



Pennsylvania Compensation Rating Bureau

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May 10, 2018

PCRB CIRCULAR NO. 1703

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 traditionally provided for the benefit of PCRB members and other interested parties, and updates information provided in prior PCRB circulars, most recently PCRB Circular No. 1680 dated April 20, 2017. The appendix of this circular provides the data underlying the charts.

This year, in addition to the information contained in this circular, we would also like to direct you to recently released reports providing more detailed Pennsylvania workers compensation marketplace activity metrics and actuarial results for the past year. Readers are encouraged to review and obtain the recently published reports from the PCRB website: 2017 State Activity Report, the new 2017 State of the Line Report, the 2016 Medical Activity Report. These noted reports are available on the left side of the Homepage via the “Data Reports / Special Studies” link and the 2017 PCRB Annual Report is found via the “Organization” link.

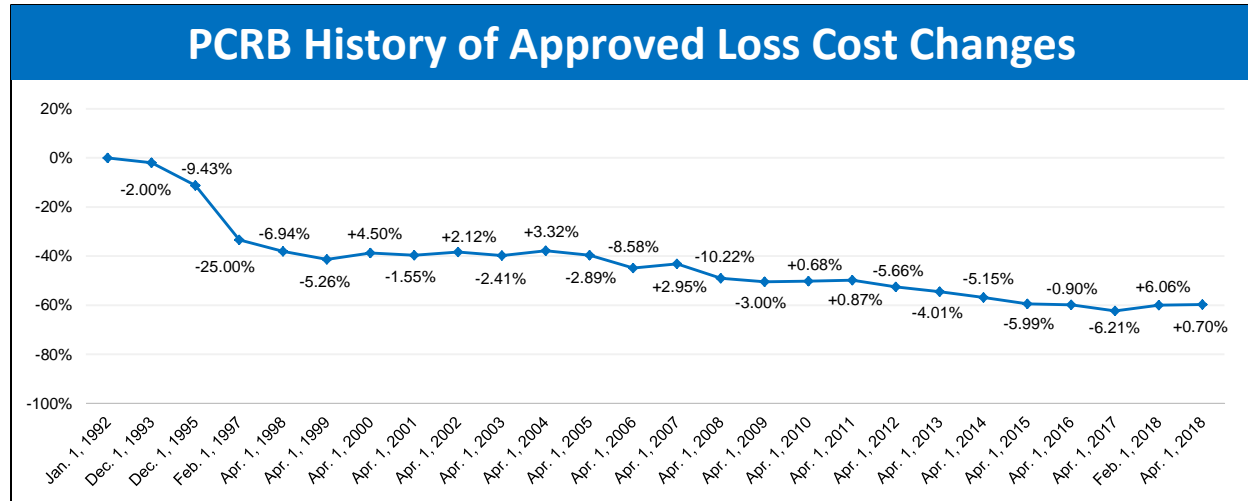
Loss Cost Changes

There were two changes in loss costs approved by the Insurance Commissioner since the April 1, 2017 annual filing. The first was submitted in Filing No. C-369, an interim increase of 6.06 percent to reflect the impact of the Protz¹ decision. This was originally filed with a proposed effective date of November 1, 2017, but was ultimately approved to become effective February 1, 2018. The second change, contained in Filing No. C-370, the annual filing, was for an increase of 0.70 percent in average collectible loss costs effective April 1, 2018. The combined impact of both filings was an overall average increase of 6.80 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 is a history of loss cost changes in Pennsylvania since the inception of the present pricing system:

¹ Protz v. WCAB (Derry Area School District). On June 20, 2017, the Pennsylvania Supreme struck down the portion of the Workers Compensation Act that provided a process for the use of Impairment Rating Evaluations (IREs) in determining whether an injured worker is permanently disabled. See PCRB Circular No. 1695.



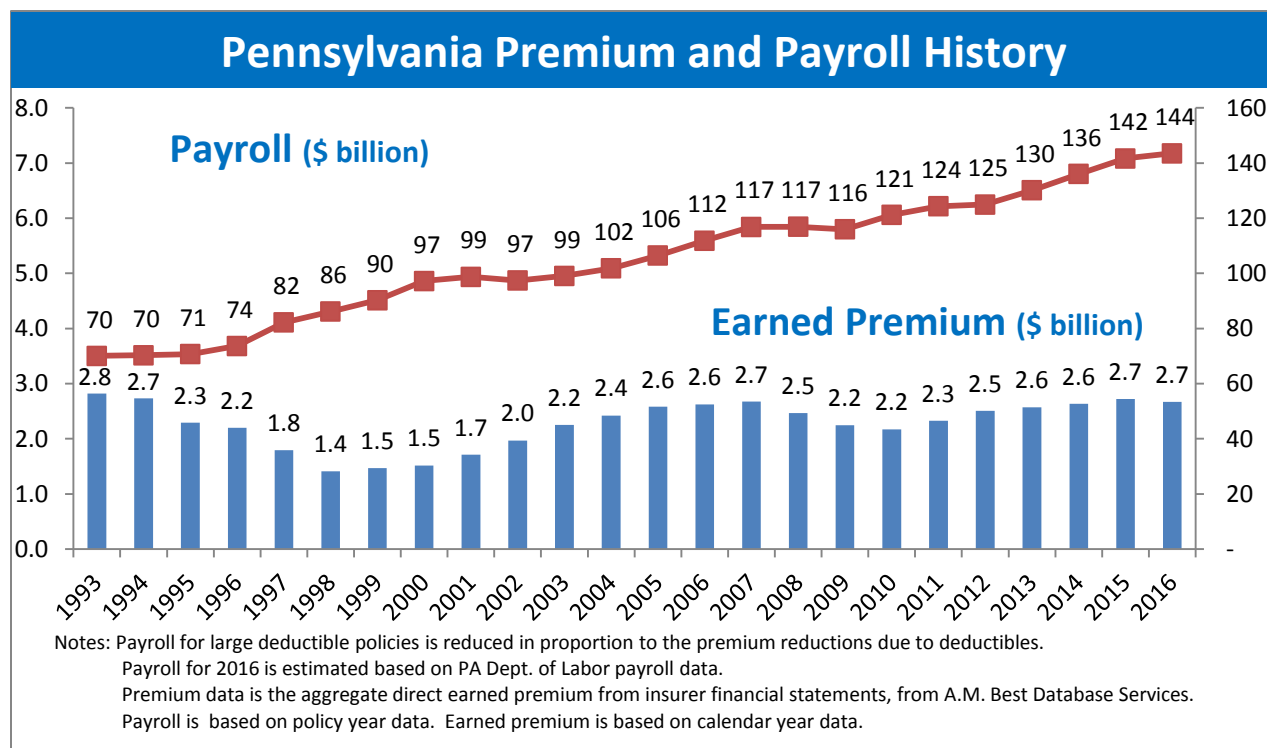
Over this 26-year period, the primary factors underlying the long-term downward trend in Pennsylvania are the improvement in claim frequency, which is decreasing by 5.6 percent annually, and the fundamental changes due to Acts 44 and 57. The downward frequency trend has been sufficient to counter upward claim severity trends for indemnity and medical benefits. The approved April 1, 2018 loss costs contemplate that claim frequency will continue to show declines through the end of 2018. However, the Protz decision, which eliminated one of the fundamental change elements in Act 57, has the potential to further increase the severity trends. With Filing No. C-369, the PCRB provided the analysis that estimated an immediate increase in indemnity benefits. However, it was not possible to estimate the long-term trend implications of claim handling and claim settling practices. Without remedy, the PCRB expects that further impact of the Protz decision on indemnity and medical severity will emerge in the experience data over time.

Pennsylvania Claim Cost Trends			
	Frequency	Severity	Pure Premium
Indemnity	-5.6%	+4.1%	-1.7%
Medical		+4.4%	-1.4%

Premium and Payroll History

The size of the Pennsylvania workers compensation insurance 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 2016. In contrast, effective payroll² has 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.

² 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.



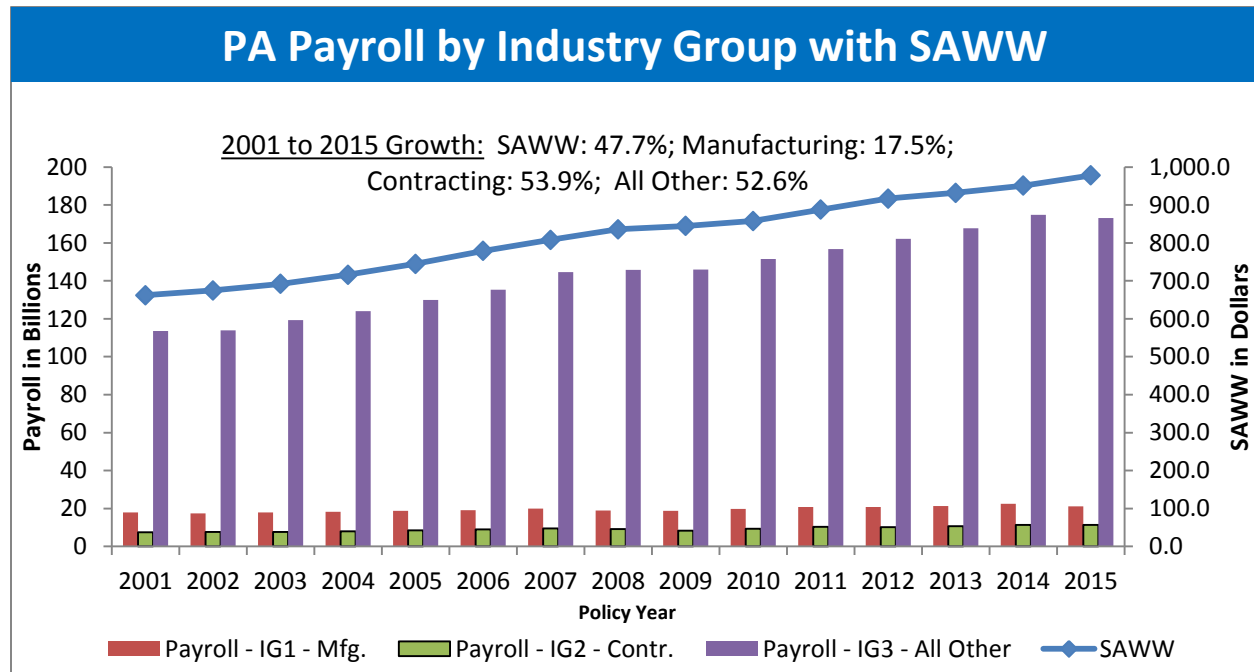
The difference in growth rates for payroll and premium appears to result from several dynamics in Pennsylvania, some of which are similar to trends across the country.

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 99.9 percent.

Second, as shown in the first chart of this circular, loss costs have generally declined since they were first implemented in 1993. The cumulative loss cost change since then is a decrease of 59.7 percent.

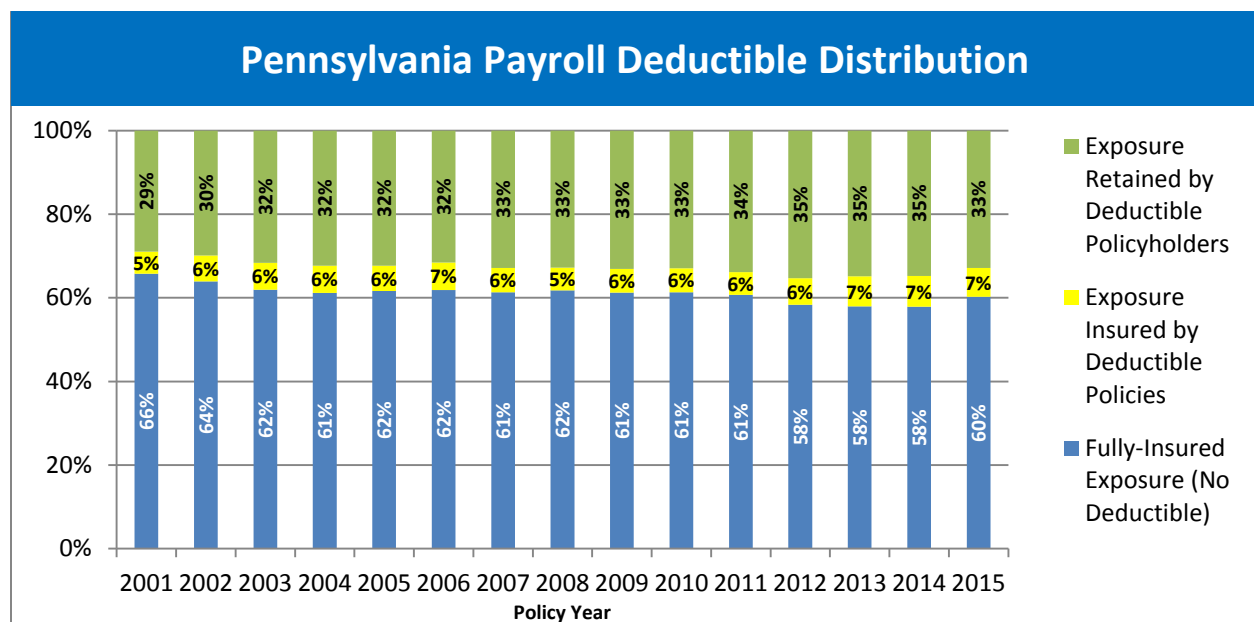
Third, payroll growth differs among the three PCRB industry groups, with manufacturing payroll lagging the other sectors which have kept pace with the growth in the Statewide Average Weekly Wage (SAWW). In the next chart, payroll is included at its full value for deductible policies (i.e., not at the “effective” level), to be comparable to the wage data. The chart shows SAWW growth from 2001 to 2015 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 \$17.9 billion to \$21.1 billion, or by 17.5 percent. For Industry Group 2 – Contracting, payroll grew from \$7.4 billion to \$11.4 billion, or by 53.9 percent. For Industry Group 3 – All Other, payroll grew from \$113.5 billion to \$173.2 billion, an increase of 52.6 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

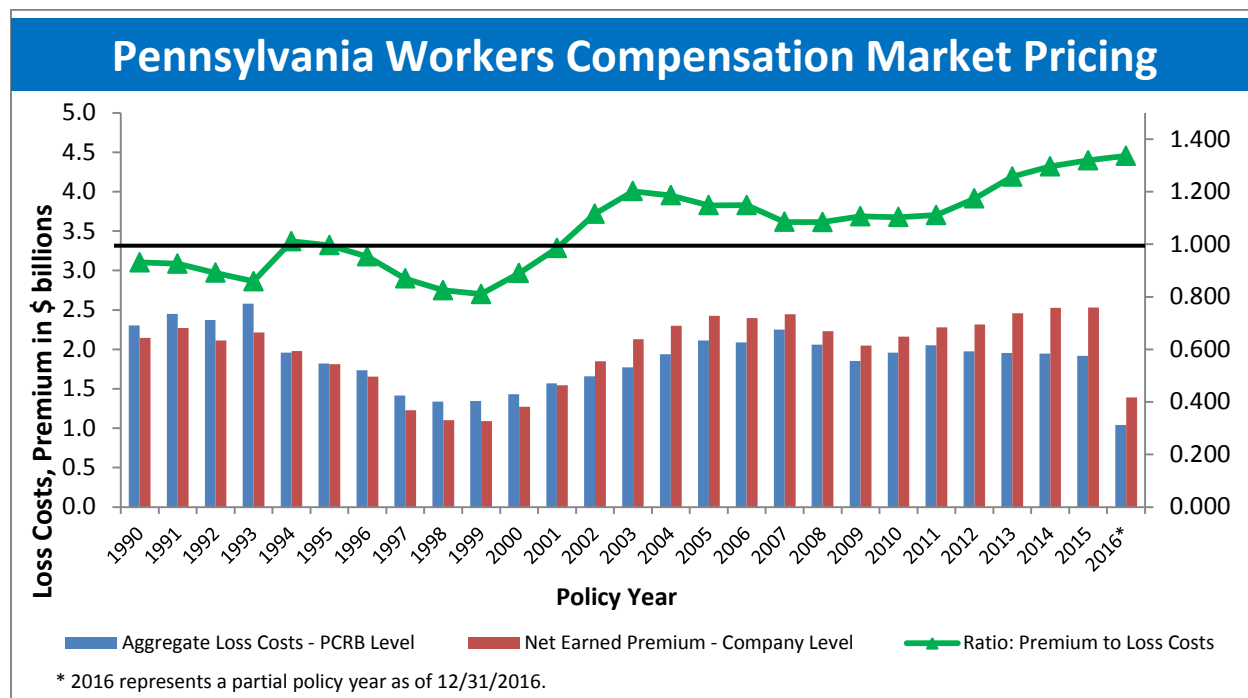
A fourth dynamic is the growth in the use of large deductible policies. In 2015, 40 percent of payroll was reported on large deductible policies, where the average portion of risk retained by policyholders is over 80 percent. The next chart shows the history from 2001 to 2015.



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 income

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 the first half of Policy Year 2016. 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 0.810, rose to a peak in 2003 at 1.202, dropped each year through 2008 to 1.084, continued slightly higher but relatively stable through 2011 reaching 1.111, and has increased since then such that the incomplete Policy Year 2016 shows the highest ratio of 1.336.



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 jpedrick@pcrb.com, or Ken Creighton, Chief Actuary, at extension 4924, or kcreighton@pcrb.com.

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Remember to visit our web site at www.pcrb.com for more information about this and other topics.

**Appendix
Data Underlying the Charts**

History of Approved Loss Cost Changes in Pennsylvania		
Policy Year Effective Date	Average Change in Loss Costs	Cumulative Change in Loss Costs
Dec. 1, 1993	-2.00%	-2.00%
Dec. 1, 1995	-9.43%	-11.24%
Feb. 1, 1997	-25.00%	-33.43%
Apr. 1, 1998	-6.94%	-38.05%
Apr. 1, 1999	-5.26%	-41.31%
Apr. 1, 2000	4.50%	-38.67%
Apr. 1, 2001	-1.55%	-39.62%
Apr. 1, 2002	2.12%	-38.34%
Apr. 1, 2003	-2.41%	-39.82%
Apr. 1, 2004	3.32%	-37.83%
Apr. 1, 2005	-2.89%	-39.62%
Apr. 1, 2006	-8.58%	-44.80%
Apr. 1, 2007	2.95%	-43.18%
Apr. 1, 2008	-10.22%	-48.98%
Apr. 1, 2009	-3.00%	-50.51%
Apr. 1, 2010	0.68%	-50.18%
Apr. 1, 2011	0.87%	-49.74%
Apr. 1, 2012	-5.66%	-52.59%
Apr. 1, 2013	-4.01%	-54.49%
Apr. 1, 2014	-5.15%	-56.83%
Apr. 1, 2015	-5.99%	-59.42%
Apr. 1, 2016	-0.90%	-59.78%
Apr. 1, 2017	-6.21%	-62.28%
Feb. 1, 2018	6.06%	-60.00%
Apr. 1, 2018	0.70%	-59.72%

Pennsylvania Premium and Payroll History		
Policy/Calendar Year	Direct Earned Premium by Calendar Year (\$000)*	Effective Payroll by Policy Year (\$000)
1993	2,817,651	70,024,598
1994	2,730,858	70,298,475
1995	2,290,920	70,706,165
1996	2,196,055	73,648,721
1997	1,794,790	82,179,812
1998	1,408,597	86,125,706
1999	1,469,706	90,266,811
2000	1,514,995	97,215,755
2001	1,712,165	98,709,006
2002	1,966,766	97,382,219
2003	2,249,933	99,057,172
2004	2,421,470	101,792,251
2005	2,581,581	106,457,361
2006	2,620,364	111,856,896
2007	2,672,758	116,850,415
2008	2,465,389	116,893,235
2009	2,244,791	115,949,398
2010	2,167,273	121,182,692
2011	2,328,257	124,321,949
2012	2,504,225	124,924,447
2013	2,569,218	130,105,771
2014	2,634,727	136,022,868
2015	2,717,988	138,162,898
2016	2,666,022	139,959,016

*A.M. Best Database Services

Pennsylvania Payroll by Industry Group with Statewide Average Weekly Wage					
Payroll Gross of Deductible (\$000)					
Policy Year	IG1 - Manufacturing	IG2 - Contracting	IG3 - All Other	Total	SAWW
2001	17,940,177	7,373,099	113,522,044	138,835,320	662.0
2002	17,326,711	7,582,746	113,951,978	138,861,435	675.0
2003	17,845,824	7,644,820	119,323,671	144,814,315	692.0
2004	18,312,464	7,974,149	124,077,340	150,363,953	716.0
2005	18,705,923	8,486,877	130,006,831	157,199,631	745.0
2006	19,089,384	9,000,073	135,320,584	163,410,041	779.0
2007	19,939,311	9,421,857	144,648,031	174,009,200	808.0
2008	18,983,676	9,116,186	145,749,459	173,849,321	836.0
2009	18,838,461	8,376,988	146,034,828	173,250,277	845.0
2010	19,830,844	9,259,855	151,540,978	180,631,678	858.0
2011	20,724,672	10,336,352	156,759,044	187,820,068	888.0
2012	20,825,626	10,168,580	162,090,839	193,085,044	917.0
2013	21,229,810	10,694,122	167,807,672	199,731,604	932.0
2014	22,395,830	11,338,714	174,815,790	208,550,334	951.0
2015	21,077,751	11,350,558	173,196,877	205,625,186	978.0

Pennsylvania Payroll Deductible Distribution (\$000)				
Policy Year	Total Gross of Deductible	Fully Insured Exposure (No Deductible)	Exposure Insured by Deductible Policies	Exposure Retained by Deductible Policyholders
2001	138,835,320	91,292,293	7,416,712	40,126,314
2002	138,861,435	88,826,192	8,556,027	41,479,217
2003	144,814,315	89,685,227	9,371,945	45,757,143
2004	150,363,953	92,054,587	9,737,664	48,571,702
2005	157,199,631	96,863,995	9,593,366	50,742,270
2006	163,410,041	101,147,789	10,709,107	51,553,145
2007	174,009,200	106,684,365	10,166,050	57,158,785
2008	173,849,321	107,389,477	9,503,758	56,956,086
2009	173,250,277	106,153,229	9,796,169	57,300,879
2010	180,631,678	110,855,872	10,326,819	59,448,987
2011	187,820,068	113,985,046	10,336,903	63,498,119
2012	193,085,044	112,706,982	12,217,466	68,160,597
2013	199,731,604	115,743,868	14,361,903	69,625,833
2014	208,550,334	120,744,685	15,278,183	72,527,466
2015	205,625,186	123,852,716	14,310,182	67,462,287

Pennsylvania Workers Compensation Market Pricing			
Policy Year	Collectible Loss Costs at Bureau Level (\$000)	Net Earned Premium at Company Level (\$000)	Ratio
1990	2,305,137	2,146,089	0.931
1991	2,451,875	2,270,677	0.926
1992	2,373,529	2,113,789	0.891
1993	2,578,350	2,215,303	0.859
1994	1,956,971	1,979,233	1.011
1995	1,819,458	1,812,915	0.996
1996	1,733,915	1,652,333	0.953
1997	1,414,136	1,228,182	0.869
1998	1,336,141	1,102,349	0.825
1999	1,345,591	1,089,397	0.810
2000	1,432,073	1,274,209	0.890
2001	1,568,198	1,544,771	0.985
2002	1,658,183	1,850,252	1.116
2003	1,771,715	2,129,603	1.202
2004	1,939,842	2,300,688	1.186
2005	2,114,245	2,426,395	1.148
2006	2,088,180	2,398,514	1.149
2007	2,252,107	2,444,350	1.085
2008	2,058,369	2,232,110	1.084
2009	1,853,261	2,050,030	1.106
2010	1,960,299	2,162,268	1.103
2011	2,052,687	2,279,971	1.111
2012	1,973,994	2,316,572	1.174
2013	1,955,378	2,457,870	1.257
2014	1,948,246	2,525,444	1.296
2015	1,918,835	2,530,921	1.319
2016*	1,042,096	1,392,433	1.336

* 2016 is an incomplete policy year.