

Report on Extension of Payroll Limitations

Excerpts from the WCIRB Classification and Rating Committee Agenda & Minutes
February 11, 2020

About this Report

The WCIRB prepares and presents reports to the WCIRB's Classification and Rating Committee to assist in the formulation of proposed changes to the Insurance Commissioner's regulations. Once adopted by the Classification and Rating Committee, the recommendations contained in the report are provided to the WCIRB Governing Committee and may be included in a WCIRB regulatory filing that is submitted to the Insurance Commissioner for approval.

About the WCIRB

The WCIRB is California's trusted, objective provider of actuarially-based information and research, advisory pure premium rates, and educational services integral to a healthy workers' compensation system. Learn more at www.wcirb.com.

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Report on Extension of Payroll Limitations

- 8601(1), Engineers – consulting – mechanical, civil, electrical or mining engineers or architects – not engaged in actual construction or operation – including Outside Salespersons and Clerical Office Employees**
- 8601(2), Oil or Gas Geologists or Scouts – including mapping of subsurface areas – including Outside Salespersons and Clerical Office Employees**
- 8601(4), Forest Engineers – including Outside Salespersons and Clerical Office Employees**
- 8741, Real Estate Agencies – all employees – including Clerical Office Employees and Outside Salespersons**
- 8749, Mortgage Bankers – all employees – including Clerical Office Employees and Outside Salespersons**
- 8801, Credit Unions – all employees – including Clerical Office Employees and Outside Salespersons**
- 8808, Banks – all employees – including appraisers, bank guards and attendants, field auditors, office machine repair, Clerical Office Employees and Outside Salespersons**
- 8822, Insurance Companies – all employees – including Clerical Office Employees and Outside Salespersons**

Background and Objective

Payroll, also referred to as remuneration, is used as a proxy for measuring exposure to workers' compensation losses for ratemaking and experience rating purposes. Remuneration is reasonably correlated with losses and can be audited and validated against other documents that are reported to state or federal government agencies.

However, given the wide dispersion of payroll among highly compensated employees and concerns as to the lack of correlation of exposure to loss at very high wage levels, the *California Workers' Compensation Uniform Statistical Reporting Plan—1995* (USRP) includes limitations on an individual's annual payroll for workers' compensation purposes for certain types of highly compensated employees. These include executive officers, partners, individual employers and members of a limited liability company as well as employees in several classifications related to entertainers and athletes.

As part of the WCIRB's continuing efforts to analyze payroll as the basis of workers' compensation premium, the WCIRB completed a study in 2018 and found that at very high wage levels there is no evidence of increasing exposure to workers' compensation losses with increasing wage levels. As a result, the WCIRB determined that it is appropriate to apply payroll limitations to classifications that (a) have unusually high levels of employees with wages above the current USRP annual payroll maximum, (b) have relatively low advisory pure premium rates that are likely driven by the high wage levels in the industry and (c) include all employees so that any payroll limitation could be administered in a relatively straightforward manner. As part of that study, the WCIRB identified five classifications¹ that met these criteria and, in the January 1, 2019 Regulatory Filing, the WCIRB proposed and the Insurance Commissioner adopted limitations to payroll for those five classifications to be effective January 1, 2020. In the January 1, 2020 Pure Premium Rate Filing, the WCIRB recommended and the Insurance Commissioner adopted adjustments to the advisory pure premium rates for those five classifications to reflect the estimated amount of payroll to be eliminated by the limitation. For 2020, the USRP annual payroll limitation for all of these above-mentioned highly compensated employees is \$139,100 per year.²

For this year's study, the WCIRB used these same criteria to identify several more classifications. The WCIRB reviewed all standard classifications and, for classifications that met the stated requirements, the WCIRB considered whether to recommend limiting individual employees' annual payroll. In completing this analysis, the WCIRB used publicly available sources of wage information by industry to estimate the

¹ Classifications 7607(1), *Video Post-Production*; 7607(2), *Audio Post-Production*; 8803, *Auditing, Accounting, or Management Consulting Services*; 8859(1), *Computer Programming or Software Development*; 8859(2), *Internet or Web-Based Application Development or Operation*; 8820, *Law Firms*; and 8743, *Mortgage Brokers*.

² The limit is adjusted annually for wage inflation.

payroll to be eliminated in each classification due to imposition of the payroll limitation and the resultant potential adjustment to advisory future pure premium rates.

Analysis and Findings

To assess the variability of losses with payroll at high wage levels, the WCIRB reviewed California wage data by industry and occupation from the American Community Survey (ACS) published by the United States Census Bureau and policy year 2017 unit statistical data.

Given the lack of evidence of increasing exposure to workers' compensation losses at high wage levels as well as potential limitations and large swings when changing advisory pure premium rates and expected loss rates for classifications for which those rates are very low, the WCIRB identified several additional classifications for which limiting each employees' annual payroll would be appropriate. Specifically, the WCIRB identified the following classifications that (a) have unusually high levels of employees with wages above the current USRP annual payroll maximum, (b) have relatively low advisory pure premium rates that are likely driven by high wage levels in the industry and (c) include all employees so that the limitation would be applied on a relatively uniform basis to employers with operations assigned to the classification:

- 8601(1), *Engineers – consulting – mechanical, civil, electrical or mining engineers or architects – not engaged in actual construction or operation – including Outside Salespersons and Clerical Office Employees*
- 8601(2), *Oil or Gas Geologists or Scouts – including mapping of subsurface areas – including Outside Salespersons and Clerical Office Employees*
- 8601(4), *Forest Engineers – including Outside Salespersons and Clerical Office Employees*
- 8741, *Real Estate Agencies – all employees – including Clerical Office Employees and Outside Salespersons*
- 8749, *Mortgage Bankers – all employees – including Clerical Office Employees and Outside Salespersons*
- 8801, *Credit Unions – all employees – including Clerical Office Employees and Outside Salespersons*
- 8808, *Banks – all employees – including appraisers, bank guards and attendants, field auditors, office machine repair, Clerical Office Employees and Outside Salespersons*
- 8822, *Insurance Companies – all employees – including Clerical Office Employees and Outside Salespersons*

In general, average indemnity and medical claim severities increase with higher wages up to the approximate level of the current USRP payroll limitation.³ However, as shown in Figure 1, there was little variation in claim severities at wage levels above that amount for the selected classes.

³ The 2020 USRP annual payroll maximum corresponds to a weekly wage of \$2,675.

Figure 1: Average Severity on Indemnity Claims by Wage Level (Selected Classes)

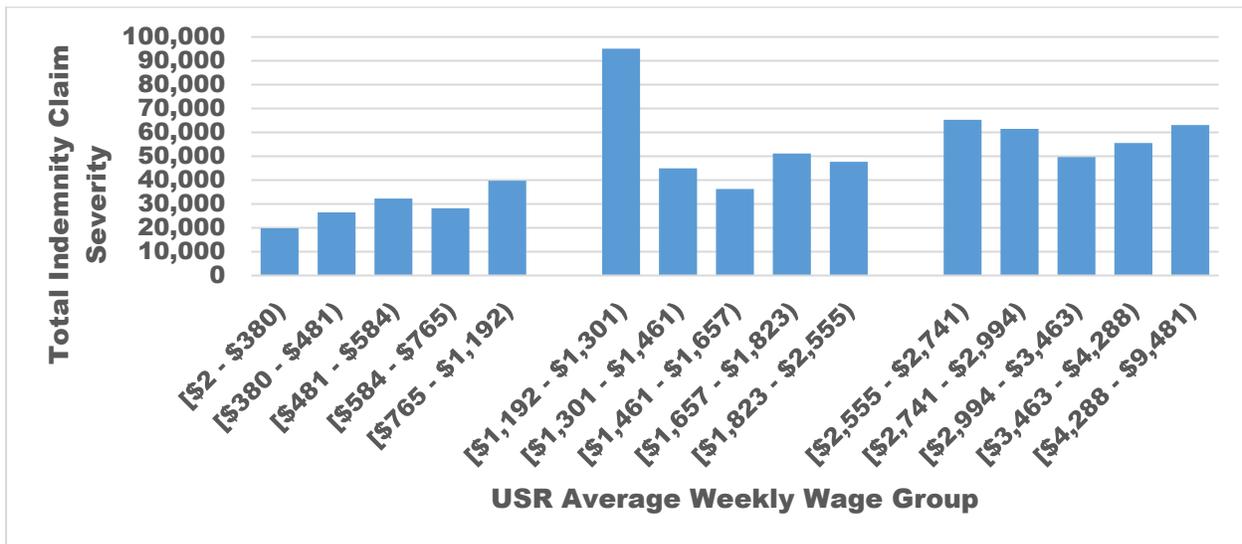
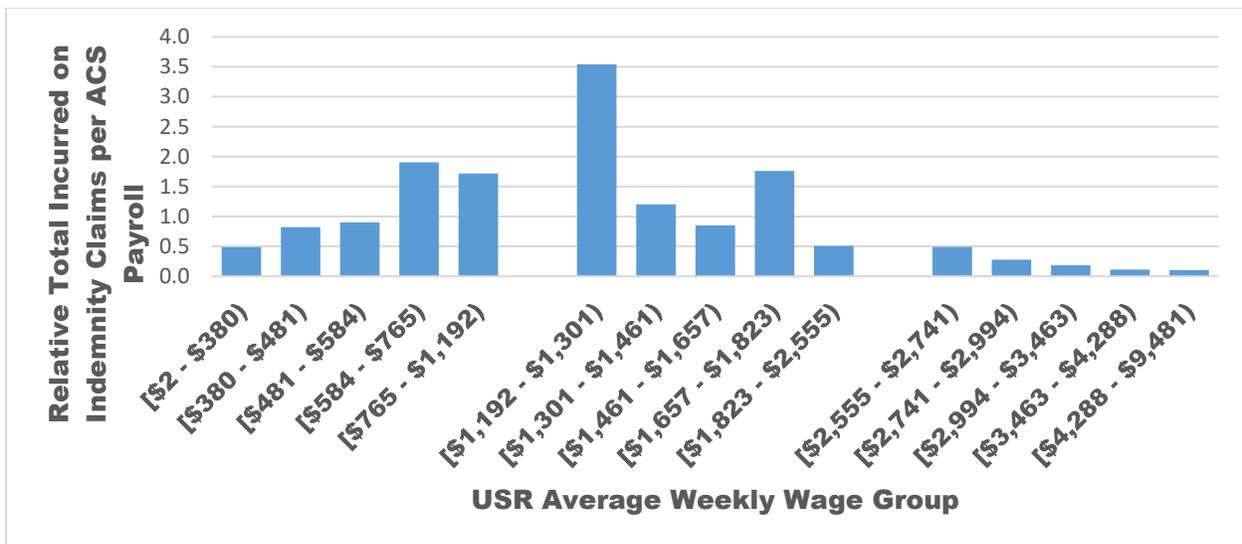


Figure 2 shows an estimated distribution of total losses on indemnity claims per ACS payroll by wage level interval for the selected classes based on ACS data and policy year 2017 unit statistical data. As shown, when considering the impact of claim frequency differences, claim costs generally decreased as higher wage levels increased. For Policy Year 2017, the USRP payroll limitation was equivalent to an average weekly wage of \$2,350. The WCIRB reviewed similar data for all industries and saw relatively similar results.

Figure 2: Relative Total Incurred per ACS payroll by Wage Level Interval (Selected Classes)



The WCIRB's preliminary analysis of ACS wage data suggests that the amount of payroll for each of these identified classifications in excess of the current USRP payroll limitation is very significant, ranging from approximately 14% to 31%. As a result, in order for the implementation of a payroll limitation in these classifications to be pure premium neutral, significant adjustments to the advisory pure premium rates for these classifications would be needed. These adjustments would be computed in a similar manner to the adjustments for the five classifications subject to the annual payroll maximum effective in 2020. Figure 3 shows the preliminary estimates of the portion of payroll which would be eliminated for each class.

Figure 3: Preliminary Estimated Share of Payroll to be Eliminated by Class

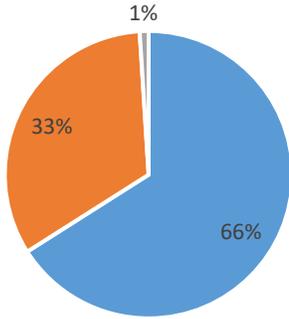
Class Code	Estimated Payroll Eliminated
8601	14%
8741	31%
8749	28%
8801	23%
8808	23%
8822	20%

The WCIRB evaluated available data sources to develop factors to adjust historical insured payrolls used in the classification relativity process to a basis with a maximum payroll limitation. The ACS data provides sufficiently refined data to estimate the share of wages and salaries expected to be above the given annual salary thresholds for select occupations and industries. The data is available at both occupation and industry levels, and can be used either independently or in combination. Additionally, the ACS allows the exclusion of data for officers of companies, as these payrolls are already generally limited for workers' compensation purposes.

The appropriateness of developing adjustment factors from the ACS data relies on an adequate mapping between WCIRB classifications and ACS industries or occupations for which statewide worker wage information is available.⁴ WCIRB staff determined a mapping that they believe appropriate for each of the selected classifications. These mappings are summarized below.

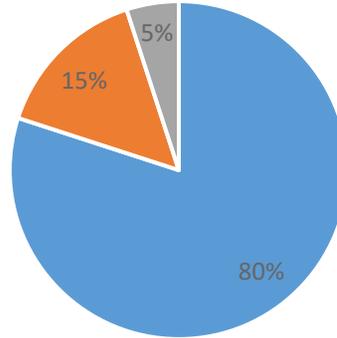
⁴ In addition to an appropriate mapping between classifications and industries or occupations, there are definitional differences among the available data sources on California wages. The WCIRB reviewed the definitions of wages and salaries in the available data sources and determined that the Bureau of Labor Statistics (BLS) wage series most closely approximates insured payrolls. The BLS series is the same used to on-level wages in aggregate ratemaking and for which the UCLA Anderson Forecast provides forecasts, but does not include information showing a distribution of wages within an industry. The BLS wage series includes income items such as profit sharing and stock bonuses that are not included in the ACS wage data but, for the most part, are included in insured payrolls. If needed, the WCIRB could correct for this in the advisory pure premium rate adjustment for each classification to be limited by adjusting the ACS source data to bring the average ACS wage level to the BLS level in the development of proposed advisory pure premium rates for each of the limited classifications.

8601 - Engineers



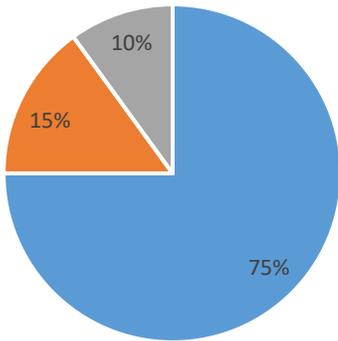
- Engineering Services
- Management, Scientific, and Technical Consulting Services
- Logging

8741 - Real Estate Agencies



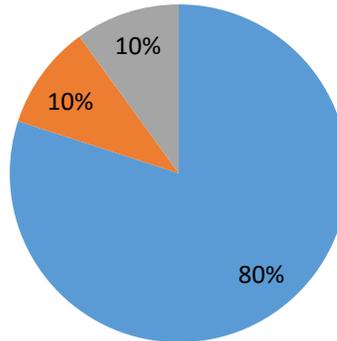
- Real Estate
- Management of Companies and Enterprises
- Residential Building Construction

8749 - Mortgage Bankers

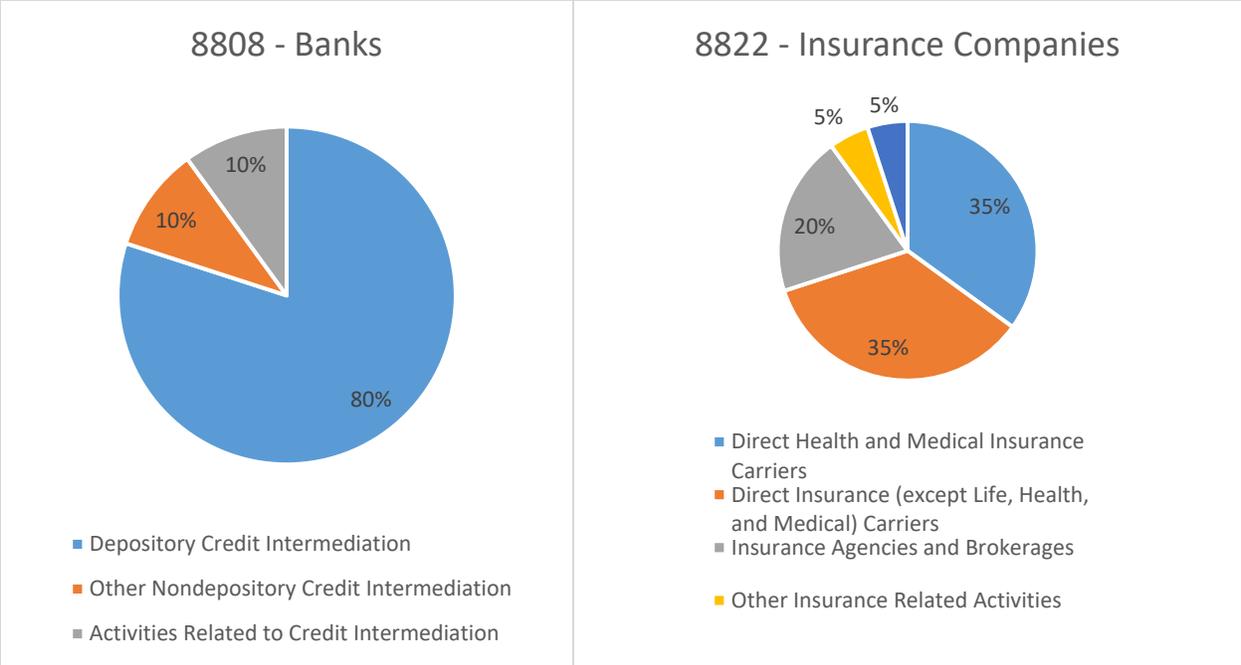


- Other Nondepository Credit Intermediation
- Other Investment Pools and Funds
- Activities Related to Credit Intermediation

8801 - Credit Unions



- Depository Credit Intermediation
- Other Nondepository Credit Intermediation
- Activities Related to Credit Intermediation



Recommendations

Based on the analysis summarized above, the WCIRB recommends that individual employee’s annual payroll developed in Classifications 8601(1), 8601(2), 8601(4), 8741, 8749, 8801, 8808 and 8822 be subject to the USRP annual payroll limitation. Given the impact of this change on employers with operations in the affected classifications, as well as on producers, premium auditors and underwriters, the WCIRB also recommends including these changes in the September 1, 2021 Regulatory Filing with a proposed effective date of September 1, 2022. If adopted by the Insurance Commissioner, this will allow the WCIRB to conduct extensive outreach prior to the September 1, 2022 effective date. Additionally, if these changes are adopted by the Commissioner, the WCIRB will propose adjusted advisory pure premium rates and classification expected loss rates in the September 1, 2022 Pure Premium Rate and Regulatory Filings to reflect the estimated reduction in reported exposure in each classification resulting from application of the limitation as outlined above.

Recommendation

Amend Classification 8601(1), *Engineers*, to limit an employee's annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

ENGINEERS – consulting – mechanical, civil, electrical or mining engineers or architects – not engaged in actual construction or operation – including Outside Salespersons and Clerical Office Employees **8601(1)**

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to engineering or architectural consultants who provide technical advice to construction companies, land development companies, building contractors or similar concerns on a fee basis, or to the testing of construction building materials in connection with consulting engineering performed by the same employer. This classification also applies to land surveying prior to or during construction for separate concerns on a fee basis.

Engineering, when performed in support of an employer's own manufacturing, processing or construction operations, is assigned to the applicable manufacturing, processing or construction classification or to the applicable Standard Exception classification.

This classification also applies to fee-based construction management companies that do not engage in or supervise construction operations, but serve as an intermediary between the general contractor and project owner, or otherwise provide expertise regarding a construction project.

Forest engineers shall be classified as 8601(4), *Forest Engineers*.

Oil or gas geologists or scouts shall be classified as 8601(2), *Oil or Gas Geologists or Scouts*.

Fee-based testing operations, including but not limited to the testing of air, water, soil, metal, concrete and other building materials not resulting in recommendations, remediation options or design advice shall be classified as 4511, *Analytical or Testing Laboratories*.

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Recommendation

Amend Classification 8601(2), *Oil or Gas Geologists or Scouts*, which is part of the *Petroleum Industry Group*, to limit an employee's annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

PETROLEUM INDUSTRY

OIL OR GAS GEOLOGISTS OR SCOUTS – including mapping of subsurface areas – including Outside Salespersons and Clerical Office Employees **8601(2)**

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to geologists or scouts who travel to potential oil drilling sites to observe and gather data that is compiled into reports that describe the probability that oil or gas

deposits are present. This classification includes analyzing technical data from monitoring instruments and analyzing drilling mud or well cuttings to identify the types of subsurface formations in the region and the presence of hydrocarbons. This classification also applies to the geophysical exploration of subsurface areas using physical methods, including but not limited to seismic, gravitational, magnetic, electrical and electromagnetic methods to measure the physical properties of rock.

Consulting engineers, including but not limited to civil, electrical, mechanical and mining engineers who do not perform oil or gas related operations as described above shall be classified as 8601(1), *Engineers*.

Geologists or scouts who perform outside operations in connection with oil or gas well drilling or redrilling, oil or gas lease operations, or oil or gas pipeline operations by the employer shall be assigned to the applicable *Petroleum* Industry Group classification.

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Recommendation

Amend Classification 8601(4), *Forest Engineers*, to limit an employee's annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

FOREST ENGINEERS – including Outside Salespersons and Clerical Office Employees 8601(4)

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification includes timber cruising.

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Recommendation

Amend Classification 8741, *Real Estate Agencies*, to limit an employee's annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

REAL ESTATE AGENCIES – all employees – including Clerical Office Employees and Outside Salespersons 8741

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to real estate agencies that represent buyers, sellers, lessees and lessors in real estate transactions.

The operation or management of rental property, construction and remodeling operations shall be separately classified.

This classification also applies to non-residing leasing agents of a property management company who are engaged exclusively in the rental or leasing of property to clients and who have no other duties of any kind except clerical office work and the property management company retains separate employees to manage the property.

Employers that specialize in residential and commercial mortgage brokerage or mortgage banking operations that do not engage in the direct lending of mortgage funds shall be classified as 8743, *Mortgage Brokers*.

Employers that specialize in the direct lending of funds for residential and commercial mortgages shall be classified as 8749, *Mortgage Bankers*.

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Recommendation

Amend Classification 8749, *Mortgage Bankers*, to limit an employee’s annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

MORTGAGE BANKERS – all employees – including Clerical Office Employees and Outside Salespersons 8749

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to companies that specialize in direct lending of funds for residential or commercial mortgages. This classification includes loaning money held on deposit and funding loans through a line of credit.

Commissioned loan brokers engaged exclusively in matching qualified mortgage applicants with lenders with no direct lending of funds shall be classified as 8743, *Mortgage Brokers*.

Real estate agencies that represent buyers, sellers, lessees and lessors in real estate transactions shall be classified as 8741, *Real Estate Agencies*.

The operation of depository financial institutions that are licensed as banks to perform financial services, including but not limited to accepting deposits, paying interest, clearing checks, making loans and exchanging currency, shall be classified as 8808, *Banks*.

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Recommendation

Amend Classification 8801, *Credit Unions*, to limit an employee’s annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

CREDIT UNIONS – all employees – including Clerical Office Employees and Outside Salespersons 8801

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to not-for-profit, member-owned depository financial institutions that are chartered as federal or state credit unions providing financial services, including but not limited to share draft accounts, individual retirement accounts, savings accounts, travelers' checks and consumer and commercial loans.

Commissioned loan brokers engaged exclusively in matching qualified mortgage applicants with lenders with no direct lending of funds shall be classified as 8743, *Mortgage Brokers*.

Companies that specialize in direct lending of funds for residential or commercial mortgages shall be classified as 8749, *Mortgage Bankers*.

Real estate agencies that represent buyers, sellers, lessees and lessors in real estate transactions shall be classified as 8741, *Real Estate Agencies*.

The operation of depository financial institutions that are licensed as banks to perform financial services, including but not limited to accepting deposits, paying interest, clearing checks, making loans and exchanging currency shall be classified as 8808, *Banks*.

The operation of properties away from the credit union premises, including but not limited to trusts, repossessed properties and other business properties shall be separately classified.

* * * * *

Recommendation

Amend 8808, *Banks*, to limit an employee's annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

BANKS – all employees – including appraisers, bank guards and attendants, field auditors, office machine repair, Clerical Office Employees and Outside Salespersons 8808

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to the operation of depository financial institutions that are licensed to perform financial services, including but not limited to accepting deposits, paying interest, clearing checks, making loans and exchanging currency. This classification also applies to depository financial institutions that operate entirely online or through electronic transactions.

The operation of properties away from the bank premises, including but not limited to trusts, repossessed properties and other business properties shall be separately classified.

Mortgage brokers shall be classified as 8743, *Mortgage Brokers*.

Mortgage bankers shall be classified as 8749, *Mortgage Bankers*.

Credit unions shall be classified as 8801, *Credit Unions*.

Check cashing locations at which the fees charged for check cashing, deferred deposit transactions, money orders and wire transfers equal or exceed 75% of gross receipts shall be classified as 8850, *Check Cashers*.

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Recommendation

Amend Classification 8822, *Insurance Companies*, to limit an employee's annual payroll to \$XXX,XXX and direct that the maximum payroll amount shall be prorated based upon the number of weeks in the policy period when the policy is in force for less than a 12-month period.

PROPOSED

INSURANCE COMPANIES – all employees – including Clerical Office Employees and Outside Salespersons 8822

The entire remuneration of each employee shall be included, subject to a maximum of \$XXX,XXX per year. When the policy is in force for less than a 12-month period, the maximum payroll amount shall be prorated based upon the number of weeks in the policy period.

This classification applies to employers licensed by the California Department of Insurance as insurance companies to underwrite a variety of commercial or personal coverages, including but not limited to health, disability, automobile, property, title, liability, workers' compensation, life and annuity insurance, and surety bonds.

Fee-based inspections for insurance, safety or valuation purposes shall be classified as 8720(1), *Inspection for Insurance, Safety or Valuation Purposes*.

The operations performed by insurance administrators, brokers, agents or adjustors who are not employed by a licensed insurance company shall be assigned to the employer's standard classification or to the applicable Standard Exception classification.

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