Pennsylvania Compensation Rating Bureau
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January 6, 1997

BUREAU CIRCULAR NO. 1345

To All Members of the Bureau:

Re: **SCHEDULE RATING PROCEDURES**

This circular is to clarify certain issues pertaining to the application of schedule rating plan premium adjustments for the benefit of all Bureau members and other interested parties. Three specific matters pertaining to such plans which the Bureau believes merit the attention of all workers compensation writers in Pennsylvania are set forth and discussed below.

EFFECTIVE DATES, ANNIVERSARY RATING DATES AND APPLICATION OF SCHEDULE RATING PLANS

All Bureau members are advised that schedule rating plans are subject to Section 1, Rule I, Paragraph G. Subparagraph 2. of the Pennsylvania Workers Compensation Manual. This rule provides in pertinent part as follows:

> If a policy is canceled and rewritten by the same or another carrier, all rules, classifications and carrier rating values of the rewriting carrier which were in effect as of the anniversary rating date shall apply to the rewritten policy until the next anniversary rating date as established by the Pennsylvania Compensation Rating Bureau.

Schedule rating plans are included within the scope of "carrier rating values" referred to above. Thus, a carrier may not apply schedule rating debits or credits to any risk until the risk's next anniversary rating date after the effective date of approval of the carrier's schedule rating plan by the Pennsylvania Insurance Department.

Examples of Application of Schedule Rating Plan Debits or Credits

Consider carrier ABC filing a schedule rating plan with the Pennsylvania Insurance Department on September 10, 1996 with a proposed effective date of November 1, 1996. This plan was approved on September 27, 1996 with the proposed effective date, i.e., November 1, 1996. The following three scenarios each present an insured and the resulting application of Carrier ABC's schedule rating plan thereto.

Employer 123 was previously insured in Pennsylvania by another carrier and has an anniversary rating date of October 1. This employer sought coverage from Carrier ABC and was issued a policy effective December 1, 1996. No schedule rating debit or credit may be applied by Carrier ABC until October 1, 1997, the next anniversary rating date for Employer 123 coming after the approved effective date of the schedule rating plan. Note that in this example the schedule rating plan was approved before the anniversary rating date in question but that the approved effective date was after this anniversary rating date.

Employer 456 was previously insured in Pennsylvania by another carrier and has an anniversary rating date of December 1. This employer sought coverage from Carrier ABC and was issued a policy effective January 1, 1997. Schedule rating debits or credits may be applied by Carrier ABC for the entire term of this policy, because the employer's anniversary rating date postdates the approved effective date of the schedule rating plan.

Employer 789 was previously insured in Pennsylvania by Carrier ABC and has an anniversary rating date of July 1. This employer renewed coverage with Carrier ABC effective July 1, 1996. No schedule rating debit or credit may be applied by Carrier ABC until July 1, 1997, the next anniversary rating date for Employer 789 coming after the approved effective date of the schedule rating plan.

As the above cases illustrate, the timing of application of schedule rating plans should be determined consistent in all respects with considerations applicable to changes in Bureau rating values or carrier loss cost multipliers for similarly-situated risks.

DISTINCTIONS IN THE APPLICATION OF SCHEDULE RATING PLANS TO EXPERIENCE RATED AND NON-RATED RISKS

Bureau Circular No. 1338, dated September 25, 1996, addressed schedule rating procedures. In part that circular cited the Pennsylvania Insurance Department's statement of procedures and included the following criteria for approval of schedule rating plans by the Insurance Department:

1. Act 57 allows approval of plans that provide (schedule rating plan) modification of the rate, including the loss cost portion of the rate, for risks ineligible for experience rating.

2. The Department will consider schedule rating plans for risks eligible for experience rating provided that the (schedule rating plan) modification for these risks is not based on measurement of loss producing characteristics of an individual insured. Per Act 44, the Experience Rating Plan is the exclusive means of providing prospective premium adjustment based on these measurements.

The Pennsylvania Insurance Department has confirmed to the Bureau that the above criteria allow schedule rating plan adjustment of the total rate for risks ineligible for the Experience Rating Plan but limit schedule rating plan adjustment for risks eligible for experience rating to the expense portion of the rate only.

It is important to note that the "expense portion" of a carrier's rate(s) <u>cannot</u> be established solely by reference to the carrier's loss cost multiplier. In fact, different carriers using the same loss cost multiplier could have different expense provisions contained within their respective rates. Expense provisions may be identified by reference to detail information supporting each carrier's loss cost multiplier filing(s).

The following examples are presented for illustrative purposes. Each of the first three examples addresses one of the loss cost adjustment factors prescribed by the Pennsylvania Insurance Department in 1993, when Pennsylvania's workers compensation system was changed from an advisory rating system to a competitive loss cost pricing system. Supporting detail and explanatory materials pertinent to the derivation of the loss cost multipliers and the underlying expense provisions used in each of these examples was previously included in Bureau Circular No. 1294 dated November 1, 1993.

In reviewing these examples it should be noted that the derivative of "other considerations" as a component of rates could vary significantly between companies. Depending on the content of this adjustment, these "other considerations" could potentially affect loss, loss adjustment expense and/or various other specific expense categories. For simplicity all the examples set forth herein omit any effects on expense provisions due to "other considerations."

<u>Case 1: No Premium Discount.</u>

Permissible Loss Ratio	92.24%
Loss Adjustment Expense Factor	1.1264
Projected Expenses:	30.82%
LAE	11.66%
Total Production	8.50%
General Expense Including Startup	8.13%
Taxes, Licenses & Fees	3.89%
Premium Discounts	0.00%
Profit & Contingencies	(1.37%)

(Note: Percentages may not add due to rounding differences)
LAE = .1264 x .9224 = .1166

Other Considerations	(23.06%)

Calculation of Prescribed Loss Cost Multiplier:

LAE Factor / (1.0 - Projected Expenses excluding LAE - Other Considerations)
or
1.1264 / (1.0 - . 1916 - (-.2306)) = 1.0841

Since in this case the expense portion of the rate = .3082, any approved schedule rating debit or credit applicable to an experience rated risk must apply only to that portion of the total rate. For example, for a risk with standard premium of $125,000, given a schedule rating credit of 20 percent, the total allowable credit would be computed as follows:

$125,000	x	0.3082	x	0.20 =		$7,705
Standard Premium	x	Expense Provision	x	Schedule Credit % =		Credit Amount

If the same schedule rating credit were applicable to a non-experience rated risk having, for example, a standard premium of $1,250, the credit would apply to the total rate and premium, as shown below:

$1,250	x	0.20 =	$250
Standard Premium	x	Schedule Credit % =	Credit Amount

Case 2: Schedule “X” Premium Discount.

Permissible Loss Ratio	87.28%
Loss Adjustment Expense Factor	1.1264
Projected Expenses	34.54%
LAE	11.03%
Total Production	8.30%
General Expense Including Startup	7.69%
Taxes, Licenses & Fees	3.84%
Premium Discounts	5.15%
Profit & Contingencies	(1.47%)

(Note: Percentages may not add due to rounding differences)
LAE = .1264 x .8728 = .1103

Other Considerations	(21.82%)

Calculation of Prescribed Loss Cost Multiplier:

LAE Factor / (1.0 - Projected Expenses excluding LAE - Other Considerations)

or

1.1264 / (1.0 - .2351 - (-.2182)) = 1.1458

Here the expense portion of the rate = .3454. Any approved schedule rating debit or credit applicable to an experience-rated risk must apply only to that portion of the total rate. For example, for a risk with standard premium of $125,000 given a schedule rating credit of 20 percent, the total allowable credit would be computed as follows:

$125,000	x	0.3454	x	0.20 =	$8,635
Standard Premium	x	Expense Provision	x	Schedule Credit % =	Credit Amount

As in the above example, however, if the schedule rating credit were applicable to a non-experience rated risk having, for example, a standard premium of $1,250, the credit would apply to the total rate and premium, as shown below:

$1,250	x	0.20 =	$250
Standard Premium	x	Schedule Credit % =	Credit Amount

Case 3: Schedule "Y" Premium Discount.

Permissible Loss Ratio	81.50%
Loss Adjustment Expense Factor	1.1264
Projected Expenses:	38.87%
LAE	10.30%
Total Production	8.07%
General Expense Including Startup	7.18%
Taxes, Licenses & Fees	3.77%
Premium Discounts	11.13%
Profit & Contingencies	(1.59%)

(Note: Percentages may not add due to rounding differences)
LAE = .1264 x .8150 = .1030

Other Considerations	(20.38%)

Calculation of Prescribed Loss Cost Multiplier:

LAE Factor / (1.0 - Projected Expenses excluding LAE - Other Considerations)
or
1.1264 / (1.0 - .2857 - (-.2038)) = 1.2270

Now the expense portion of the rate = .3887. Any approved schedule rating debit or credit applicable to an experience-rated risk must apply only to that portion of the total rate. For example, for a risk with standard premium of $125,000 given a schedule rating credit of 20 percent, the total allowable credit would be computed as follows:

$125,000	x	0.3887	x	0.20 =	$9,718
Standard Premium	x	Expense Provision	x	Schedule Credit % =	Credit Amount

Again, as in the above examples, if the schedule rating credit were applicable to a non-experience rated risk having a standard premium of $1,250, the credit would apply to the total rate and premium, as shown below:

$1,250	x	0.20 =	$250
Standard Premium	x	Schedule Credit % =	Credit Amount

The final example provided below illustrates a hypothetical carrier having a loss cost multiplier below unity.

<u>Case 4: Hypothetical Loss Cost Multiplier Below Unity (1.0000)</u>

Permissible Loss Ratio	110.70%
Loss Adjustment Expense Factor	1.0750
Projected Expenses	19.30%
LAE	8.30%
Total Production	7.50%
General Expense Including Startup	5.50%
Taxes, Licenses & Fees	3.00%
Premium Discounts	0.00%
Profit & Contingencies	(5.00%)

(Note: Percentages may not add due to rounding differences)
LAE = .0750 x 1.1070 = .0830

Other Considerations	(30.00%)

Calculation of Prescribed Loss Cost Multiplier

LAE Factor / (1.0 - Projected Expenses excluding LAE - Other Considerations)
or
1.0750 / (1.0 - .1100 - (-.3000)) = 0.9034

Now the expense portion of the rate = .1930. Any approved schedule rating debit or credit applicable to an experience rated risk must apply only to that portion of the total rate. For example, for a risk with standard premium of $125,000 given a schedule rating credit of 20 percent, the total allowable credit would be computed as follows:

$125,000	x	0.1930	x	0.20	=	$4,875
Standard Premium	x	Expense Provision	x	Schedule Credit %	=	Credit Amount

As in all the above examples, if the schedule rating credit were applicable to a non-experience rated risk having a standard premium of $1,250, the credit would apply to the total rate and premium, as shown below:

$1,250	x	0.20	=	$250
Standard Premium	x	Schedule Credit %	=	Credit Amount

STATISTICAL REPORTING REQUIREMENTS FOR SCHEDULE RATING PLANS

Statistical reporting requirements pertinent to schedule rating plans were previously described or illustrated in Bureau Circular No. 1338 and are included below for reference and information.

The following statistical codes will apply to the reporting of premium adjustments under schedule rating plans in Pennsylvania:

Code 9887 - Schedule Rating Plan Credits
Code 9889 - Schedule Rating Plan Debits

Schedule rating plan premium adjustments are computed based on total modified premium and are not subject to experience rating. On hard copy reports schedule rating premium adjustments are to be reported on lines D, E or F.

All members are urged to take note of the above provisions pertaining to schedule rating plans in order to avoid Bureau criticisms of policies and/or unit reports submitted on risks to which schedule rating premium adjustments have been made.

Timothy L. Wisecarver
President

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