measure of historical indemnity severity ratio trend. The indicated indemnity severity trend inherent in PCRB indemnity experience is equivalent to an annual increase of approximately +8.1 percent per year, down slightly from the comparable indication one year ago (+8.2 percent).

As previously noted, information obtained in the PCRB's 2004 survey of large writers of workers compensation insurance in Pennsylvania (summarized in a separate enclosure with this filing) indicates that, in many cases, compromise and release settlement amounts are being recorded either exclusively as indemnity amounts or with a disproportionately large allocation to indemnity, when compared to the anticipated future liabilities prior to the recognition and application of the compromise and release settlement. This bias appears to result from various system limitations and/or coding procedures in evidence for many (but not all) carriers. The PCRB expects that, as a result of this tendency, indemnity loss ratio and severity trends may be artificially inflated, while medical loss ratio and severity trends may be artificially deflated to a largely offsetting extent.

The PCRB's most pertinent information pertaining to claim frequency compares indemnity claims incurred to expected losses at a constant (current) loss cost level. The expected losses used to compute claim frequencies in the PCRB's internal data respond to changes in the mix of employments being insured and for which claims are being reported and also incorporate ongoing changes in wage levels in Pennsylvania. As there has been a tendency for the Pennsylvania economy to become more service-oriented and less focused on manufacturing and contracting, this shift has itself contributed to lower claim counts over time.

Historical claim frequency data shows a protracted and persistent trend of declining claim frequencies now extending back for approximately 15 years. Setting aside a brief period of three years during which the observed declines approached or exceeded double-digit rates of decline, the long-term trends in claim frequency have fallen in a relatively narrow range. Since the extraordinary double-digit declines noted above ended in 1995, claim frequency has continued to fall at an average annual rate in the six percent range. The PCRB has selected a claim frequency trend of -6.2 percent as the basis for its projections of claim frequency changes in its trend analysis supporting indications proposed in this filing.

The PCRB would point out that loss cost indications are relatively sensitive to changes in trend, regardless of the respective component(s) which may be producing any given trend. Even a relatively nominal deterioration in claim frequency and/or claim severity trend(s) from the provisions incorporated in this filing could render the indemnity trend used for this filing significantly understated.

**Medical Trend** - The PCRB has proceeded in a manner as respects medical trends similar to that described above for indemnity trend in preparing this filing.

An exponential trend model, based on the seven policy years from 1996 through 2002 inclusive, was selected for use in this filing as the measure of historical medical severity ratio trend. This model gives significant credence to policy year loss ratios seen in recent years in Pennsylvania. For this filing, this trend model produces an effective trend model in which on-level medical severity ratios are increasing at a rate of approximately +7.2 percent per year. The same claim frequency trend as was used for indemnity benefits has been applied to medical losses.

The comments offered above with respect to indemnity losses regarding the sensitivity of loss cost indications and the potential effects of even relatively small adverse changes in claim frequency or claim severity trends are equally applicable to medical losses.

## **INDICATED CHANGE IN LOSS COSTS**

Exhibit 12 enclosed in support of this filing presents the derivation of indicated changes in collectible loss costs effective April 1, 2005. The indicated change in collectible loss costs is derived based on estimates of prior policy year loss ratios, including the effects of Act 44 on medical benefits and Act 57 of 1996 on indemnity benefits. These estimated policy year loss ratios are then trended forward to the mid-point of the proposed loss costs (April 1, 2006) considering the anticipated claim frequency trend discussed above, and those loss ratios are then adjusted for the estimated effects of Act 44 on indemnity benefits. The loss ratio thus estimated is 0.9711. Since in the PCRB's loss cost filings the target loss ratio is 1.0000, this result supports the proposed 2.89 percent decrease in current loss costs for the policy period beginning April 1, 2005.

Because average experience modifications are expected to be slightly lower during the period for which the proposed loss costs will apply than was the case for currently-approved loss costs, average proposed decreases in manual loss costs (at 0.90 percent) are less pronounced than the indicated decrease in collectible loss costs of 2.89 percent. By industry group the proposed average changes in manual loss costs effective April 1, 2005 are:

|               |        |
|---------------|--------|
| Manufacturing | -0.38% |
| Contracting   | -0.74% |
| All Other     | -1.17% |

These indicated changes to manual loss costs were derived by industry group on Page 1 of Exhibit 12, using information regarding the historical operation of the Experience Rating Plan (see Exhibits 18 and 19 of the enclosures to this filing). Anticipated collectible premium ratios are compared to provisions in current rates, with the ratios used to adjust the proposed change in collectible loss costs to appropriate manual levels on the bottom of Page 1 of the Exhibit 12.

## **EMPLOYER ASSESSMENT FACTOR AND LOSS COST LOADINGS**

In preparing this filing, the PCRB has reviewed experience pertinent to the employer assessment factor to be applied to Pennsylvania workers compensation business in accordance with Act 57 of 1997. Exhibit 13 enclosed presents a summary of the PCRB's determination of the appropriate employer assessment factor. The net effect of reported changes in budgetary amounts, bases for allocation among payer groups, and premium volume result in a proposed provision of 0.0191, lower than the currently-approved provision of 0.0236.

The provision for assessments supporting the Office of the Small Business Advocate, which continues to be part of proposed PCRB loss costs, is proposed to remain at 0.0001.

PCRB loss costs continue to include adjustments for the effects of the Merit Rating Plan and the Certified Safety Committee Program. These provisions are proposed to change from 0.0036 and 0.0055 to 0.0035 and 0.0052, respectively, as shown in Exhibit 13 and separately derived in Exhibits 15 and 16.

This filing also proposes to update classification loss costs to reflect indicated loadings for the Pennsylvania Construction Classification Premium Adjustment Program (PCCPAP).

Since 1991 the PCCPAP program has been in effect for designated construction classifications. This program offers tabular premium credits to employers subject to those specified classifications that demonstrate the payment of wages above certain threshold levels. The PCCPAP program had been revised effective January 1, 2002 to eliminate adjustment of experience modifications in recognition of the effects of PCCPAP credits as the approved means of avoiding providing redundant credits. The adjustment of experience modifications had been seen as a potential impediment to participation in the program. The revised plan makes adjustment within the computation of the credits themselves for the effect of high wages on experience modifications. Manual loss costs for each construction classification then incorporate "offsets" intended to recover the premium credits given to higher-wage employers from all employers insured in each construction classification. Thus, the PCCPAP program is intended to be "revenue-neutral" and should reallocate premium obligations between low- and high-wage employers without either increasing or reducing the overall amount of premium collected in these classifications.

For this filing the PCRB has been able to analyze participation in this program and the level of credits generally obtained by participating employers in each classification using the most recent available experience. Results of that analysis and proposed PCCPAP loads on loss costs by classification are included as Exhibit 14 of the enclosures to this filing.

Available experience, as summarized on Exhibit 14, produces a revised average indicated PCCPAP offset of 2.80 percent of loss costs, down somewhat from the current average of 3.06 percent.

The proportion of construction industry premiums and payrolls represented by eligible employers seeking and/or qualifying for credit under the plan has decreased somewhat in the most recent available experience. Those risks that did qualify for PCCPAP credits produced only nominally lower average credits than had been the case in the recent past.

In addition, Exhibit 14 reveals that there continue to be material differences between construction classifications in terms of the portion of employers receiving PCCPAP credits and/or the level of credits provided to such employers. Proposed offsets range from 0.02 percent in Code 662, Household Appliance Service, to 6.01 percent in Code 649, Ceiling Installation.

## **EXPERIENCE RATING PLAN PARAMETERS**

The Experience Rating Plan provides a prospective means of recognizing differences in loss potential between employers. This recognition is accomplished by means of a comparison of each qualifying employer's loss and exposure experience over a specified period of time (experience period) to the average experience of all employers engaged in similar businesses.

As part of each loss cost filing, the PCRB reviews the results of its Experience Rating Plan and proposes certain updates or revisions to the plan as are deemed necessary or appropriate to maintain the effective operation of the plan.

Effective April 1, 2004, the Experience Rating Plan was materially revised. Changes adopted at that time included a revised credibility table (generally assigning increased credibility to smaller risks' experience and lower credibility to larger risks' experience than had the legacy Experience Rating Plan) and a new loss limitation procedure in which all losses were limited to

a flat amount of \$42,500 (instead of employing a sliding scale of loss limitations that increased with risk size). In addition, a 25 percent limitation was imposed on the extent to which an employer's experience modification could change (up or down) in any one year.

Recognizing the significant changes recently adopted with respect to the Experience Rating Plan, the PCRB constructed the analytical exhibits pertaining to this plan and offered in support of this filing by applying the revised Experience Rating Plan to prior rating periods. This approach effectively demonstrates what the performance of the new plan would have been rather than displaying what the performance of the legacy plan actually was.

Exhibit 18 of the enclosures to this filing presents a detailed analysis of results of the new Experience Rating Plan within each industry group over the most recent available five years. These analyses are set forth in tabular form by premium size group and experience modification range by year and are also depicted in graphic form for additional reference. Exhibit 19 of this filing presents summaries of collectible premium ratios and detail of the derivation of expected loss cost factors supporting the Experience Rating Plan parameters proposed in this filing.

The changes in collectible premium ratios presented on Exhibit 19 must be accounted for in establishing manual levels of loss costs, as shown on the bottom portion of Page 1 of Exhibit 12.

Final Experience Rating Plan parameters proposed in this filing are shown in Exhibits 27 and Exhibit 28.

### **OPTIONAL RETROSPECTIVE LOSS DEVELOPMENT FACTORS**

Because loss valuations tend to change (and generally to increase) over time, some retrospective rating plans provide for application of development factors to preliminary loss reports in computing retrospective premiums. The PCRB has historically presented appropriate voluntary loss development factors based on aggregate PCRB experience as part of its filings for use by carriers and insureds in negotiating and agreeing upon their retrospective rating plans.

Exhibit 26 of the enclosures to this filing shows the PCRB's proposed optional retrospective loss development factors on an unlimited basis. In addition, the PCRB includes in its Manual reference to the formula for adjusting unlimited loss development factors to limited bases by reference to the ELF's described above. That formula is also shown in Exhibit 26 for reference.

### **CLASSIFICATION LOSS COST RELATIVITIES**

Workers compensation insurance is written under a classification system that provides varying rating values for different types of businesses, based on the risk of loss inherent in those businesses subject to each distinct classification. As a result, any overall loss cost indication must ultimately be apportioned to each individual classification with due recognition given to the comparative experience of employers subject to each classification.

In preparing individual classification loss costs for this filing, the PCRB has continued to apply pricing procedures established as a result of a 1994 study of the classification plan conducted in cooperation with the Insurance Department, Milliman & Robertson, Inc. and the Commonwealth Contractors' Coalition. These procedures have been used and approved in several previous PCRB loss cost filings.

Exhibit 17 of the enclosures to this filing provides an overview of the classification loss cost formulae utilized in preparation of this filing. These procedures are consistent with previously-submitted and approved methods.

The PCRB has elected for purposes of this loss cost filing to apply "swing limits" or allowable fluctuations in classification loss costs of 25 points above and below the average loss cost change within each industry group. In addition, the PCRB applies a testing procedure to identify potential significant reversals in classification loss cost changes relative to overall average indications year-after-year and intervenes where such indicated changes exceed selected amounts. These swing limits apply to "pure" loss costs, which include an adjustment for the operation of the Experience Rating Plan. The values so determined are subsequently adjusted to include appropriate provisions for the following items:

- Offsets for net Merit Rating Plan credits
- Offsets for Pennsylvania Construction Classification Premium Adjustment Program credits
- Offsets for Certified Safety Committee credits
- Assessment for the Office of the Small Business Advocate

The Index to Classification Exhibits and the accompanying Class Book in the enclosures to this filing present detail of the experience and loss cost indications derived for each classification in this filing. Within the Index to Classification Exhibits, certain parametric components of the classification loss cost review process are presented, and the bases for establishing credibility tables applicable to both payroll and expected losses are provided. Summary unit statistical data pertinent to the classification experience analysis is also included as Exhibits 20A, 20B and 20C of the enclosures to this filing.

Item 8 within the Index to Classification Exhibits presents identification of several classifications, in which some form of selection or other intervention in the statistical procedures generally applied to the determination of classification loss costs was deemed appropriate. For 30 of these classifications, the bases for loss cost selection were references to prevailing national procedures or values (for example, the explosives classifications or the aircraft seat surcharge), specified procedures to allocate loss costs between ratable and non-ratable components, recognition of statutory provisions for occupational disease benefits, combinations of separately-defined codes for purposes of determining loss costs and/or responses to data reassignments occurring during the latter stages of classification pricing analysis.

For some 23 additional classifications applicable to temporary staffing businesses, the loss cost "selections" proposed in this filing were computed using an experience analysis applied to the historical data presented in those respective classifications. In loss cost filings proposed since December 1, 1995, loss cost indications were selected for this series of temporary staffing classifications, as well as for Classification 889, Temporary Clerical Service, based on specified non-temporary staffing classifications that described operations analogous to those

of the temporary staffing entities' clientele. The PCRB has submitted a proposal (Bureau Filing No. 214) that would discontinue this selection procedure and develop loss cost indications for temporary staffing codes commensurate with the experience presented by those classifications. As of this writing, Bureau Filing No. 214 is still pending before the Insurance Department. This filing is submitted consistent with the proposals of Bureau Filing No. 214 and will require amendment if Bureau Filing No. 214 is not approved as submitted. In particular, if Bureau Filing No. 214 were disapproved in its entirety, loss cost values for many temporary staffing classifications would be reduced from those submitted herewith, while loss cost values for many non-temporary staffing classifications would be increased.

Item 11 of the Index to Classification Exhibits presents "supplemental Class Book pages" detailing the derivation of loss costs for classifications treated in combination or subject to reassignments of data from/to another class(es). The Class Book presents detail of the experience and loss cost indications derived for each individual classification in this filing, performed without special consideration using the proposed procedures.

The loss costs developed in accordance with the procedures set forth on Exhibit 17 and presented in portions of the Index to Classification Exhibits and the Class Book exclude the following considerations previously discussed in this letter:

- PCCPAP offsets from Exhibit 14
- Merit Rating Plan credit offsets derived in Exhibit 15
- Offsets for Certified Safety Committee credits derived in Exhibit 16
- Assessment loading for the Office of the Small Business Advocate shown in Exhibit 13

The loss costs prior to application of these latter considerations may be thought of as "pure" loss costs and are the values to which the loss cost change limitations or "swing limits" have been applied.

For this filing, consideration was given to past filings' changes by classification relative to average or overall indications in making final rating value selections. This procedure mitigated what otherwise would have been substantial fluctuations above and below average levels between successive filings for a limited number of classifications.

Exhibit 28 in support of this filing presents a complete table of proposed loss costs and expected loss factors pertinent to the Experience Rating Plan. Exhibit 29 presents both summary results and classification detail of the PCRB's tests of proposed loss costs against intended levels. Finally, Exhibit 30 depicts in graphic form the distribution of percentage changes in classification loss costs, both before and after the application of swing limits or "caps."

## **HEPATITIS C LOSS COST SURCHARGES**

H.B. 1633, enacted in December 2001, established a rebuttable presumption of work-related causality for Hepatitis C if contracted by professional and volunteer firefighters, volunteer ambulance corps personnel, volunteer rescue and lifesaving squad personnel, emergency services personnel and paramedics.

For the April 1, 2003 Loss Cost Filing the PCRB researched available public documentation and some selected independent reports provided by their authors toward the objective of establishing a benchmark set of surcharges to reflect the increased claims potential precipitated by H.B. 1633. Selected surcharge amounts were included with that filing for the following classification codes:

Code 807, Non-Volunteer Ambulance Services  
Code 985, Salaried Police or Firefighters  
Code 993, Volunteer Ambulance Corps  
Code 994, Volunteer Fire Companies

After review of the April 1, 2003 filing by the Insurance Department, surcharge amounts originally proposed for the above-cited classifications were amended to reflect available information regarding the incidence of Hepatitis C in the general U.S. population. For the April 1, 2004 Loss Cost Filing, procedures consistent with those approved levels of surcharges were retained, and those procedures are continued for purposes of this filing.

## **MANUAL LANGUAGE REVISIONS**

Proposed Manual language to accomplish the changes described briefly below is included in this filing.

- ***Designated Auditable Payrolls***

The filing proposes updates to several of these values for the continuing effects of wage inflation, including specifically the following:

Executive officers - the maximum auditable payroll is proposed to change from \$1,700 to \$1,750 per week.

Taxicab operators for leased cab - the annual auditable payroll, absent available payroll records, proposed to change from \$33,750 to \$34,500.

Salaried police or firefighters - the minimum auditable payroll proposed to change from \$3,400 to \$3,450 per year.

Specific Manual language proposed in support of the above changes is provided under cover of a staff memorandum dated November 18, 2004 accompanying this filing.

Item Filing No. P-1389, filed in most jurisdictions countrywide by the National Council on Compensation Insurance, Inc. (NCCI), proposed revisions to two existing endorsement forms.

The first of these endorsement forms is the Employers Liability Coverage Endorsement – WC 00 03 03 B. Changes proposed for this endorsement would remove the exclusion of “bodily injury to any member of the flying crew of any aircraft” reflected in current language. The second endorsement form affected by Item Filing No. P-1389 is the Federal Employers Liability Act Coverage Endorsement – WC 01 01 04. Changes proposed to this endorsement would add clarifying language to specify that the policy exclusion of FELA coverage does not apply effective April 1, 2005.



To maintain consistency across jurisdictions with respect to the language and operation of these endorsements, the PCRB is proposing adoption of Item Filing No. P-1389 as part of this filing.

### **EXCESS LOSS (PURE PREMIUM) FACTORS, STATE AND HAZARD GROUP RELATIVITIES AND LOSS ELIMINATION RATIOS**

As of the date of this filing, the PCRB continues to refine its update and analysis of the captioned rating values. In order to maintain consistency between various sets of these values, the PCRB expects to submit a separate filing addressing these items collectively. That filing will also include NCCI Item Filing No. R-1388-2004, Update to Retrospective Rating Plan Parameters, updating expected loss size ranges for use in adapting countrywide retrospective rating plan value tables for use in Pennsylvania.

This filing, Proposal C-348, fully and fairly reflects the most recent available experience indications in Pennsylvania, together with all initial and continuing effects of both Act 44 and Act 57. The PCRB respectfully requests a timely review of this filing toward the objective of its implementation, as proposed, on a new and renewal basis **effective April 1, 2005**. In requesting review of this filing, the PCRB is especially hopeful that adequate and appropriate advance notice of final loss costs and related rating values may be given to all participants in the Pennsylvania marketplace. Such notice would, of course, be assisted by as prompt and expeditious a review of this matter as possible. Toward that objective, the PCRB will be pleased to answer any questions or provide any available supplementary information which you or your staff may require.

Sincerely,

Timothy L. Wisecarver  
President

TLW/kg

Enclosures: Brown Book  
Actuarial and Classification & Rating Committees Minutes  
Summary of Responses to Survey of 36 Large Carrier Groups  
Discussion of Casualty Actuarial Society's "Statement of Principles Regarding  
Property and Casualty Loss and Loss Adjustment Expense Reserves"  
Index to Classification Exhibits  
Class Book  
Exhibit 5 Table I - Summary of Financial Call Data  
Exhibit 6 Paid & Incurred Loss Development & Trend  
Exhibit 7 Tail Factors for Loss Development  
Exhibit 8 Claim Frequencies  
Exhibit 9A Measures of Goodness of Fit in Trend Calculations Using Loss  
Ratios  
Exhibit 9B Measures of Goodness of Fit in Trend Calculations Using Severity  
Ratios  
Exhibit 10 Graphs of Indemnity and Medical Loss Ratios  
Exhibit 11A Retrospective Test of Trend Projections for Loss Ratios

Enclosures continued:

- Exhibit 11B Retrospective Test of Trend Projections for Severity Ratios
- Exhibit 12 Indicated Change in Loss Costs
- Exhibit 13 Loss-Based Assessments and Employer Assessment Factor
- Exhibit 14 Pennsylvania Construction Classification Premium Adjustment Program ("PCCPAP")
- Exhibit 15 Merit Rating Plan Off-Balance Indications
- Exhibit 16 Certified Safety Committee Program Offset
- Exhibit 17 Loss Cost Formulae
- Exhibit 18 Review of Experience Rating Plan Results
- Exhibit 19 Review of Experience Rating Plan Parameters
- Exhibit 20A Table II
- Exhibit 20B Table III
- Exhibit 20C Table IV
- Exhibit 26 Retrospective Development Factors
- Exhibit 27 Table B
- Exhibit 28 Loss Costs and Expected Loss Factors
- Exhibit 29 Tests of Indicated & Selected Loss Costs
- Exhibit 30 Distribution of Loss Cost Percentage Changes
- Exhibit 31 Hepatitis C Surcharge
- Miscellaneous Manual Amendments
  - Staff Memorandum of November 18, 2004 - Proposed Revisions to Designated Auditable Payrolls
  - Staff Memorandum of December 8, 2004 – Proposed Revisions to Employers Liability Coverage Endorsement – WC 00 03 03 B and to Federal Employers Liability Act Coverage Endorsement – WC 01 01 04