Pennsylvania Compensation Rating Bureau
The Widener Building • 6th Floor
One South Penn Square • Philadelphia, PA 19107-3577
(215)568-2371 • FAX (215)564-4328 • www.pcrb.com

May 24, 2001

BUREAU CIRCULAR NO. 1419

To All Members of the Bureau:

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

As announced in Bureau Circular No. 1417, revised loss costs have been approved for new and renewal policies effective on or after April 1, 2001. The Bureau is taking this opportunity to provide some background discussion and explanation about this loss cost revision and the workers compensation pricing system as a whole for the benefit of members and other potentially interested parties.

The average change in collectible loss costs filed by the Bureau and approved by the Insurance Commissioner effective April 1, 2001 was a reduction of 1.55 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 – 1993-2001

Effective Date	Average % Change in Loss Costs
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

The Bureau's analysis indicates that, in addition to the significant impacts of legislative enactments in 1993 and 1996, the primary factor underlying the downward trend in loss costs under the competitive pricing system in Pennsylvania has been improvement in claim frequency. The Bureau believes that claim frequency trends will be an important factor in determining future loss cost indications in the Commonwealth.

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 41 percent beginning with the December 1, 1993 loss cost revision through the April 1, 1999 loss cost revision.

- Workers compensation earned premiums decreased 46 percent from $2.8 billion for Calendar Year 1993 to $1.5 billion for Calendar Year 1999.

- Insured payrolls <u>increased</u> approximately 35 percent between 1993 and 1999.

In order for premiums to decrease 46 percent while the insured exposure base increased 35 percent, carrier prices per unit of exposure had to <u>decrease by approximately 60 percent</u> over this same period of time (i.e., 0.40 x 1.35 = 0.54). While some shift in exposures away from such activities as manufacturing and construction and into services and technology has occurred in Pennsylvania and such shifts would account for a part of the observed premium reductions over time, carrier prices have clearly changed much more dramatically than have Bureau loss costs since the implementation of a competitive pricing system in Pennsylvania.

Financial data collected by the Bureau provides another way of looking at market pricing activity. Much of the Bureau's recordkeeping 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:

Policy Year	Collectible Loss Costs at Bureau Level ($M)	Net Earned Premium at Company Level ($M)	Ratio
1996	$2,085	$1,998	0.958
1997	$1,765	$1,531	0.867
1998	$1,687	$1,377	0.816
1999*	$ 978	$ 776	0.793

* 1999 represents a partial policy year as of December 31, 1999. At this writing, data through December 31, 2000 is in the process of collection and summarization.

The above table shows that carriers have consistently written business in Pennsylvania at levels significantly below Bureau loss costs and that the differences between carrier prices and Bureau loss costs increased significantly in recent past years.

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. Historically, loss adjustment expenses have represented almost 15 percent of losses, and other expenses have represented approximately 27 percent of premium. Using these relationships, if a carrier wrote business at 85 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:	118	(100 / 0.85)
Indicated Loss and LAE Ratio:	136	(118 x 1.15)
Indicated Combined Ratio:	163	(136 + 27)

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.

While Bureau rating values can serve as meaningful benchmarks within an overall pricing approach, numerous other important factors must also be carefully accounted for on an ongoing basis in each carrier's pricing analysis.

Timothy L. Wisecarver
President

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