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March 24, 2004

By facsimile and US Mail

Honorable Senator Royal C. Johnson
MONTANA STATE SENATE
2915 Illinois Street
Billings, Montana 59102

Re: Senate Bill 304 Study Committee

Dear Senator Johnson:

I would like to provide you with some of my thoughts on the agenda items that will be considered by our committee in its meeting on Friday and the general principles the American Insurance Association [AIA] believes should guide decisions on the creation and maintenance of state compensation insurance funds. I am prepared to discuss each of these in more detail, but I think that it will give you a sense of the positions that I will advocate in our discussions. As background, Employers Insurance Company of Nevada now is a member of the AIA. While Liberty Northwest is not an AIA member, it is my belief it will endorse much of what follows, but not all. I will try to point out those differences. State Farm Insurance and Farmers Insurance have not been active on these particular issues. Again it is my unconfirmed belief these carriers endorse the following.

AIA's policies on this issue are first grounded in the principle that a state in which the workers' compensation system is in balance has no need for a state fund. Where the system is not in balance, systemic reform and a rate law permitting rate adequacy are essential; a state fund will not reduce underlying system costs or produce adequate rates. AIA policy is opposed to government competition with private insurers, except in extraordinary circumstances. With this in mind, however, once a state fund is established, it is not AIA policy to eliminate them and I will not support the sale or privatization of the Montana State Fund at this time or under current circumstances.

In states in which state funds are created, however, AIA strongly advocates the incorporation of acceptable design criteria. A state fund should:

(1) be the market of last resort;

(2) be regulated by the insurance department on the same basis as private insurers with respect to rate adequacy, reserves, and financial reporting and examinations;

(3) not be a member of the guaranty fund;

(4) participate in ratemaking on the same basis as private insurers, including membership in the rating or advisory organization, adherence to uniform classes, the uniform statistical plan, and the uniform experience rating plan;

(5) the governing board should be politically independent;

(6) the fund should be authorized to write full coverage for all workers' compensation liability, including federal coverages and incidental coverage;

(7) the fund should not be permitted to write workers' compensation coverage for employer operations outside the state or for nonstate employers, or to write lines other than workers' compensation; and

(8) the fund should operate on a level playing field. That is, a fund should be subject to state premium taxes and assessments, and standards applicable to the private market for reserving, claims handling, examinations and prompt payment. A state fund also should be subject to assessments for operating the workers' compensation agency and financing the second injury fund, and be subject to any other special assessments on the same basis as private insurers. Unless a state fund serves as the residual market, it also should be subject to federal income taxes or to an assessment by the state in lieu of federal taxes otherwise owed.

In short, a state fund should not operate outside traditional parameters that reflect a justifiable public policy rationale for the state's participation in a commercial enterprise. Where a state fund does operate outside traditional parameters – writing other lines, writing exposures out-of-state, forming or acquiring subsidiaries for such purposes; or entering into joint ventures for providing coverage or services to nondomiciled employers – it forfeits its public policy justification. It should not enjoy tax preferences or other advantages that permit it to leverage capital and surplus earned through these preferences to compete against the private insurance market.

Montana's state fund does not yet meet all of the above criteria, although in working out of the financial crises in the late 80's and early 90's some of the above have been incorporated, there has been collaborative effort among all three workers compensation insurance plans to achieve some of the others, and some had been agreed to in the study leading up to the drafting of SB 153. While they may not necessarily agree with the policy or timing of implementation, principals at the Montana State Fund are fully aware of these AIA policy positions. I have discussed them at length with Carl Swanson, Mark Barry, Nancy Butler, and most recently with Lanny Hubbard. AIA believes that the State Fund and the State of Montana are capable of moving forward on all of these points and advocates that this is an appropriate time to implement those not already enacted.

With the above criteria in mind, AIA would support the following:

(1) clarification of the role and purpose of the state fund to prioritize and emphasize its function as the market of last resort;

(2) clarification that the State Fund may write Longshore or Black Lung coverage and other such incidental coverages;

(3) require regulation by the Department of Insurance on same basis as private insurers for rate adequacy, reserves, and financial reporting examinations. AIA supports limiting the regulation in the event of insolvency to rehabilitation of the fund and not liquidation;

(4) require participation in ratemaking system (adherence to uniform statistical plan, uniform classification system and experience rating plan) under the Insurance Code (Title 33, chapter 16, part 10). The Fund is required to belong to the designated licensed advisory organization and the Fund provides its loss data to the advisory organization. However, the Fund is not subject to the rating law and adoption of the Fund's premium rates instead must adhere to the procedures and process of the state's Administrative Procedures Act. 39-71-2316, MCA;

(5) require regulation by the Department of Insurance on same basis as private insurers for producer (agent) appointment and regulation;

(6) require Board members to be selected by policyholders. A sufficient number should be selected by the Governor as is now required to preserve the Fund's federal tax exemption, an acceptable *quid pro quo* for serving the residual market;

(6) require payment of premium tax under 33-2-705, MCA. While this tax is paid by an insurer based on premium written, it is incorporated into the insurer's expense base for rating purposes under the Insurance Code rating law;

(7) removing competitive advantages such as

(a) exclusive guaranteed books of business
(b) protection from punitive damages
(c) fraud investigation and prosecution through Department of Justice
(d) other advantages as a result of state agency status that can be substantiated as preferential.

AIA does not support:

(1) State Fund participation in the Guaranty Fund (and I believe that Liberty differs with the AIA and EICN on this point);

(2) removal of Legislative Auditor oversight until there is implementation of all of the above recommendations and full regulation of the State Fund under the Department of Insurance;

(3) payment of fee in lieu of federal income tax to the General Fund (I believe that Liberty differs with AIA and EICN on this point).

Finally, I am enclosing an article that appeared in a recent issue of *Business Insurance* regarding the experience of several California school districts with loss portfolio transfers involving an insolvent and now defunct workers' compensation insurer. I believe the article underscores the care and high level of due diligence that is necessary when these sort of financial arrangements are undertaken.

I have not copied the committee with these thoughts and I will leave it to you to determine whether that would be useful. I hope the foregoing is helpful and look forward to seeing you on Friday.

Very truly yours,

Jacqueline T. Lenmark

Enclosure (1): *Business Insurance*, School loss portfolio transfer at risk, January 19, 2004

cc: (by email only w/o enclosure)
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Business Insurance

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;chool loss portfolio transfer at risk

emont insolvency raises questions oout who will cover pool's liabilities

ROBERTO CENICEROS

HDALE, Calif.—Loss portfolio sfer arrangements involving a unct workers compensation to- could leave a number of Cali- la school districts saddled with ions of dollars in unpaid liabili-

hool district risk managers and ol manager who arranged the sfer are now consulting with attorneys to determine who uld pay the claims.

he problem could be particular- ainful for the school districts be- e a fiscal crisis in California is ng a toll on school budgets.

This is the worst time for this to occur, given the financial situation of the schools," said Ed Godwin, risk manager for the Riverside Community College District in Riverside, Calif. "It is something of real concern."

Like many California school districts, Riverside Community College participates in a joint powers authority. JPAs are similar to purchasing groups or self-insurance pools.

In 1998, a JPA that Riverside Community College District participates in—the Community College/County Superintendent Self Insured Plan for Employees—paid $1.4 million to transfer about

See JPA/page 16

For 54 school districts, millions of dollars in unpaid liabilities resulting from the insolvency of Fremont Indemnity Co. could exacerbate problems they already face due to California's current fiscal crisis.

California employers fear litigation from new labor code law

y JUDY GREENWALD

alifornia employers will face umerous lawsuits because of a ew law that provides financial ncentives for workers to sue eir employers for labor code olations, observers warn.

The Labor Code Private Attorneys General Act of 2004, which as been dubbed the "sue your ss bill" by its opponents, took fect Jan. 1. The law permits nployees to sue their employers—on behalf of themselves nd present and former workers—for any alleged labor code olations that have not already en addressed by the state labor mmissioner. The code governs such issues as wages, overtime and working conditions, and observers warn that even its most obscure aspects could serve as the basis for litigation.

As a result, employers should conduct audits to make sure they are in compliance with labor code to the fullest extent possible, attorneys say.

Under the new law, if there is no stated civil penalty for a particular labor code violation, employers can be fined $100 per "aggrieved" employee per pay period and $200 for each subsequent violation, in addition to attorneys' fees and costs. The aggrieved employees will receive

See LABOR/page 15

Current, future retirees to lose health benefits

Alcatel cuts cover for U.S. retirees

By MICHAEL BRADFORD

PLANO, Texas—Current and future retirees from a large telecommunications company will have to shoulder all the cost of their health insurance in an unusual and extreme benefit cutback.

High costs prompt cuts in retiree health care page 4

Alcatel Inc., the Plano, Texas-based operation of the French telecommunications company, has begun to phase out its subsidy of health insurance for thousands of former U.S.-based employees. A company spokesman would not say how many retirees are affected by the move but confirmed that "several thousand" had worked for Alcatel operations across the United States.

Since the early 1990s, employers, amid soaring costs, have been paring back their retiree health care plans, significantly upping premiums paid by retirees and boosting deductibles.

And in many cases, employers have eliminated retiree health care coverage, but typically only for employees hired after a certain date. Rarely, though, have employers that aren't in extreme financial distress totally eliminated financial support for health care plans covering current retirees.

"It is a case of last resort, short of taking away coverage altogether,"

See ALCATEL/page 18

Late News

California wildfires raised insured catastrophe losses in 2003.

Catastrophe claims hit $12.8 billion in 2003

Catastrophes caused an estimated $12.8 billion in insured property damage last year, according to the Insurance Services Office Inc.'s Property Claim Services unit. That made 2003 the third-costliest year of the past decade in terms of catastrophe losses, according to Jersey City, N.J.-based PCS. Last year's total included losses from the costliest fourth quarter in 10 years, representing an estimated $2.64 billion in insured losses, most of which stemmed from two California wildfires.

Aspen opening U.S. reinsurance unit

Aspen Insurance Holdings Ltd. is forming a Connecticut-based property reinsurance unit. Aspen Re America will operate from Rocky Hill, Conn., and will write proportional and excess treaty reinsurance. Brian Boornazian, formerly of XL Reinsurance America Inc., is joining Aspen Re as president and chief operating officer. The unit will give reinsurance buyers access to the London market through Aspen Insurance U.K. Ltd.

Official urges state to buy Canadian drugs

Matt Brown, secretary of state for Rhode Island, is urging Gov. Donald Carcieri to ask the federal government for permission to reimport Canadian prescription drugs for state employees and retirees. Under the U.S. Food, Drug and Cosmetic Act, it is illegal for anyone other than the original manufacturer to reimport prescription drugs into the United States. Congress recently passed a measure allowing the Secretary of Health and Human Services to issue waivers to individuals for drug reimportation, but only if safety standards are met.

See LATE NEWS/page 19

International

MOVES CAST DOUBT ON Rx IMPORTS

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BGC: Reports record deficit

inued from page 3

C was hit with a string of mas- losses as underfunded plans terminated. In 2002, for exam- t recorded its biggest loss—$3.9 on—when it took over the pen- plan of failed Bethlehem Steel .

nd last year, it terminated and over pension plans sponsored Weirton Steel Corp., a bankrupt producer; and US Airways Inc., financially ailing airline. Those inations cost the agency about billion.

spite the massive losses, the C is in no imminent danger of ding out of money to pay bene- med to plan participants. Cur- ly, the PBGC has more than $39 billion in assets.

But the future of the agency, which is funded through premiums paid by employers with defined benefit plans, currently appears bleak. The PBGC collects about $1 billion annually in premiums, but now is paying out about $3 billion a year in benefits.

However, help could be on its way.

PBGC Executive Director Steve Kandarian said the administration soon will present a comprehensive reform package, which is expected to include provisions to tighten pension funding rules. Such a change would reduce the likelihood of plans being so drastically underfunded if their employer sponsor gets in financial trouble, which could trigger a PBGC takeover.

On Capitol Hill, Rep. John Boehner, R-Ohio, chairman of the House Education and the Workforce Committee, said lawmakers' goal is to put the PBGC on a sound financial footing.

Chris Bone, chief actuary for Aon Consulting in Somerset, N.J., said that while funding rules may need some tightening, the rules should not be so stiff as to discourage employers from offering defined benefit plans. If employers turned away from the plans, that would drain the PBGC's premium base and exacerbate the agency's financial problems, he noted.

PA: School loss transfer at risk

inued from page 1

,000 in long-tail workers comp ation liabilities in a loss portfo- transfer deal with Glendale, f.-based Fremont Indemnity

loss portfolio transfer enables a insured entity to sell a portfolio ncurred claims to a third party, h as an insurer, which typically sts the sale proceeds to pay the ms and make a profit.

ut in June 2003, the Depart- t of Insurance obtained a con- ation order for insolvent Fre- t Indemnity. About $600,000 he $900,000 in long-tail liabili- the JPA included in the loss folio remained unpaid by Fre- t, Mr. Godwin said.

t none of the premium was re- ed, the JPA lost nearly $1 mil- as a result of Fremont's insol- y, which is equivalent to about third of its existing assets, he

ltimately, the school districts icipating in those JPAs can be ssed to cover any liabilities that joint powers authorities cannot , Mr. Godwin said.

o, for some of us, this is our st nightmare come true," said Godwin, who said he opposed loss portfolio transfer but was ruled by the JPA's board of di- ors.

r. Godwin said he opposed the ngement because of the price and because he believed that JPA was adequately funded for ong-tail workers comp liabili-

Additionally, a regulator from fornia's Self Insurance Plans at time questioned the legitimacy uch arrangements, Mr. Godwin id.

orrance, Calif.-based Keenan & ociates arranged the deal and ers like it for other school dis- s. The broker also manages a ber of California school district s, including the one in which erside Community College Dis- participates.

ve community colleges, 54 ool districts and three offices of cation involved in seven sepa- loss portfolio transfers have n affected by Fremont Indemni- insolvency, said David J. De Wester, executive vp and chief operating officer at Keenan & Associates. The LPTs were arranged during 1997 and 1998.

Keenan & Associates is making every effort to help those clients, Mr. De Wester said. For example, the brokerage hired the Los Angeles firm of Roxborough Pomerance & Nye to help convince the California Insurance Guarantee Assn. to cover the liabilities that Fremont Indemnity purchased. CIGA is the state insurance guaranty fund.

Attorney Nicholas Roxborough said the Department of Insurance regulated Fremont, and the insurer went into liquidation, so CIGA should be responsible for paying off the insurer's liabilities.

CIGA, however, is rejecting the claim. In 1998, the state's labor code was silent on whether public entities can participate in loss portfolio transfers, Mr. De Wester said. But he said the labor code was amended in 2000.

CIGA is rejecting the claim because the transfers were not recognized insurance policies at the time they were arranged, according to a Department of Insurance spokesman.

CIGA officials could not be reached for clarification.

"If we can't go after CIGA, we will figure out who else we can go after, but we are certainly not going to sit here idle and let the school districts get hammered," Mr. Roxborough said. "That is just not going to happen without a large fight."

Through agreements worked out by Keenan & Associates, school districts paid about $16 million to transfer their workers comp claims liabilities through loss portfolio transfers that are now in dispute, he said.

Not all of the LPTs were directly placed with Fremont, Mr. De Wester said. Fremont acquired some of the liabilities in a deal worked out with another insurer, a unit of WellPoint Health Networks.

Several school district risk managers are sharing information and consulting attorneys about the possibility of forcing Keenan & Associates to fund the liabilities, Mr. Godwin and others said.

Tony Norwood, president of the Sacramento-based California Assn. of Joint Powers Authorities, said that in the late 1990s he turned down a pitch by Keenan & Associates to participate in an LPT arrangement.

"I was just a little uncomfortable with it," and his JPA's loss reserves adequately covered its liabilities, Mr. Norwood said. He is also chief administrative officer for Southern California Schools Risk Management, a Colton, Calif.-based JPA.

In 2001, however, Mr. Norwood entered into a loss portfolio transfer agreement with Discover Re, a Farmington, Conn.-based unit of The St. Paul Cos. Inc. By then, regulators had ruled that the transfers were acceptable insurance arrangements, he said.

The agreements became an established practice among joint powers authorities, Mr. Norwood added. But JPAs that entered into them earlier might have done so too soon.

"Those that were conservative and watched the concept of loss portfolio transfers develop and made their placement after the insurance department ruling are sitting well," Mr. Norwood said. "Those early innovators found out that maybe that wasn't a good idea because it hadn't all been put to rest or determined by the Department of Insurance, and now they are suffering the consequences."

LPTs arranged in the 1990s followed an open rating law. "Astronomically low rates" that did not cover projected future claims costs became available, he recalled. And school districts that had previously self-insured then purchased insurance.

Likewise, for outstanding long-tail liabilities, schools found that LPTs in some cases beat their reserve cost estimates, Mr. Norwood said.

"If I beat my reserve rate, I can come out with cash in hand," he said. But the low rates offered by insurers at the time have also been blamed for several insolvencies in California's workers comp market.

Hiring: Deaths spur look at practices

Continued from page 3

information, experts say.

"We've always had the threat of the problems in giving too much information when people call for references," said Peggy Nakamura, assistant vp, chief risk officer and associate counsel for Adventist Health System/West in Roseville, Calif. "It's difficult to blame employers when they've had that threat of litigation on the other side if they've provided too much information."

But Ms. Nakamura is quick to point out that patient safety must remain the primary consideration of health care employers.

"We have to keep that mindset because we're not just talking about someone messing up at a manufacturing plant, we're talking about patients being injured by this criminal misconduct," she said. "When patients are under our care, we have an absolute obligation to protect them, and that's a little different than other industries."

In terms of minimizing the chance of hiring employees who would harm patients, as Mr. Cullen allegedly has, Ms. Nakamura said, "In my opinion, it comes down to background checks and, I think, doing a little better job in reference checking and doing some investigation into employment history. Not that that will always identify problem individuals, but at least it's a start, particularly when you're talking about individuals who are going to have access to medications or potentially damaging or lethal procedures or treatments for our patient population."

Experts point out that until hospitals are given some immunity for sharing more detailed information about nonphysician employees to prospective employers, changes in practices are unlikely.

In contrast, experts point to the rigorous credentialing and peer review process that hospitals undertake when hiring physicians.

"As part of the (physician) credentialing process, you sign a legal release that authorizes anybody and everybody to release any and all information about you in your prior positions and whether or not you've had any problems and difficulties and you give them immunity that you won't assert any claims or challenges to the people who provide that information," said Mark Kadzielski, a health care attorney at Fulbright & Jaworski in Los Angeles.

"We don't really credential our nurses, particularly in nursing homes, as well as we do credentialing for physicians and other people who get clinical privileges in hospitals," Mr. Kadzielski said.

"I've seen cases where hospitals respond honestly and forthrightly about a physician's abilities and let another hospital know that the physician lost his or her privileges for one reason or another," said John C. West, a senior consultant in the health care management division of AIG Consultants Inc. in Atlanta. "That's been held to be qualifiedly immune under the Health Care Quality Improvement Act because it's a message to the performance improvement and peer review process of the other hospital."

While Mr. West noted there are varying interpretations of the law, "I'm not aware of any privilege that attaches to ordinary correspondence about a nurse's performance," he said.

"Absent any state protections, I think hospitals are going to probably continue to give name, rank and serial number—just give the minimum information necessary," he said.

> 'We've always had the threat of the problems in giving too much information when people call for references. It's difficult to blame employers when they've had that threat of litigation on the other side if they've provided too much information.'
>
> *Peggy Nakamura*
> *Adventist Health System/West*

Earlier this month, Sens. Jon S. Corzine, D-N.J., and Frank R. Lautenberg, D-N.J., called on the Senate Health, Education, Labor and Pensions Committee to hold hearings into the current system of screening health care professionals.

In a letter to Sens. Judd Gregg, R-N.H., and Edward Kennedy, D-Mass., the chairman and ranking minority member of the HELP Committee, the New Jersey senators noted that Mr. Cullen had been fired by five hospitals and one nursing home for suspected wrongdoing, but reference checks failed to stop him from gaining employment at successive hospitals.

"We must act in the interest of promoting patient safety," Sen. Lautenberg said in a statement. "And we must give hospitals and health care facilities the ability to share vital information without fear of being punished. The health and safety of patients should and must be our top goal."

Meanwhile, lawsuits are starting to mount in Mr. Cullen's case.

In one of the latest examples, Easton, Pa.-based Two Rivers Hospital Corp., the former owner of Easton Hospital, filed notice Jan. 9 that it plans to sue Healthforce, a Harrisburg, Pa.-based temporary staffing agency that supplied Easton Hospital with Mr. Cullen.

Donald R. Auten, a partner in the Philadelphia law firm of Duane Morris L.L.P., who represents Two Rivers, declined to comment about its lawsuit. He did confirm, however, that Easton Hospital has been named in a malpractice lawsuit filed by the family of a 78-year-old patient who died in 1998. Mr. Cullen is a suspect in the death.