

RULES AND REGULATIONS

Title 34—LABOR AND INDUSTRY

DEPARTMENT OF LABOR AND INDUSTRY

[34 PA. CODE CH. 125]

Workers' Compensation Self-Insurance

The Department of Labor and Industry (Department), Bureau of Workers' Compensation (Bureau), by this order, adopts the following amendments to Chapter 125 (relating to workers' compensation self-insurance), which governs the processing of applications for and the administration of self-insurance under the Workers' Compensation Act (act) (77 P. S. §§ 1—1041.4) and the Pennsylvania Occupational Disease Act (Occupational Disease Act) (77 P. S. §§ 1201—1603).

The Department specifically amends §§ 125.2, 125.3, 125.9 and 125.16. Those sections are part of Subchapter A (relating to individual self-insurance), which pertains to self-insurance by individual employers. The Department also amends §§ 125.132—125.135, 125.148, 125.150 and 125.152, which are a part of Subchapter B (relating to group self-insurance). Subchapter B enforces and administers the group self-insurance provisions of the act set forth in Article VIII of the act (77 P. S. §§ 1036.1—1036.18). The Department also amends § 125.202 (relating to definitions), which falls under Subchapter C (relating to the self-insurance guaranty fund). Subsection C provides regulations relating to the Self-Insurance Guaranty Fund (Guaranty Fund). Provisions concerning the Guaranty Fund are in Article IX of the act (77 P. S. §§ 1037.1—1037.7).

Statutory Authority

These amendments are adopted under the authority provided in section 435 of the act (77 P. S. § 991), which provides that the Department will adopt regulations as necessary to explain and enforce the act. In addition to section 435 of the act, the amendments to Subchapter B are promulgated under section 818 of the act (77 P. S. § 1036.18), and the amendment to Subchapter C is promulgated under section 908 of the act (77 P. S. § 1037.8). Section 818 of the act authorizes the Department to promulgate rules and regulations for the administration and enforcement of group self-insurance. Section 908 of the act authorizes the Department to promulgate rules and regulations for the administration and enforcement of the Guaranty Fund.

Purpose of Amendments

On June 24, 1996, Governor Tom Ridge signed into law the act of June 24, 1996 (P. L. 350, No. 57) (Act 57), which substantially amended the act. Among many other things, Act 57 amended sections 305 and 802 of the act (77 P. S. §§ 501 and 1036.2) and added section 819 of the act (77 P. S. § 1036.19). Those changes affected matters relating to the requirements for self-insurance. Portions of the amendments to §§ 125.2 and 125.9 (relating to definitions; and security requirements) and the amendments to §§ 125.134, 125.148 and 125.152 bring Chapter 125 into conformity with the Act 57 amendments.

The Bureau is also amending § 125.9 to modify the formulas for calculating the amount of security which must be posted by individually self-insured private em-

ployers and to permit the discounting of the required amount of security in certain circumstances.

Another amendment to § 125.2 and amendments to §§ 125.3, 125.16 and 125.150 (relating to application; reporting by runoff self-insurer; and runoff fund) provide needed clarification to Chapter 125. The need to clarify these sections has been identified by those charged with the administration of Chapter 125 since its promulgation in October of 1995.

In addition, the Bureau amends Subchapter B to permit group self-insurance funds to use individual loss-cost multipliers to recoup operating expenses. Previously those funds were required to follow the State Workers' Insurance Fund's (SWIF's) loss-cost multiplier for that purpose. The amendments to §§ 125.132, 125.133 and 125.135 (relating to definitions; application; and classification system; experience rating; contribution rates) relate to that change.

Finally, the amendment to § 125.202 simply updates the definition of "SWIF" used in Subchapter C to bring it in conformity with Act 57, which renamed the State Workmen's Insurance Fund the State Workers' Insurance Fund.

Background

The notice of proposed rulemaking was published at 27 Pa.B. 6161 (November 22, 1997). During the 30-day public comment period, the Department received comments on the proposed amendments from the following: Stanley H. Siegel, Hepford, Swartz & Morgan; Kenneth P. Breyley, Gencorp Inc.; Kevin F. Longenbach, Pennsylvania Turnpike Commission; Nanette Beerens, Pennsylvania Services Corporation; Mark Melvin, Pennsylvania Risk Management Co., Inc.; John R. Doubman, The Insurance Federation of Pennsylvania, Inc.; W. Edwin Jackson, Susquehanna Pfaltzgraff Co.; Jayne K. Lemon, Employer Services Corporation; and Joseph B. Petko, Occidental Petroleum Corporation. The Department also received written comments from the Independent Regulatory Review Commission (IRRC), by means of a letter dated January 22, 1998.

After the close of the 30-day public comment, the Department received the comments of Gary Wilson, C & K Coal Company, regarding the proposed amendments.

The proposed amendments were also reviewed by the Pennsylvania Workers' Compensation Advisory Council under section 447(b)(3) of the act (77 P. S. § 1000.3).

Response to Comments

The Department carefully considered all comments, including those received after the 30-day comment period, when formulating its final rulemaking. The following addresses the concerns raised by the commentators and IRRC.

1. Security Constant

The largest number of comments received on the proposed amendments related to the security constant, which will be added to the outstanding liability amount of private-sector self-insured employers in calculating their required amount of security.

As published, the proposed amendments § 125.9(d), would have set the security constant as the Statewide average weekly wage multiplied by 1,000, or the retention amount of the self-insurer's current specific excess insur-

ance if the self-insurer has that coverage. The Department had intended for the security constant to be the lesser of these two amounts, but the phrase outlining that intention was inadvertently deleted from the proposal. Occidental Petroleum Corporation, Employer Services Corporation and Hepford, Swartz & Morgan as well as IRRC requested that the regulation be clarified to specifically include that phrase.

Beyond that matter, however, Pennsylvania Risk Management Co., Inc., Susquehanna Pfaltzgraff Co., Gencorp Inc. and C & K Coal Company expressed concern over the results of the proposed security constant. They questioned whether the increase in security that could result from the proposed security constant is justified.

Subsequent to receipt of the comments, the Bureau conducted additional analysis on the effects of the proposed security constant on the amount of security provided by self-insurers. As a result, it concluded that the effect of the proposed security constant on the amount of security would have been unjustifiably severe in certain instances. For example, security increases of \$1.4 million to \$1.9 million and of \$400,000 to \$800,000 were possible with no change in the amount of the outstanding liability of the self-insurer. While there continues to be a need for the security constant to provide a margin for error and stability for self-insurers with a low volume of claims, the additional analysis concluded that the margin does not need to be as high as originally proposed.

The final-form regulations set forth a security constant of the Statewide average weekly wage (SAWW) multiplied by 300. Based on the current SAWW of \$561, the security constant for 1998 equals \$168,300. That security constant provides coverage for one claim of total disability for 5 years plus a margin for medical benefits. This will provide sufficient time to identify the potential cost of most claims. If a claim develop adversely, the Bureau will be able to adjust the security accordingly. Also with the addition of § 125.9(m), the Bureau retains authority to require these security adjustments even after a self-insurer terminates or nonrenews its self-insurance status.

The Department has also deleted the self-insurer's retention amount as one of the factors for determining the security constant in the final-form regulations. Since the Department believes that the SAWW multiplied by 300 is less than the retention amount of the excess insurance applying to all current self-insurers, the use of the retention amount as a factor for determining the security constant is unnecessary.

IRRC suggested that since the description of the security constant is actually a definition of a term which is used in several sections, the Department should relocate its description to § 125.2. The Department concurs with that recommendation and has added "security constant" to the terms defined under § 125.2.

2. Application of Amendments

The C & K Coal Company expressed concern that employers already on self-insurance runoff status would be unfairly required under the proposed amendments to provide additional security. Although the Department did not intend to subject current runoff self-insurers to the revised security requirements, the C & K Coal's comment demonstrated a need for clarification regarding the application of the regulatory amendments on applicants, self-insurers, runoff self-insurers, group self-insurance funds and runoff funds. As a result, the Department provides the following schedule for the application of the amendments as set forth in paragraph (d) of the Order.

3. Requirement for a Funding Trust

The Employers Service Corporation and Pennsylvania Services Corporation recommended that the Department clarify the conditions under which the Department would require the establishment of a funding trust under § 125.9(i). In response, the Department has added language to that section stating that a funding trust might be required when the Bureau has determined that a dedicated source of funds is needed to further ensure the timely payment of benefits. In the past, the Bureau has analyzed the self-insurer's payment of benefits in relationship to its resources in determining whether to require a funding trust. The Bureau will continue that practice under the amended regulations.

IRRC recommended that the trust provided for under § 125.9(i) be identified as a funding trust to distinguish it from a security trust, which is described under § 125.9(b)(2). The Department has adopted that recommendation.

The Department has also adopted another recommendation of IRRC to clarify § 125.9(i) for the conditions which a self-insurer must satisfy for a reduction in security under the subsection. The final-form regulations outline security reduction conditions which apply equally to situations when the establishment of a funding trust is required by the Bureau or when a self-insurer elects on its own to establish a funding trust.

4. Security Discounts Based on Debt Ratings

The Insurance Federation of Pennsylvania, Inc. recommended that as part of the final-form regulations' review process, an outside expert opine that the security discounts as in § 125.9(l) are appropriate when considered against the need for security.

The scrutiny applied by the rating agencies will ensure that only the most financially capable self-insured employers will qualify for the security discounts under § 125.9(l). Because the risk of default is low for those self-insured employers that meet the required debt ratings, the security discounts should have little effect on the injured workers' guaranty of benefits under the act. Further, the addition of § 125.9(m) provides further protection in this area since it provides the Department authority to make security adjustments on self-insured employers whose financial condition declines, even if they terminate self-insurance status. The Department will closely monitor the results of the security discounts under § 125.9(l) for any adverse affect they might have on injured workers. If adverse affects are noted, the Department will initiate appropriate corrective action.

5. Definitions of "Commonwealth" and "Political Subdivisions"

The Pennsylvania Turnpike Commission (Commission) communicated its concern that the Bureau would consider the Commission to be an instrumentality of the Commonwealth, which is required to post security, rather than the Commonwealth, which is exempt from the security requirement. Various laws of the Commonwealth treat the Commission as an agency of the Commonwealth. The Bureau agrees that it is correct to consider the Commission the Commonwealth for purposes of final-form regulations.

The Philadelphia Gas Works requested clarification on whether, as a political subdivision, it would be required under final-form regulations to maintain the trust fund it is required to establish under § 125.10 (relating to funding by public employer). The trust fund described

under § 125.10 is not security as that term is defined under § 125.2. Since neither the Act 57 amendments nor these amendments affect § 125.10, political subdivisions, as well as all other public employers except the Commonwealth, must continue to maintain the trust funds established under that section.

6. *Group Self-Insurance Loss-Cost Multiplier*

The Insurance Federation of Pennsylvania, Inc. questioned whether it is prudent to continue to benchmark group self-insurance contribution rates on SWIF rates under § 125.135. The amendments to § 125.135 require group self-insurers to file their own loss-cost multiplier, rather than use the loss-cost multiplier approved for SWIF. Group self-insurance funds also must use the loss-costs approved by the Insurance Commissioner for all insurers to recoup benefit payments under the act and the Occupational Disease Act unless the Bureau grants a request to deviate from those rates. The overall effect of the final-form regulations is the elimination of SWIF rates as the benchmark for group self-insurance fund rates.

The final-form regulations delete the second sentence of proposed § 125.135(b), which had permitted a fund to discount a member's contributions based on the Schedule Y premium discount used by the SWIF. Schedule Y discounting had originally been permitted to give group members the benefits of reduced contribution rates resulting from the efficiencies of the fund in administering, adjusting and servicing the large exposure base of a combined number of employers. Since these efficiencies will be reflected in a fund's loss-cost multiplier, specifically authorizing the Schedule Y discount is no longer needed. Although the deletion had not been in the proposed amendments, doing so will eliminate a redundancy in the final-form regulations. Funds affected by this change were notified of the proposed change by letter dated April 9, 1998.

7. *Workplace Safety Committee Discounts*

IRRC recommended that the phrase "regulations thereunder" in § 125.135(b) be replaced with a reference to the Health and Safety Statement of Policy which currently provides guidance for the approval of workplace safety committees under section 1002 of the act (77 P.S. § 1038.2). That statement of policy was published at 25 Pa.B. 3943 (September 16, 1995).

The Department intends to submit proposed amendments for workplace safety committees under the act later this year. Because of this, the Department hesitates referencing the statement of policy, which will be replaced under § 125.135(b). While the term "regulations thereunder" has been maintained in the final-form regulations, the Department will continue to use the Health and Safety Statement of Policy as guidance for the approval of workplace safety committees until regulations are published in that subject area.

IRRC further recommended other changes to the third sentence of § 125.135(b) to improve clarity. The Department has made those changes in the final-form regulations.

8. *Miscellaneous Clarity Concerns*

The term "International Accounting Standards Board" contained in the proposed rulemaking under § 125.3(c)(3)(i) should have read "International Accounting Standards Committee." The final-form regulations have been corrected accordingly.

Section 125.135(d) of the final rulemaking has been revised to clarify whether certain "its" and "it" used in the proposed regulatory amendments refer to the Bureau or to group self-insurance funds.

Fiscal Impact

Overall, the amendments will have a beneficial fiscal impact on most individual self-insured employers and group self-insurance funds affected by them. The amendments also will not affect the Bureau's costs of administering the self-insurance regulations.

By implementing Act 57's provisions expanding the self-insurance security requirement exemption to all self-insured political subdivisions, the Commonwealth and to group self-insurance funds comprised of political subdivisions, the regulatory amendments permit those entities to reduce the administrative costs of their self-insurance programs by eliminating associated costs for the security instruments as surety bonds and letters of credit.

The statutory amendment changing the independent ratings a bank must possess to post a letter of credit as self-insurance security increases the potential pool of banks acceptable for that purpose. This will increase competition among banks in providing letters of credit, which may reduce the self-insurers' cost in obtaining letters of credit.

The Act 57 amendment authorizing an association of employers to establish a consolidated board of trustees overseeing the operation of more than one group self-insurance fund may reduce the cost of operating the affected group self-insurance funds by permitting a consolidation of their service providers.

The regulatory amendments changing the formulas for calculating the amount of security materially reduces the required amount of security of one-third of the self-insured private employers, while it increases the amount of security of another one-fifth of the self-insurers. The total decrease in the amount of security is far greater than the amount of additional security required. The average increase in security will be no greater than \$200,000 per affected self-insurer, while individual security decreases will be as large as \$10 million. Those self-insurers required to increase their amount of security are those with a low volume of claims which do not possess an investment grade debt rating. The increase in security for these self-insurers is justified because of their vulnerability to dramatic increases in the value of their outstanding liability and their generally lower financial capacity to absorb those fluctuations.

Approximately 10% of the self-insured private employers will qualify for the 40% discount to their amount of security due to their superior debt rating while 20% of the current self-insured private employers will qualify for the 20% reduction in security.

The amendments permitting certain group self-insurance funds to charge contribution rates reflective of their own administrative costs rather than a standard administrative rate may reduce the contribution rates which those group self-insurance funds charge their members.

Since the amendments to the definition of "applicant" under § 125.2 and to §§ 125.3(c)(3)(1), 125.16 and 125.150(a) clarify existing regulations, they do not have a fiscal impact.

Affected Persons

The amendments relating to the elimination of security affects the Commonwealth and current and prospective individually self-insured political subdivisions and self-insurance funds comprised of political subdivisions. The amendments pertaining to group self-insurance expense charges and board of trustees affect current group self-insurance funds and prospective funds. The changes to the required ratings for banks posting letters of credit most directly affects the additional banks which now provide letters of credit, but also affects all self-insurers required to post security. The percentage of self-insured private employers affected by changes to the formulas for calculating security and the discounting of security is discussed previously.

Paperwork Requirements

Only the amendments to Subchapter B relating to individual fund loss-cost multipliers require additional paperwork. A fund shall complete and submit a form and supporting documentation to request Bureau approval of its proposed loss-cost multiplier. The potential savings should outweigh the paperwork requirement associated with the proposal.

Sunset Date

No sunset date is necessary for the final-form regulations. The final-form regulations are continuously monitored by the Workers' Compensation Advisory Council and by the Bureau in the day-to-day handling and processing of individual self-insurance and group self-insurance fund applications. If needed, corrections can be initiated based on information obtained by these operations.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P. S. § 745.5(a)), on November 7, 1997, the Department submitted a copy of the notice of proposed rulemaking, published at 27 Pa.B 6161 to IRRC and the Chairpersons of the House Labor Relations Committee and the Senate Committee on Labor and Industry for review and comment.

Under section 5(c) of the Regulatory Review Act, IRRC and the Committees were provided with copies of the comments received during the public comment period, as well as other documents when requested. In preparing these final-form regulations, the Department has considered all comments received from IRRC, stakeholders and the public.

Under section 5.1(d) of the Regulatory Review Act (71 P. S. § 745.5a(d)), these final-form regulations were deemed approved by the House and Senate Committees on September 8, 1998. IRRC met on September 10, 1998, and approved the amendments in accordance with section 5.1(e) of the Regulatory Review Act.

Contact Person

The contact person is George Knehr, Chief, Self-Insurance and Safety Division, Bureau of Workers' Compensation, Department of Labor and Industry, (717) 783-4476, 1171 South Cameron Street, Room 324, Harrisburg, PA 17104-2501.

Findings

The Department finds that:

(1) Public notice of intention to amend the administrative regulations amended by this order has been given under sections 201 and 202 of the act of July 31, 1988

(P. L. 769, No. 240) (45 P. S. §§ 1201 and 1202) and the regulations thereunder, 1 Pa. Code §§ 7.1 and 7.2.

(2) The amendment of the regulations of the Department in the manner provided in this order is necessary and appropriate for the administration and enforcement of the authorizing statute.

Order

The Department, acting under the authorizing statutes, orders that:

(a) The regulations of the Department, 34 Pa. Code Chapter 125, are amended by amending §§ 125.3, 125.16, 125.132—125.134, 125.148, 125.150, 125.152 and 125.202 to read as set forth at 27 Pa.B. 6161 (November 22, 1997); and by amending §§ 125.2, 125.9 and 125.135, to read as set forth in Annex A.

(b) The Secretary shall submit this order and Annex A to the Office of General Counsel and the Office of Attorney General for approval as to form and legality as required by law.

(c) The Secretary shall certify this order and Annex A and deposit them with the Legislative Reference Bureau as required by law.

(d) This order shall take effect upon publication in the *Pennsylvania Bulletin* with the following exceptions:

(i) The amendments to §§ 125.2, 125.3, 125.9(a) and (b), 125.16, 125.134, 128.148, 125.150, 125.152 and 125.202 applies to applicants, self-insurers, runoff self-insurers, group self-insurance funds, and runoff funds upon publication in the *Pennsylvania Bulletin*.

(ii) The amendments to § 125.9(d) and (i) and the addition of § 125.9(l) applies to a self-insurer upon commencement of the exemption period subsequent to final publication of the regulations in the *Pennsylvania Bulletin*.

(iii) Section 125.9(m) applies to a runoff self-insurer commencing that status after it has renewed its permit subsequent to final publication of the regulations in the *Pennsylvania Bulletin*.

(iv) The amendments to §§ 125.132, 125.133 and 125.135 applies to a group self-insurance fund for the fund year commencing after final publication of the amendments in the *Pennsylvania Bulletin*.

JOHNNY J. BUTLER,
Secretary

(Editor's Note: For the text of the order of the Independent Regulatory Review Commission relating to this document, see 28 Pa.B. 4845 (September 26, 1998).)

Fiscal Note: Fiscal Note 12-49 remains valid for the final adoption of the subject regulations.

Annex A

TITLE 34. LABOR AND INDUSTRY
PART VIII. BUREAU OF WORKERS'
COMPENSATION

CHAPTER 125. WORKERS' COMPENSATION
SELF-INSURANCE

Subchapter A. INDIVIDUAL SELF-INSURANCE

§ 125.2. Definitions.

The following words and terms, when used in this subchapter, have the following meanings, unless the context clearly indicates otherwise:

Act—The Workers' Compensation Act (77 P. S. §§ 1—1038.2).

Actuary—A member in good standing of the Casualty Actuarial Society or a member in good standing of the American Academy of Actuaries.

Affiliates—Employers which are closely related through common ownership or control.

Aggregate excess insurance—Insurance which provides that the excess insurer pays on behalf of or reimburses a self-insurer for its payment of benefits on claims incurred during a policy period in excess of the retention amount to the excess insurer's limit of liability.

Applicant—An employer requesting permission to initiate or to renew self-insurance, an employer requesting permission for it and its affiliates or subsidiaries to initiate or to renew self-insurance, or a parent company requesting permission for its subsidiaries to initiate or to renew self-insurance.

Bureau—The Bureau of Workers' Compensation of the Department.

Cash flow protection amount—The maximum amount of benefits a self-insurer pays over a 2-year period on an occurrence without reimbursement from an excess insurer under a specific excess insurance policy with a per year per occurrence cash protection plan.

Claims service company—An individual, corporation, partnership or association engaged in the business of servicing a self-insurer's claims, including the adjusting and handling of claims, the payment of benefits and the provision of required reports.

Commonwealth—

(i) The government of the Commonwealth, including the following:

(A) The courts and other officers or agencies of the unified judicial system.

(B) The General Assembly, and its officers and agencies.

(C) The Governor, and the departments, boards, commissions, authorities and officers and agencies of the Commonwealth.

(ii) The term does not include any instrumentalities of the Commonwealth or political subdivisions.

Department—The Department of Labor and Industry of the Commonwealth.

Employer—An employer as defined in section 103 of the act (77 P. S. § 21) or under section 103 of the Occupational Disease Act (77 P. S. § 1203), or both.

Excess insurer—An insurance company authorized to transact the class of insurance listed in section 202(c)(14) of The Insurance Company Law of 1921 (40 P. S. § 382(c)(14)).

Instrumentality of the Commonwealth—An employer, politic and corporate, exercising an essential government function. The term does not include the Commonwealth or any political subdivisions.

Loss development—The tendency of the cost of a group of claims to increase as they mature.

Occupational Disease Act—The Pennsylvania Occupational Disease Act (77 P. S. §§ 1201—1603).

Parent company—A corporation which owns a majority of the voting stock of an employer or controls a majority

of the employer's board of directors appointments if the employer has no voting stock.

Permit—The document issued by the Bureau to an employer which authorizes the employer to operate as a self-insurer.

Political subdivision—A county, city, borough, incorporated town, township, school district, vocational school district and county institution district, municipal authority, or other entity created by a political subdivision under law.

Private employer—An employer who is not a public employer as defined in this section.

Public employer—The Commonwealth, an instrumentality of the Commonwealth or a political subdivision.

Quick assets—The sum of an applicant's cash, cash equivalents, current receivables and marketable securities.

Retention amount—The maximum amount of benefits a self-insurer pays without reimbursement from the excess insurer under an aggregate excess insurance policy or under a specific excess insurance policy which does not include an annual cash flow protection plan. The term also includes the maximum amount of benefits a self-insurer pays on each occurrence without reimbursement from the excess insurer, if any, under a specific excess insurance policy which includes an annual cash flow protection plan.

Runoff self-insurer—An employer that had been a self-insurer but no longer maintains a current permit.

Security—Surety bonds, letters of credit or cash or negotiable government securities held in trust to be used for the payment of a self-insurer's workers' compensation liability upon order of the Bureau if the self-insurer fails to pay its liability due to its financial inability or due to the self-insurer filing for bankruptcy or being declared bankrupt or insolvent.

Security constant—The Statewide average weekly wage multiplied by 300.

Self-insurance—The privilege granted to an employer which has been exempted by the Bureau from insuring its liability under section 305 of the act (77 P. S. § 501) and section 305 of the Occupational Disease Act (77 P. S. § 1405).

Self-insurer—An employer which has been granted the privilege to self-insure its liability and to maintain direct responsibility for the payment of this liability under the act and the Occupational Disease Act. The term includes a parent company or affiliate which has assumed a subsidiary's or an affiliate's liability upon the termination of the parent-subsidiary or affiliate relationship.

Specific excess insurance—Insurance which provides that the excess insurer pays on behalf of or reimburses a self-insurer for its payment of benefits on each occurrence in excess of the retention amount to the excess insurer's limit of liability.

Statewide average weekly wage—The amount calculated and reported by the Bureau under section 105.1 of the act (77 P. S. § 25.1).

Subsidiary—An employer whose voting stock or board of directors appointments are controlled by a parent company.

§ 125.9. Security requirements.

(a) This section applies to self-insured employers except the Commonwealth and political subdivisions. A private employer shall provide security in an amount as set forth in subsection (d). An instrumentality of the Commonwealth shall provide security in the minimum amount of the security constant rounded upward to the nearest hundred thousand or in a greater amount as determined by the Bureau to protect employes and their dependents against temporary interruptions in the payment of benefits by the self-insurer. The security required in this section is not a substitute for the applicant demonstrating its financial ability to pay compensation under the act and the Occupational Disease Act. A self-insurer's security may be adjusted annually or more frequently as determined by the Bureau.

(b) The following forms of security are acceptable:

(1) A surety bond on a form prescribed by the Bureau issued by a company authorized to transact surety business in this Commonwealth by the Insurance Department.

(i) The surety company shall possess a current A. M. Best Rating of B+ or better or a Standard and Poor's rating of claims paying ability of A or better.

(ii) The self-insurer shall replace the bond with a new bond issued by a surety company with an acceptable rating or with another acceptable form of security if the surety company's rating falls below the acceptable rating after the bond is issued. If the bond is not replaced within 60 days, the Bureau will have discretion to draw on the surety bond and deposit the proceeds with the State Treasurer to secure the self-insurer's liability.

(2) A security deposit held under a trust agreement prescribed by the Bureau and maintained for the benefit of employes of the self-insurer:

(i) The deposit shall consist of cash; bonds or other evidence of indebtedness issued, assumed or guaranteed by the United States of America, or by an agency or instrumentality of the United States; investments in common funds or regulated investment companies which invest primarily in United States Government or Government agency obligations; or bonds or other security issued by the Commonwealth and backed by the Commonwealth's full faith and credit.

(ii) The securities shall be held in a Commonwealth chartered bank and trust company or trust company as defined in section 102 of the Banking Code of 1965 (7 P. S. § 102) or a Federally chartered bank or foreign bank with a branch office and trust powers in this Commonwealth.

(3) An irrevocable letter of credit using language required by the Bureau issued by and payable at a branch office of a commercial bank located in the continental United States, Alaska or Hawaii. The letter of credit shall state that the terms of the letter of credit automatically renew annually unless the letter of credit is specifically nonrenewed by the issuing bank 60 days or more prior to the anniversary date of its issuance:

(i) At the time of issuance of the letter of credit, the issuing bank or its holding company shall have a B/C or better rating or 2.5 or better score by Thomson

BankWatch or the issuing bank shall have a CD rating of BBB or better by Standard & Poor's Corporation.

(ii) The self-insurer shall replace the letter of credit with a new letter of credit issued by a bank with an acceptable credit rating or with another acceptable form of security if a bank's rating falls below the acceptable rating after the letter of credit is issued. If the letter of credit is not replaced within 60 days, the Bureau will draw on the letter of credit and will deposit the proceeds to secure the self-insurer's liability.

(iii) The applicant shall execute a trust agreement on a form prescribed by the Bureau with a Commonwealth chartered bank and trust company or trust company as defined in section 102 of the Banking Code of 1965 or a Federally chartered bank or foreign bank with a branch office and trust powers in this Commonwealth. The trust agreement will accommodate proceeds from a letter of credit drawn on by the Bureau.

(c) Affiliates included under a consolidated permit under § 125.4(a) (relating to application for affiliates and subsidiaries) must be included together under the forms of security provided. For purposes of this section, affiliates included under a consolidated permit are considered to be one self-insurer.

(d) The amount of security required of self-insured private employers is as described in paragraphs (1)—(4).

(1) For a new self-insurer, the Bureau will determine the amount of security. The initial security will be no less than the amount of the applicant's total greatest annual insured incurred workers' compensation losses in this Commonwealth during the 3 complete policy years prior to its application plus the security constant and rounded upward to the nearest hundred thousand.

(2) For those who have been approved for self-insurance for more than 1 year but less than 3 years, the amount of security is the greater of that outlined in paragraph (1) or 100% of the self-insurer's outstanding liability net of excess insurance recoveries, as adjusted by its history of loss development by the Bureau or as projected by an actuary, plus the security constant and rounded upward to the nearest hundred thousand.

(3) For those who have been approved for self-insurance for 3 or more years, the amount of security is 100% of the self-insurer's outstanding liability net of excess insurance recoveries, as adjusted by its history of loss development by the Bureau or as projected by an actuary, plus the security constant and rounded upward to the nearest hundred thousand.

(4) Notwithstanding this subsection, the Bureau may require security in an amount greater than outlined in this section if it finds that the security resulting from the description in paragraphs (1)—(3) would not be adequate to secure fully and guarantee the payment of incurred and future benefits to each self-insurer's employes.

(e) A self-insurer wishing to refute the Bureau's adjustment of its outstanding liability by its history of loss development may do so by providing a report prepared by an actuary.

(f) Only a projection of a self-insurer's outstanding liability prepared by an actuary may be discounted to present value. The present value discount rate will be no more than the current yield of a 30-year United States Treasury bond.

(g) The Bureau may make adjustments to the loss development procedures it deems appropriate under the circumstances if the Bureau believes that a self-insurer has changed its reserving methodology in such a way as to invalidate loss development factors based on past experience. The Bureau may further require the self-insurer to obtain the services of an actuary to project its outstanding liability or require an appropriate party to conduct an audit of the self-insurer's claims reserves.

(h) The Bureau may reduce the amount of security required of a self-insurer under subsection (d) if the self-insurer confirms that liabilities under the act and the Occupational Disease Act are funded through a Black Lung Benefits Trust established under section 501(c)(21) of the Internal Revenue Code of 1986 (26 U.S.C.A. § 501(c)(21)).

(i) The Bureau may reduce the amount of security required of a self-insurer under subsection (d) to no less than the security constant rounded upward to the nearest hundred thousand if the self-insurer establishes a funding trust to provide a source of funds for the payment of its liability. A self-insurer may elect to establish funding a trust or it may be required by the Bureau to establish a funding trust where the Bureau determines that a dedicated source of funds is needed to further ensure the timely payment of the self-insurer's liability. In either case, the following conditions shall be met:

(1) The trust agreement shall be in a form prescribed by the Bureau.

(2) The trust assets shall be held in a Commonwealth chartered bank and trust company or trust company as defined in section 102 of the Banking Code of 1965 or a Federally chartered bank or foreign bank with a branch office and trust powers in this Commonwealth.

(3) The value of the trust fund shall be adjusted at least annually to the required funding level as determined by the Bureau or an actuary.

(j) A self-insurer with security as of October 14, 1995, which is less than the level of security required by subsection (d) may be permitted to phase in the level of required security over a maximum of 3 years. The Bureau will determine the terms of the phase-in period, including the length of time and the annual adjustments.

(k) The Bureau will not grant a request for a reduction in or release of security by a runoff self-insurer until at least 1 year has passed since the termination of its self-insurance status or the runoff self-insurer provides a certificate of insurance evidencing that its self-insurance liability has been assumed by an authorized workers' compensation carrier. Requests shall be supported by a report prepared by an actuary projecting the runoff self-insurer's outstanding workers' compensation obligation, a claims reserves analysis prepared by an appropriate party or a certificate of insurance evidencing assumption of self-insurance liability. The Bureau will consider but is not bound by the findings of the reports in deciding security reduction or release requests.

(l) The amount of security required of a self-insurer under subsection (d) shall be discounted by 40% and rounded upward to the nearest hundred thousand if the debt of the self-insurer or of the affiliate guarantying the self-insurer's liability is rated Aaa or Aa by Moody's Investors Services or AAA or AA by Standard & Poor's Corporation. The amount of security required of a self-insurer under subsection (d) shall be discounted by 20% and rounded upward to the nearest hundred thousand if the debt of the self-insurer or of the affiliate guarantying

the self-insurer's liability is rated A or Baa by Moody's Investors Services or A or BBB by Standard & Poor's Corporation. A self-insurer receiving one of the discounts outlined in this subsection shall increase its security to the amount required under subsection (d) as limited by this subsection, if applicable, if the debt rating of the self-insurer or of its guarantying affiliate is downgraded to below the rating qualifying it for the discount.

(m) Termination of self-insurance status may not relieve a runoff self-insurer from the obligation to provide security under this section, including the obligation to provide additional security due to increases in the value of its outstanding liability.

§ 125.135. Classification system; experience rating; contribution rates.

(a) A fund shall adhere to the uniform classification system and uniform experience rating plan filed with the Commissioner of the Insurance Department by a rating organization under Article VII of the act (77 P. S. §§ 1035.1—1035.22).

(b) A fund shall base its member contribution rates on no less than the current effective loss costs plus the fund's approved loss-cost multiplier. A fund may also reduce a member's contribution rates for up to 5 years by 5% if the member establishes a workplace safety committee which received certification by the Department and continues to meet certification requirements under section 1002 of the act (77 P. S. § 1038.2) and regulations thereunder.

(c) No later than 45 days prior to the beginning of a fund year, a fund may request the Bureau's permission to change its loss-cost multiplier for member contributions payable during that next fund year. The request to change a fund's loss-cost multiplier shall be on a form prescribed by the Bureau. The fund may support its loss-cost multiplier request with a report prepared by an independent actuary but an actuarial report is not required.

(d) If the Bureau determines that the loss-cost multiplier requested under subsection (c) is unreasonably low, so that it impairs the fund's ability to meet its expenses, the Bureau will notify the fund that the loss-cost multiplier request is denied. The notification will be sent to the fund no later than 30 days after the filing of the request. Use of a loss-cost multiplier which has not been approved by the Bureau shall result in the revocation of the fund's permit under section 805(a) of the act (77 P. S. § 1036.5).

(e) No later than 45 days prior to the beginning of a fund year following its third year of operation, a fund may request permission of the Bureau to deviate from the uniform classification system, uniform experience rating plan, loss costs and discounts outlined in subsections (a) and (b), including the use of retrospectively rated and deductible plans. An applicant comprised of a majority of prospective members who are participants in a group insurance purchase cooperative/safety group for at least 3 years prior to the submission of its application or comprised of a majority of prospective members who are political subdivisions approved as self-insurers under section 305 of the act (77 P. S. § 501) may also request permission of the Bureau to deviate from the requirements of subsections (a) and (b).

(f) A deviation request under subsection (e) shall be supported by a report prepared by an independent actuary projecting the incurred loss experience of the fund for

its next fund year by various levels of actuarial confidence and rendering an opinion that the total contributions received if the deviation is permitted will be adequate to satisfy the applicant's obligations and expenses. A request for deviation from the loss costs of a rating organization shall include a schedule of the loss costs proposed for the fund year.

(g) If the Bureau determines that the deviation requested under subsection (e) may impair the fund's ability to meet its obligations, it will notify the fund that

the deviation request is denied. The notification will be sent to the fund no later than 30 days after the filing of the request. Use of loss costs which have not been approved by the Bureau will result in the revocation of the fund's permit under section 805(a) of the act (77 P. S. § 1036.5).

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