



Legislative Study Committee Meeting  
September 23, 2002

*A look at Montana's Workers' Compensation Crisis  
It's origins, the dilemma, the solution, and into the future*

**Into the abyss**

It was the perfect storm. In the early 1980s, Montana's economy suffered one blow after another in virtually each of its major sectors. Our farmers and ranchers were in the midst of a prolonged drought, and were faced with declining incomes and increasing debt. Major construction projects that had poured hundreds of millions of dollars into Montana such as the building of the interstate highway system and the missile defense system had come to completion and there was nothing else to take their place. The closure of the Anaconda smelter signaled the demise of this once proud mainstay of the Montana economy. Our timber industry was squeezed on the one side by a soft housing market in the U.S and on the other by increased competition from lower cost off shore producers. Other traditional industries were facing challenges from economic and social issues that they never had to contend with heretofore.

All these factors combined resulted in an exodus from our state that had not been seen since the dustbowl days of the 1930s and the Great Depression. Between 1980-1985, Montana experienced a net out migration of population, as people unable to find jobs had to leave the state they loved in order to support their families. These were difficult times, and as revenues declined, businesses and governmental entities were faced with extraordinary challenges. During this difficult period, government was looking for solutions to help existing businesses hold down their operating costs to try and keep them competitive.

It was in this political and economic milieu that decisions were made which allowed for workers' compensation insurance premium rates to be influenced by the political process rather than actuarially analysis. With rates being set at artificially low levels, and with payouts increasing as the economy continued to falter, the workers' compensation system in Montana became fatally unbalanced. During this time, the State Fund (a bureau within the Division of Workers' Compensation/Department of Labor) had minimal reserves or investment income, and was collecting premiums that were inadequate to cover liabilities. Because losses far exceeded premiums collected, the un-funded liability grew at a staggering rate, hitting a high of \$499 million dollars in the later years. It is impossible to sustain any organization when expenditures constantly exceed revenues and reserves. (The burst of the dot com bubble is a recent and painful reminder of what happens when these fundamentals are ignored) And, because the State was operating in a fashion that under priced the market, private carriers determined that they could not remain competitive and still profitably write coverage, choosing to leave the state. The departure of these carriers meant that



Montana businesses had fewer options for their insurance and placed a greater burden on a flawed system. Once it became clear that the structure was no longer workable, and that an un-funded liability was compounding at an alarming and uncontrollably rapid rate, the legislature found it necessary to intervene. In 1987, in order to raise revenues, they made the difficult and unpopular decision to enact a 0.3% payroll tax on employers. It was only the beginning.

### **Born in crisis**

In 1989, one of the most critical issues confronting our legislature was trying to bring some semblance of order back into our workers' compensation system. Any hope of economic recovery in the state was being undermined by the chaos and uncertainty produced by the growing un-funded liability. Legislators were faced with a seemingly unsolvable dilemma. In order to bring more revenue into the system, rates for workers' compensation coverage needed to rise dramatically. However, there was tremendous resistance to rate increases of the magnitude that would be needed to effectively deal with the problem. Montana's workers' compensation crisis was already receiving national media attention, and was perceived to be a significant drag on the economy. The legislature, recognizing that the states' workers' compensation system was in need of a major overhaul, created a new entity entitled the State Compensation Insurance Fund (SCIF).

The SCIF was structured to operate as a domestic mutual insurance company, and as such, function independently of state agency requirements. Acknowledging the problems created by a legislative process running an insurance company, the SCIF was also set up to be regulated by the Insurance Commissioner, just like every other insurance company in the state. In June 1989, there was a special session called that appropriated \$20 million of General Fund to the State Compensation Insurance Fund. Saddled with mounting liabilities, the SCIF announced there would need to be a dramatic increase in rates to try and achieve some semblance of balance in the system.

The uproar created by this announcement was vocal and swift. Increases of this magnitude would be devastating to existing or new businesses in Montana, and were simply unacceptable. Another solution needed to be found, and found quickly. As each day passed, the un-funded liability was continuing to grow. It was increasingly apparent that a bold innovative approach needed to be found to resolve this crisis once and for all.

The legislature reconvened in May 1990 in a special session and approached the problem from a totally different perspective. Realizing that saddling the SCIF with an astronomical debt was unworkable, the legislature separated the liability of the State Fund into claims occurring before and after July 1, 1990. Those



claims occurring before this date became known as the “Old Fund”. Any claims after that date were the responsibility of the “New Fund” which became known as the Montana State Fund (MSF). In doing this, they determined that the Old Fund would be funded by the payroll tax (see sidebar for history). Bonds were sold to cover the un-funded liability, and were to be serviced by proceeds from the payroll tax. MSF was given the task of administering the “Old Fund” on behalf of the legislature, but have no liability or funding responsibilities. (MSF would be reimbursed for the cost of administering the claims) The financial issues facing the state fund in 1990 resulted in legislative modifications intended to address those issues. After start-up, Montana State Fund was funded solely by insurance premiums and the investment income on insurance premiums and began operations on July 1, 1990.

### **Molded by changing times**

In 1915, the Montana legislature first enacted laws to create a fair and equitable system of workers’ compensation insurance. Over the years, the system has been modified numerous times to meet the changing needs of Montana employers and employees. The creation of the Montana State Fund by the legislature in 1990 is but another example of government responding to the needs of a changing social and economic structure. It is the strength of our democratic system.

Since 1990, MSF has worked with Governors and legislatures to build a viable and competitive workers’ compensation system, improving operational efficiencies, and allowing for employers to have the most flexibility to obtain coverage at competitive prices. It’s a system that has worked for Montana. The debt on the bonds sold to cover the Old Fund liabilities were retired far earlier than anyone had initially predicted. Workers’ compensation problems are no longer a drag on our economy. In fact, since 1994 the cost of workers’ compensation coverage for Montana businesses has actually decreased by 38.9%.

Montana State Fund has also gone through numerous changes since our creation in 1990. We have transitioned from a traditional organizational structure to one that is adapted to the needs of the information age. We have improved efficiencies in a number of operational areas and have made a major investment in our safety management services, working with Montana employers to try and prevent accidents from occurring. As Montana’s economic structure undergoes another evolutionary change, we continue to fill our critical roles as the guaranteed market.

### **The need for change**



Legislative Study Committee Meeting  
September 23, 2002

The Board of Directors and management of Montana State Fund believe that the operation of a competitive state fund is a unique activity for state government and that a public corporate structure, rather than that of a state agency, will best enable us to be managed and operated in an entrepreneurial and business-like manner. We also feel that there needs to be mechanisms in place to protect the assets of MSF policyholders, so they can only be used for the purposes for which they had been paid. During the last two legislative sessions, attempts have been made to transfer MSF assets to the General Fund.

Therefore, we are approaching the legislature with a restructuring proposal that will change the way we operate under Montana law. MSF conducts its business in a highly competitive environment. Traditional governmental regulatory structures are cumbersome for operating in the insurance industry, which require flexibility and rapid response to ever changing market conditions. MSF is not a regulatory agency, but an insurance company.

We have already made significant strides in changing our internal structure to operate as efficiently as possible. We have reorganized from a vertical, top down management system to a horizontal structure that is appropriate for a company of our kind, and fitting for an organization operating in the rapidly changing Information Age. However, under current law, each time MSF needs authority to more fully function as an insurance company, it must seek legislative approval. Private carriers can act based on market realities, putting MSF at a considerable competitive disadvantage in providing desired services to employers. Operating as a non-profit public corporation, we believe that the benefit of these changes will flow directly to our policyholders, assuring long-term financial and operational stability, and allowing us to best serve the people of Montana in fulfilling our obligations.

It is of paramount importance to the 32,000+ businesses in Montana that there is a reliable, stable workers compensation system in place for this essential and mandatory type of insurance. Our vision, as an organization is that Montana State Fund is committed to the health and economic prosperity of Montana. We accomplish this by providing superior service, leadership, and caring individuals working in an environment of teamwork, creativity and trust.

The true measure of who we are goes beyond our fiduciary responsibilities. We are Montanans, and recognize how fortunate we are to call this place our home. Our motivation for introducing this legislation is not to increase our market share or try and gain a competitive advantage, but to be able to position our company so that we can best serve the people of this great state now and into the future. Montana State Fund plays a unique and important role in Montana. As a public entity, we acknowledge the obligation we have to the 900,000 citizens of our state. It is imprudent to wait for a crisis to occur before making structural



Legislative Study Committee Meeting  
September 23, 2002

improvements. A well-run organization is constantly fine tuning itself, responding to the current and anticipated market environment. Among those states that have a state fund, most have taken the step to create or restructure their state fund to meet the challenges of the 21<sup>st</sup> century. Montana needs to be properly positioned to maintain our competitive ness in the marketplace.