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March 3, 2010

BUREAU CIRCULAR NO. 1572

To All Members of the Bureau:

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

Prior Bureau circulars, most recently Bureau Circular No. 1561, 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, 2010 was an increase of 0.68 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 - 2010

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
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

The Bureau'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 Bureau believes that claim frequency trends will continue to be an important factor in determining future loss cost indications in the Commonwealth. Approved April 1, 2010 loss costs contemplate that claim frequency will continue to show declines through the end of 2010.

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 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 Bureau filings are just one. Consider the following:

- Bureau loss costs decreased 49 percent beginning with the December 1, 1993 loss cost revision through the April 1, 2008 loss cost revision.

- Workers compensation earned premiums decreased 12 percent from $2.82 billion for Calendar Year 1993 to $2.47 billion for Calendar Year 2008.

- Effective insured payrolls (as discussed below) are now estimated to have <u>increased</u> approximately 68 percent from 1993 to 2008.

With regard to insured payroll and premium trends noted above, some shift in exposures away from such activities as manufacturing and construction 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 Bureau 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 85 percent. For this year's analysis, the Bureau 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 98 percent from 1993 to 2008, "effective" payrolls increased just 68 percent during that same period.

In order for premiums to decrease 12 percent while the effective insured exposure base increased 68 percent, carrier prices per unit of exposure had to <u>decrease by approximately 47.6 percent</u> over this same period of time, as illustrated below:

Price per Unit of Exposure x Exposure Base = Premium

Or

Price per Unit of Exposure = Premium / Exposure Base

So

Factor to New Price per Unit of Exposure = Factor to New Premium / Factor to New Exposure Base
= (1.00 – 0.12) / (1.00 + 0.68)

Factor to New Price per Unit of Exposure = 0.524

And

Change in Price per Unit of Exposure = 0.524 – 1.000 = – 0.476

Financial data collected by the Bureau provides another way of looking at market pricing activity. Much of the Bureau'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 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	$1,911	$1,833	0.959
1997	$1,585	$1,375	0.868
1998	$1,519	$1,230	0.810
1999	$1,543	$1,238	0.802
2000	$1,575	$1,400	0.889
2001	$1,643	$1,627	0.990
2002	$1,685	$1,898	1.126
2003	$1,752	$2,145	1.224
2004	$1,837	$2,255	1.228
2005	$2,010	$2,385	1.187
2006	$1,994	$2,238	1.173
2007	$2,163	$2,410	1.114
2008	$1,269	$1,427	1.125

* 2008 represents a partial policy year as of December 31, 2008. At this writing, data through December 31, 2009 is not yet available from our member companies.

The above table shows that prior to 2002 carriers had written business in Pennsylvania at levels significantly below Bureau loss costs. The ratio of carrier prices to Bureau loss costs reached a low point in 1999, peaked in 2004 and has dropped each year since but for the incomplete Policy Year 2008.

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. Recently, loss adjustment expenses (LAE) have represented approximately 14 percent of losses, and other expenses have represented approximately 19 percent of premium. Using these relationships, if carriers wrote business at 112.5 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:	89	(100 / 1.125)
Indicated Loss and LAE Ratio:	101	(89 x 1.14)
Indicated Combined Ratio:	120	(101 + 19)

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 Bureau circulars and further reinforced by the above narrative and information, Bureau 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.

Timothy L. Wisecarver
President

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