

SB304
Testimony of Laurence A. Hubbard
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March 26, 2004

Mr. Chairman, I wish to commend the Committee in its vote not to sell MSF and/or create an assigned risk plan. Clearly, Montana's employers and their employees have today won a vote of confidence in the MSF's role and responsibility as a competitive workers' compensation carrier and guaranteed market. The Committee has provided *all* interested stakeholders to present testimony and material in support of their positions, and has chosen wisely – in our opinion – after considering the proper course for Montana.

We look forward to finding ways to improve and strengthen our organization and our important role in supporting the health and economic prosperity for all Montanan's. Later in my testimony I will specifically address a number of proposals that have surfaced both under former SB153 but through discussions with other interested parties.

Old Fund

Mr. Chairman. You have requested a presentation by State Fund management on the 'Old Fund' in consideration of the cost

effectiveness of 'selling' what remains of that fund. Specifically, you have asked management for a status update and review of the costs associated with administration of the 'Old Fund.' For the record, I want to give a brief overview of history of the "Old Fund."

The 'Old Fund' was created by the Legislature during a special session in 1990 to address the substantial unfunded liabilities that existed in the fund. Those liabilities were unfunded in excess of \$500 million.

In splitting the "new" fund as it exists today from the "old" fund, the Legislature assumed those liabilities as a general fund obligation and at the same time, revised and implemented a payroll tax on employers and employees. It should be noted that employers began paying a payroll tax in 1987.

MSF is required by law to administer the 'Old Fund' claims for a maximum annual reimbursement of \$1,250,000.

There remain approximately 1,256 open/active claims in the Old Fund managed by 7 full-time adjusters. Of that number, 399 are indemnity (wage loss) claims. 54% of those indemnity claims are for permanent total disability; 30% are payments made to beneficiaries of fatality victims; 14% are permanent partial disability payments, and; 2% are

for temporary total disability benefits [usually the result of surgical procedures creating a TTD entitlement]. The remaining 875 claims (68%) are medical only claim payments.

Of the indemnity case reserves of \$45,489 million, 44.4% are for fatalities; 49.5% are for permanent total disabilities; 5.5% are for permanent partial disabilities and .6% are for temporary total disability. The average indemnity reserve is \$114,007. Fatal claims average \$168,314 per claim; PT's at \$104,269; PP's at \$43,907, and; TTD's at \$24,212 average per claim.

Reimbursement

MSF is reimbursed for administering the claims of the 'old fund.' We receive up to \$1.25 million per year to pay for all aspects of claim management, including but not limited to, financial reporting, management of staff, quality assurance, document processing, facilities, IT development and support, and representation in claim litigation.

I will refer you to the most recent Legislative Audit Report of the 'Old Fund' [HANDOUT]. For FY03, expenses of the Old Fund are as follows:

Old Fund Unit - \$460,102

Other Expenses – discussed above - \$618,726

Legal Cost Allocation - \$37,543

Depreciation - \$55,250

Amortization - \$120,653

Compensated Absences - \$14,981

Total - \$1,307,254

The average adjustment cost of an 'Old Fund' claim is \$1,215 compared to the average adjustment cost per claim of the 'New Fund' of \$1,426.

Financial Statement FY04

I am submitting for your review the current financial statements presented to our Board of Directors this morning as of December 31, 2003. It is important to note, by law, Old Fund liabilities are *discounted* for purposes of our financial reporting. Our current discount rate is 5%. Thus, the *undiscounted* liabilities are \$106,308,545. We project FYE (fiscal year end) discounted liabilities of \$70,514,319. Funds available for transfer to the general fund are contained in the Statement of Operations. End of year fund equity is projected to be \$444,695 (FASB by law) and include adjustments for unrealized gains and losses. If the Committee desires more detailed discussion of the financial statements, Mark Barry is available for questions.

Financial Transfers

I am submitting for the record a Summary of Old Fund – Taxes and Transfers. The summary provides a review of paid-in funds in the total amount of \$515,465,091 from the payroll tax and payments made by the “new fund” in the form of dividends as required by law. The payroll tax was terminated on December 31, 1998 when the ‘Old Fund’ was considered “adequately funded.” Adequate funding included a 10% contingency fund as a cushion against future financial uncertainty.

In the August, 2002 Special Session, SB19 provided for \$4.0 million to be transferred to the general fund. In addition, in the regular session HB363 removed the 10% contingency reserve, transferring \$9,090,000 and the excess from FY02 of \$9,178,000. Total transfers to the general fund in FY03 were \$22,268,000. By way of further historical funding background, I am providing the Committee a graphic display of cash flows between the new fund and old fund.

Mr. Chairman, if there are no immediate questions, I would like to introduce Bruce Hockman, Senior Vice President, Towers Perrin Reinsurance to discuss potential options for financial management and/or valuation considerations in the disposition of the ‘Old Fund.’

MSF Legislative Issues Discussion

Mr. Chairman, in the last meeting of the Committee we were requested to be prepared to discuss legislative options for improvement of MSF operations in the context of input received during these hearings. Specifically, the Committee requested review of former SB153 prepared as a consensus Bill as a result of the interim SB19 study Committee. I will provide comment on aspects of SB153 that we believe remain potential areas for further consideration by the Committee. I will address those issues as they appear in the agenda:

State Agency Status

SB153 provided for a statutory change in the status of MSF from a state agency to an independent public corporation exempt from many laws applying to state agencies and permitting MSF to move more closely to industry standard financial reporting and oversight (I will discuss oversight, below). As will be discussed in further detail, we believe maintaining our current state agency status at this juncture, with several exceptions, is in the best interests of MSF and Montana employers we insure.

Tax Issues

As the 'guaranteed market' MSF is entitled to a federal income tax exemption under federal law. We will maintain this exemption. However, MSF has conceded both under SB153 and today to payment of a premium tax to the state of Montana (2.75%), again with an appropriate transition period. Ultimately, payment of premium tax by MSF is a policy decision of the Legislature and a cost that must be passed through in our operating costs.

Guaranteed Book of Business

SB153 provided for removing the requirement that state agencies insure their workers' compensation liability with MSF. The first action toward removal of the 'exclusivity' or 'captive' state agency market began with the ability of the U system to competitively purchase workers' compensation insurance. That effort eventually led to the MUS self-insuring in July, 2003. MSF is prepared to support legislative removal of the requirement state agencies insure with MSF. In doing so, should this occur, we request a period of time to make internal and administrative adjustments to the inevitable impact of losing approximately \$12 million in business. In addition, MSF believes it should be able to compete for state agency business (as is

the case with the U system) and be able to bid on third-party claims administrative services in the event state agencies, or other public entities, choose to self-insure. It makes inherent sense to permit this ability in view of the expertise and resources available under a self-insurance plan.

Title 33 Regulation

One of the most significant aspects of SB153 (unintroduced), is limited regulation by the Insurance Commissioner under Title 33. The reasons for certain exceptions from the insurance code were by and large, sound. MSF serves as a 'guaranteed' market and cannot decline coverage to any employer requesting that coverage except if they are in default on an obligation to MSF. We were created by the Legislature, and can only be liquidated by act of the Legislature, and only then (realistically) if an alternative guaranteed market mechanism is in place.

With the above context, it should be clearly understood that Insurance Commissioner regulation can only bring similarity of regulation with private carriers, not parity of regulation. This is exemplified even by the position of the AIA and other private insurer

representatives that MSF not participate in the Guarantee Fund, as do all other P&C carriers.

SB153's provisions allowed rate review, but not approval or disapproval of MSF's rates by the insurance commissioner. Our Board would retain the responsibility of ratemaking and pricing deviations.

In addition, Insurance Commissioner regulation/oversight would be delayed to enable transition of MSF to calendar year financial reporting from its current 'fiscal year' method.

Other exceptions from Title 33 include the requirement the Insurance Commissioner issue a continuous certificate of authority; MSF not be subject to the mutual insurer formation and structure requirements, and; not be bound by NCCI rates and classifications – this would be reserved to our Board.

Under the Bill MSF would pay premium tax on the same basis as private carriers (2.75%) to begin 2 years after passage. In addition, MSF would be subject to the Unfair Trade Practices Act and subject to punitive damages for bad faith. While currently subject to common law bad faith actions, as a state agency MSF is exempt from punitive damage awards.

The Bill also contained provisions for a stated surplus floor and target surplus range.

Admittedly, a reading of SB153 can beg the question; why have any Insurance Commissioner regulation if it is not *full* regulation? We can certainly appreciate the challenge of having some, but not all, oversight responsibilities – few people want accountability for something they do not have complete authority to control.

In reality, the insurance regulation provisions of SB153 evolved as the legislation came together. For example, a number of insurers objected to MSF participating in the Guarantee Fund, and upon further investigation the Mutual Insurer formation requirements would put MSF at risk of losing its Federal Tax Exemption status, provide for assessable policies and require policyholder election of Board members.

In the final analysis, we do not believe it prudent at this juncture to pursue Insurance Commissioner regulation. The exception requirements are too important to MSF's unique needs as the guaranteed market to ignore, and it would be unrealistic to foist a responsibility upon the State Auditor that the office can not fully implement. In addition, even the more limited regulation proposed in

SB153 would take time to implement. Moving to full Insurance Commissioner regulation would, by necessity, require an implementation period of greater duration. That is not to suggest that in the future such an endeavor would be worthwhile; rather, now is not the time.

In addition, the Committee understands through the various presentations on the operations of MSF, we are in a period of rapidly escalating claim severity and cost. Our organization must be able to commit all of its limited resources on claim cost containment and improved injured worker outcomes. In other words, we cannot afford to take our 'eye off the ball' during this critical period in the workers' compensation business.

Other Issues

We would ask the Committee to consider several other aspects of SB153 that deserve further review. In particular, and as mentioned above regarding state agencies, we believe MSF should be permitted to provide TPA services for public self-insured entities.

In addition, in recognition of the value of competitive choice – not only for state agencies – but for our own operations, we believe MSF should be exempt from the state agency procurement requirements

for good and service, as well as exemption from the Information Technology requirements currently required by law (SB131) for state agencies and the requirement to use state IT resources.

With the above positions and recommendations in mind, we look forward to discussions with the Committee on these and other topics. Our desire is to assist the Committee in strengthening the value a competitive state fund brings to Montana employers and their employees, ensuring accountability to stakeholders, and in recognizing the unique role of MSF as an insurance business.