

MONTANA STATE FUND STUDY COMMITTEE

September 23, 2002

Elkhorn Room - Holiday Inn Downtown

The first Montana State Fund Study Committee Meeting was held on September 23, 2002 at the Holiday Inn Downtown, 22 North Last Chance Gulch, Helena, Montana.

Committee Members Attending

Rep. Rick Laible	Sen. Walter McNutt
Rep. Joe McKenney	Jerry Driscoll
Rep. Gary Matthews	Larry Jones
Sen. Vicki Cocchiarella	George Wood
Sen. Dale Mahlum	Angela Caruso

Others Attending

Dave Pillatzke, Western States Insurance
Kelly Gorin, ODPP
Jennifer McKee, Lee Newspapers
Stacey Bird, MPEA
Michael Harrold, Nat'l Assoc. Independent Insurers
Steve Beckham, Liberty Northwest
Dave Davidson, Liberty Northwest
Tom Schneider, MPEA
Scott Darkenwald, Dept. of Administration
Marti L. Wangen, RMS Management Services
Jean Carstensen-Garrett, Legislative Audit Division
Bob Biskupiak, Payne Financial Group
Jerry Keck, Department of Labor & Industry
Jacqueline Lenmark, American Insurance Association
Mari Gray, State Auditor
Chuck Mazurek, MT Agent's Association & Payne Financial Group
Lynn Zanto, LFD
Kelly Jenkins, MPER Board
Riley Johnson, NFIB
Webb Brown, MT Chamber
Marianne Krpan, Blue Cross & Blue Shield of Montana
Larry Kibbee, Northwest Alliance of American Insurance
Carl Swanson, Montana State Fund
Mark Barry, Montana State Fund
Nancy Butler, Montana State Fund
Matthew Cohn, Montana State Fund
Curtis Larsen, Montana State Fund
Joanne Shydian, Montana State Fund
Kathy Gowen, Montana State Fund

Carl Swanson, President/CEO of the Montana State Fund (MSF) gave a short welcome. Mr. Swanson stated that MSF's vision is to be committed to the economic health and prosperity of Montana. MSF accomplishes this by providing superior service and leadership with caring individuals working in an environment of teamwork, creativity and trust. MSF's motivation for introducing legislation is not to increase MSF's market share or to create a competitive advantage, but to be able to position the company so it can best serve the people of Montana. MSF plays a unique and important role in Montana as a public entity, and acknowledges the obligation it has to the over 900,000 citizens of Montana. Since 1915, Montana legislatures have recognized that workers' compensation coverage is a fundamental requirement that provides significant benefits to employers and employees. It is imprudent to wait for a crisis to occur before making structural improvements. A well-run organization is constantly fine-tuning itself and anticipating market conditions. Among those states that have a state fund, most have taken the step to create or re-structure their state fund to meet the challenges of the 21st century. Montana needs to be properly positioned to maintain competitiveness in the marketplace. MSF welcomes all attendees' questions, comments and scrutiny. Mr. Swanson believes that working together through open and honest dialogue will strengthen MSF's proposal. MSF's hope is that when the study committee completes its work, MSF will be able to take to the legislature a comprehensive bill that best serves and meets the needs of the people of Montana.

Mr. Swanson introduced Murray Steinman, the facilitator of the meeting. Mr. Steinman is the principal and founder of Strategicom, a Bozeman firm engaged in a wide variety of specialized services, including communications and strategic planning. He has worked with the public sector, and is currently working with the Montana Department of Health and Human Services in facilitating meetings to come up with Montana's response to bio-terrorism issues. He was highly recommended by DPHHS.

Mr. Steinman explained the method of recording the meeting, which will include the taking of notes on an electronic white board and a tape recording of the meeting, and then he introduced the committee members. Mr. Steinman mentioned that the agenda had been revised because Bruce Hockman was delayed due to travel complications. His presentation, which was scheduled for the morning, was moved to the afternoon.

Mr. Steinman reviewed the charge of the committee, which is in Senate Bill 19. The committee is to analyze MSF's proposed legislation and make recommendations. Then Mr. Steinman asked each committee member what he or she would like to get out of this meeting.

Larry Jones, from Liberty Northwest, thanked Mr. Swanson for setting the non-partisan tone of the meeting, and echoed his comment about a healthy, competitive workers' compensation marketplace. His expectations are to answer the following question - What is the role of the State Fund in a competitive Montana workers' compensation marketplace? Mr. Jones thinks the committee can only discharge its legislative duty in studying the structure of the State Fund if that question is answered first. He believes

that role will determine structure. Once the committee knows what the role of the State Fund is in Montana, in a competitive marketplace, so all employers and employees benefit, only then can they discharge their legislative duty.

Rep. Rick Laible stated that he wanted to know what role state comp will provide in this theater. Obviously, the committee wants to make sure that they provide a competitive marketplace for other insurers to come to Montana, because he believes that is the only way that rates for Montana employers can be kept low. If rates for employers can be kept low, then at the same time, opportunities will be provided for more jobs, because the costs of labor will have been reduced. Also, Rep. Laible wants to make sure that injured workers are properly cared for.

Sen. Dale Mahlum would like to make sure that when the study is completed, the focus is on what is going to be done for the workers of Montana, and that they are taken care of. Also, that businesses are taken care of in Montana, so none are driven out of business. Senator Mahlum also wants to make sure that the State Fund remains a viable and competitive entity in the state. When Senate Bill 19 goes to the legislature, he would like to see that all legislators have a good grasp of the bill, and will know what is good for the state of Montana. Senate Bill 19 is supposed to help the state and people of Montana.

Rep. Joe McKenney stated that he has no personal agenda. He stated that he does need more definition and understanding of the term “public corporation”, both so he can understand it, and so he can explain it to other interested people who ask about it. He also wants to ensure plenty of public comment and participation.

Sen. Walter McNutt stated that he also had some confusion between the two structures and that the committee needs a more complete understanding of them. He would also like clarification of the interaction and the complexity between private industry and state, and how that can further be developed. He would also like to keep a competitive market. He feels that the committee needs to really understand the issue, so that when the bill goes to the legislature, they can answer questions.

Angela Caruso, Deputy Insurance Commissioner, would like to get an in-depth understanding of the proposal, and the changes that have been made since the last proposal. Also, she would like to know what the auditor’s role will be in regulating this entity.

Senator Vicki Cocchiarella does not want to see another work comp crisis and bailout by the taxpayers of Montana. She would like to make sure that the committee clarifies and makes a distinction between perception and reality. She believes there are lots of rumors and ideas that people have about what the State Fund is and what they are trying to do. The committee members need to have straightforward information about what happened and where money has come from and where it is going to and what the future will be.

Jerry Driscoll, from the AFL-CIO, stated that since this is a legislative committee, the first order of business should have been to elect a chair. The legislature created the committee, so a legislator should be the chair. He does not want to see any more cuts in benefits because of mistakes made by the people who run the State Fund.

Rep. Gary Matthews would like the committee to look at what the proposal does to the market share and how it affects rates of businesses. He believes that it is very important to have private insurers, and it is also very important to know what happens to the employees of MSF. Also the legislature is also looking at taking some of the MSF's money, and that issue needs to be addressed.

George Wood, Montana Self-Insurers Association, believes that the committee should ask what the State Fund's proposal allows that the present statute does not allow, and why a change is necessary.

Mr. Steinman asked the public to introduce themselves, and mentioned that there would be a public comment period after lunch. Mr. Steinman also introduced Tom Horn, who is a member of the MSF Board of Directors.

Mr. Steinman asked the committee if it would be valuable for a representative of MSF (Mr. Swanson or another representative) to be at the table with the committee to answer questions. Senator McNutt said that he did not believe that would be necessary, and the committee concurred.

Matthew Cohn, MSF Communications Team Leader, provided a presentation of the Montana State Fund, reviewing the current structure and the current conditions, and providing basic financial facts. (See attachment)

Carl Swanson, MSF President/CEO, provided a presentation reviewing MSF's proposed legislation, the significance of the proposed legislation for Montana businesses, and MSF's economic development efforts. (See attachment)

Nancy Butler, MSF General Counsel, provided a presentation on the details of MSF's proposed legislation. (See attachment) Regarding policyholder surplus language in the bill, Mr. Driscoll asked if that language would be put into the law. Ms. Butler replied that MSF has looked at other state funds who have this language in their laws, and that usually the courts have said that since the language is in place, the trust cannot then be violated. Mr. Driscoll stated that MSF would be better off putting the language into the policy. Ms. Butler stated that that would be "extra insurance", but that in the cases that were researched, the courts relied upon the language in the statutes that have set up trusts, where the funds are in trust for the purpose for which they were collected.

Mr. Wood asked if there is any other public corporation created by the state of Montana, and Ms. Butler replied that she did not think there was. Mr. Wood asked if the ownership of the mutual fund would be with the state of Montana. Ms. Butler replied that ultimately, the state would have the responsibility for making sure obligations are

taken care of if the state fund were repealed in the legislature. In order for MSF to be tax exempt, there must be the tie-back to the legislature having the ultimate responsibility for assets and dissolutions.

Mr. Wood asked if the distribution of surplus would be with the legislature, and Ms. Butler replied that this would be the case if there were a dissolution, but otherwise would be with the Board of Directors.

Mr. Driscoll asked if MSF employees would be state employees. Ms. Butler stated that this is something that is still being worked on, but that the goal is to keep things consistent and appropriate for MSF employees.

Sen. Cocchiarella asked Ms. Butler to prioritize MSF's list of wants. Ms. Butler stated that the primary focus would be the protection of MSF's surplus, by structuring MSF as much like an insurance company as possible, while still remaining the guaranteed market. Currently, MSF looks more like a state agency, which makes MSF's assets seem more accessible. The benefit is that the state fund would be structured and regulated as much as possible like other insurance companies in the state, which should provide an overall benefit to employers by having a good, competitive workers' compensation market.

Mr. Jones asked if the trust language in the proposed legislation provided that the legislature could only access the surplus if it first dissolved the State Fund, no matter how much the surplus became. Ms. Butler stated that the trust language is already in the law today, so it would just be strengthened. MSF's argument would be that it is unconstitutional for the legislature to take those funds.

Senator Mahlum asked if the Board of Directors would still be charged to declare dividends if money was available. Ms. Butler explained that MSF would still be a non-profit, self-supporting, independent, public corporation. The Board would be responsible for setting appropriate rates and surplus, and then if there were a dividend that could safely be paid, the Board would be responsible for declaring that dividend.

Senator Cocchiarella asked if MSF would provide bill auditing, TPA, safety, rehab consulting, or contracted services. Mr. Swanson replied that MSF does not plan to write insurance in other states, or write other lines of insurance. Senator Cocchiarella asked if that could be added to the law. Mr. Swanson replied that it could.

Mark Barry, MSF VP Corporate Support, provided a presentation on the estimated operating costs of MSF's proposed legislation.

Mr. Jones asked about tort liability and if MSF will stay with the State Comprehensive Insurance Plan, and if MSF is planning on getting out from under the State Comprehensive Insurance Plan. Mr. Barry explained that MSF has gotten some price estimates on how much it would cost to carry our own insurance, and it is in our proposed legislation

There was discussion about appointing a chair for the committee. Senator Cocchiarella suggested that Senator McNutt be appointed chair. The consensus of the committee was to appoint Senator McNutt as chair of the committee. Senator Cocchiarella mentioned that legislators have access to the legislative staff, and that the chair should contact these staff members when the committee has requests.

Public Comment

Larry Kibbee, Regional VP of Northwest Alliance of American Insurance, distributed two handouts, one entitled "The State Fund Role & Structure" and another handout on how state fund organization has been structured in Michigan and Nevada. (See attachment) Mr. Kibbee suggested that the private insurance industry has some concerns. Mr. Kibbee and his organization believe that there are alternatives, based on things that have happened with state funds in other states, which he would like the committee to consider. Mr. Kibbee also believes that the State Fund's role in the process is something that needs to be discussed. He stated that the question is - does the state of Montana want to run an insurance company and compete with the private marketplace, or does the state want to have an entity that is a privatized state fund that works with the rest of the market, is competitive with the rest of the market and go forward in that matter. Mr. Kibbee believes that the role will be dictated by structure. He has the following concerns:

1. The regulatory structure - in order to have a competitive market place in which companies like their members can come in and compete with State Fund, there needs to be a level regulatory playing field. Mr. Kibbee would be willing to talk to the committee in more detail about where he thinks inequities might exist in terms of the competitiveness of the State Fund and how they operate with the rest of the marketplace. Mr. Kibbee had some concerns about the language in the proposed legislation regarding regulation by the insurance commissioner. He asked if we are truly looking at a level playing field with regulatory considerations. There are a number of reasons why that is important. One reason has to do with State Fund's desire to become a player in the guaranty fund. He has a concern that any business entity operating an insurance company that isn't playing by the same rules and doesn't have the same regulatory oversight be a part of a guaranty fund. Nevada privatized their state fund and Michigan actually sold their state fund. He would like the committee to take a look at a wider scope of what may be possible and doable.

Mr. Driscoll asked if Michigan and Nevada set up a shared risk pool. Mr. Kibbee replied that he believes Michigan does have a shared risk pool. Senator Mahlum asked if Nevada is the insurer of last resort. Mr. Kibbee replied that he does not believe that they are the insurer of last resort. Senator Mahlum asked if Michigan sold their state fund because of the liabilities they had at the end of the 1980's. Mr. Kibbee replied that he believed that was the case. They were at a crossroads and they decided

to privatize, and decided to actually sell the state fund to another company. Mr. Swanson commented that Michigan already had an existing assigned risk pool and a state fund and that Oregon has a similar arrangement. Nevada was a monopolistic state fund prior to 1999, when the legislature created a three-way system, where private carriers could compete for the first time. They privatized the state fund and created an assigned risk pool.

Bob Biskupiak from Payne Financial Group made two points. First, his agency works with MSF and he emphasized the progress that he has seen from their customers' point of view on the progress that MSF has made in the last decade. It is their opinion that in order to continue that progression, MSF needs to evolve further and Senate Bill 19 seems to be the logical method of getting that done. Secondly, he believes that MSF needs to be competitive. In the insurance business, competitive is not just the lowest price on the marketplace. Any approach that is taken should consider the long-term health of the marketplace. Mr. Biskupiak has worked very closely with many companies who operate on a national basis and has had discussions with them on why they do or do not want to do business in the state of Montana. The fact is they are not lined up to do business here, and Montana does not represent a lot of the market share. Having good competition is healthy for the companies, but also for the consumers. Looking at competitiveness needs to be from a long-term consumer perspective.

Tom Horn, member of the MSF Board of Directors and ranch owner spoke about surplus. He stated that the MSF Board of Directors has never considered having unlimited surplus. Surplus is not extra money for insurance companies, and unlimited surplus for any insurance company would not be prudent. The Board and staff have worked very hard to make MSF solvent and strong, and the next step would be to get MSF a step farther from state government. Mr. Horn would like to see MSF privatized. Regarding the guaranteed market and guaranteed customer base, MSF has tried to stay competitive and price insurance so it is competitive, and business has been lost because other companies were able to price better. The Board intends for MSF to be here to take care of the workers in the state.

Senator McNutt asked how MSF could create unlimited surplus and remain competitive. Mr. Horn replied that it can't, and that is not the Board's intention. That is why MSF and the Board work with Towers-Perrin, the independent actuary, to set appropriate surplus. A surplus is necessary to cover future claims.

Senator Cocchiarella asked a question regarding privatization and guaranteed customer base. She asked if the MSF Board would be willing to give up all the state agencies that are required to pay premium and be under the state fund. Mr. Horn replied that if the committee and the legislature want MSF to be the insurer of last resort, MSF would like to insure the state agencies. Senator Cocchiarella asked what the Board and Mr. Horn see as the biggest concern with the status of the State Fund as it is. Mr. Horn replied that his number one concern would be protecting the surplus that the employers of

Montana have trusted MSF with. Also, because of MSF's structure as a state agency, it is somewhat limited in what benefits, such as Pay for Performance, can be offered.

Senator Mahlum asked if the MSF Board of Directors would consider declaring a large dividend to the rate payers as an alternative to the money going to the general fund. Mr. Horn replied that neither one is a responsible option. Senator Mahlum stated that many legislators do not understand surplus and why it is needed. He asked if it wouldn't be more beneficial to pay the money to the rate payers. Mr. Horn replied that it would be more responsible to pay it back to the rate payers than to give it to the general fund, but in neither case is the money there to actually do that.

Mr. Wood asked what the amount of MSF's surplus is now, and what it is as a percentage of the other reserves. Mr. Barry replied that the estimated surplus at the end of fiscal year 2002, subject to Board approval, is \$158 million. Liabilities are \$340 million.

Jacqueline Lenmark, of the American Insurance Association (AIA), offered public comment. The AIA is a trade association comprising in excess of 400 independent insurance companies, many of whom write workers' compensation insurance in Montana under Plan 2. Ms. Lenmark offered the resources of her association to the committee, and remarked that MSF's proposed legislation is a very complex piece of legislation, which will require the committee's very careful scrutiny. The AIA has supported the continued existence of state funds in many states, and with the right sort of legislation, would probably do so in Montana. The AIA has been supportive of the continued fiscal stability of the State Fund, its function as and its continuation as the market of last resort. In the abstract, the AIA would support the regulation of the State Fund as an insurance company in the same way that other private insurance carriers are regulated under the Montana Insurance Code and the Montana Workers' Compensation Act. While there may be valid reasons to deviate from that regulation in certain instances, those deviations should be looked at carefully, and Ms. Lenmark will be prepared to offer specific comments to the committee as it considers some of those deviations. To the extent that the proposal deviates from any regulation that applies to other insurance carriers, the AIA would be concerned. As an example, a huge concern for the industry and the AIA is the State Fund's participation in the Montana Guaranty Fund. Ms. Lenmark encouraged the committee to carefully consider the policy reasons for which any deviation is requested and the impact the deviation may have on the competitive marketplace.

Mr. Driscoll asked if Ms. Lenmark was familiar with the credits of guaranty funds, as for example with the life insurance guaranty fund. Ms. Lenmark responded that the life and health guaranty fund operates in an entirely different manner than the property and casualty guaranty fund. There are no premium tax offsets and any losses are accommodated in the rate filings that a carrier would make if they are called upon to take care of the insolvency of a carrier member. Mr. Driscoll asked how the carrier members absorb a loss. Ms. Lenmark replied that in theory, if a member company has to pick up a portion of an insolvency for another member of the guaranty fund, then that

portion of the insolvency is a loss that can go back into the expense portion of the rate that the carrier would file with the insurance commissioner for their rate going forward. It is a cost of doing business to the other member carriers.

Rep. Laible expressed a concern that MSF controls about 50% of policyholders in the state. He would like to know how we get ourselves to a level playing field where we can have competition for those rates. He believes that up until now, MSF has been the lifeblood of the workers' compensation industry and providing workers' comp in an area where it wasn't available before. He asked how an environment can be created where insurance companies would want to come back in this marketplace and possibly drive the prices down for Montana employers. Ms. Lenmark responded that there are several important items. First is regulation. Carriers are regulated by the insurance commissioner and are obligated to meet the same regulatory standards. If the State Fund were to be regulated in precisely the same way, a message would be sent to carriers to come into the market. Currently, in Montana, there is a bifurcated regulatory scheme where carriers respond to the Montana insurance code, and there is a different oversight of the State Fund. To the extent that carriers have confidence in that separate regulatory scheme, they are going to come into the market. To the extent that carriers have confidence in the fairness of a uniform regulatory scheme, Ms. Lenmark believes carriers will re-enter the market. To the extent the legislature can stay the course, and continue to send messages that they are progressing to that end, and not simply responding to an emergency, carriers will be encouraged into the market. Predictability and stability are a strong invitation to the insurance industry to participate in the marketplace. The progress made since 1987 has helped Montana continue to move toward that goal.

Senator Cocchiarella asked if market issues that are totally out of the committee's realm have a lot to do with whether or not an insurance company wants to come to Montana. Ms. Lenmark responded that certainly any company has its own independent concerns and criteria for participating in this marketplace. She reminded the committee that Montana represents 3/10ths of 1 percent of the national insurance market, and marketing and business decisions are made on that basis. Sen. Cocchiarella asked what percentage of carriers have left the market for other reasons, based on the last 5 or 6 years. Ms. Lenmark replied that in fact, based on her observation, companies have returned to the marketplace, given many of the reforms that Montana has enacted since 1991. Senator Cocchiarella asked what the role of the State Fund should be in Montana, and if they should be the insurer of last resort. Ms. Lenmark replied that her association's and her personal belief is that the State Fund should act as the insurer of last resort in Montana. She does not support an assigned risk pool under any circumstance. The function that might be served by an assigned risk pool is adequately and competently served by a properly constituted state fund. Acting as the insurer of last resort, it can offer insurance to those employers who have difficulty finding insurance in the voluntary market. It should also be on a competitive basis.

Senator McNutt asked how many of the members of AIA sell workers' compensation in Montana. Ms. Lenmark replied that she did not have the precise figure, but that she

would be happy to provide that at the next meeting. She believes that the majority of those carriers are admitted in Montana and could write workers' compensation insurance as an accommodation. Senator McNutt asked Ms. Lenmark to find out how many carriers have left in the last 3 to 5 years. In the last 3 years, Senator McNutt has had 7 providers, and is tired of independent insurance people writing their program, then 6 months later they have either doubled the premium or are leaving the state. Senator McNutt would like to know if this is a result of something the legislature has done. Ms. Lenmark will try to determine the answer and bring it to the next meeting.

Riley Johnson represented the National Federation of Independent Businesses (NFIB), which has 7000 members of small businesses in Montana. The average employer has 2- 3 employees with \$250, 000 in gross sales. NFIB is very concerned about the proposed legislation because workers' compensation insurance is a major part of their businesses. Mr. Johnson offered his association's assistance to the committee. 90- 95% of NFIB's members are insured with State Fund, rather than private insurers, and most of these members are below \$5,000 in annual premium. The priority of the small business people in Montana is the protection of the surplus and to keep politics out. NFIB is confident in the leadership of the State Fund. The second priority of small business people is service. Service has improved greatly in the last 10 years, and Mr. Johnson is very happy with State Fund's service. Mr. Johnson is not in a position to make a pro or con decision without balloting NFIB's members. A ballot regarding the proposed legislation will go to NFIB's members this fall.

Mr. Wood asked Mr. Johnson to clarify his remark about being willing to accept the system as it is now. Mr. Johnson stated that he is actually in favor of anything that will give the system more flexibility and that will help make the system better. In fact, we should be looking at other alternatives that could perhaps enhance the system for members.

Mr. Driscoll asked if Mr. Riley has seen any game playing with the rates since the Board of Directors now hires the President. Mr. Riley responded that he has not.

Webb Brown, representing the Montana Chamber of Commerce, agreed that the State Fund has come a tremendous distance. The Chamber would like to see the move towards privatization. Many of their members are small businesses, so the insurer of last resort is very important, but they can also be competitive. The basis on which the State Fund operates is what needs to be taken into consideration. They have the responsibility of being the insurer of last resort, so that gives them some special consideration, but it needs to be balanced throughout with the other providers. Mr. Brown offered his organization's assistance to the committee.

Rep. Matthews stated that ratemaking authority will be a big issue, and asked Mr. Brown whether or not he trusts the State Auditor to deal with the rates. Mr. Brown stated that he does trust the auditor to oversee ratemaking with the involvement of the MSF Board of Directors.

Mr. Wood asked if Mr. Brown would trust the State Auditor to set the rates for private insurance companies. Mr. Brown responded that he thinks the State Auditor would have a different role. Mr. Wood asked Mr. Brown to clarify if the State Fund will be private or semi-public. Mr. Brown replied that as long as the State Fund has the mandatory role of providing the insurer of last resort, they cannot ever be truly private. However, he would like to see the State Fund move towards privatization.

Mr. Steinman asked the committee to identify the critical issues.

Senator Cocchiarella stated that one of the key issues is "surplus takings". She feels that most of the committee members agree that premium dollars should be used for the purpose they were paid. Mr. Steinman suggested that the word "surplus" be defined.

Mr. Wood stated that in addition to defining "surplus", the committee also needs a definition of where surplus starts and ends - what percentage should be considered surplus. Ms. Caruso stated that this should also include reserves - how reserves are defined and how they are determined to be adequate or not.

Senator Cocchiarella felt that the next critical issue should be regulation and deviations from regulation, and participation in the guaranty fund.

Senator Mahlum asked if the guaranty fund refers to the insurer of last resort. Ms. Caruso explained that other carriers are required to be part of the Montana Property and Casualty Guaranty fund. In case of an insolvency, member carriers are assessed if they need to bail out that company. The question is what happens to those member companies if the State Fund belongs to the guaranty fund and something were to happen. Senator Cocchiarella feels that this falls under the topic of regulation. She also asked if there is a limit that the guaranty fund pays on an individual claim, and who pays after that point. Senator McNutt stated that the committee needs an explanation of who the guarantor is today. Mr. Wood suggested that the committee also needs to consider what happens to the State Fund if another member of the guaranty fund goes under, and the State Fund is assessed.

Mr. Murray asked the committee whose interests the committee is looking out for. Senator McNutt stated that the committee is protecting the interests of the policyholders and the State Fund. Rep. McKenney stated that the committee is looking at the users of the workers' compensation system, and the committee's responsibility is to make sure that the users have a viable workers' compensation system. Senator Cocchiarella stated that the injured workers, employees of the State Fund, taxpayers and other insurers need to be considered.

Mr. Steinman asked if competitive marketplace issues would be a primary concern. Mr. Driscoll said that the committee needs to know what MSF wants to do. He does not think that MSF can be privatized, unless it is sold. He believes that the main goal should be to protect the \$500 million. The trust language in the statute should be

strengthened, but he also believes that the language should be written into the policy, and then the legislature could not impede a contract.

Representative McKenney agreed with Mr. Driscoll. He feels that the primary goal is protecting the surplus. The secondary goal is allowing flexibility for the State Fund to respond to the marketplace.

Senator Cocchiarella spoke about her concerns about MSF being a state agency, and the inconveniences that go along with being a state agency.

Senator Mahlum said that it looks like private insurance companies are getting the big policies, while State Fund is getting the small policies. Mr. Jones stated that one of the obvious answers is that policyholders made a decision to change insurers. Mr. Driscoll stated that over the years there was a lot of pooling, where like employers got together and formed pools, i.e. contractors, bar owners, NFIB, loggers, etc. Some of them were over \$25,000 and many of them are now self-insured. He feels that was probably the reason for the loss of some of the bigger accounts.

Mr. Swanson stated that there are 35,000+ businesses in Montana, and MSF writes 26,000 of them. 20,000 of MSF's customers are under \$5,000 in premium, which distorts the percentages. The amount of premium for customers \$25,000 or greater constitutes 1/3 of MSF's premium. MSF is the small business carrier. 30% of MSF's premium is now in \$25,000 or greater customers. Mr. Wood stated that just because a business is small does not mean it is unprofitable.

Mr. Steinman asked if there were other critical issues.

Representative Laible stated that it would be helpful if the State Fund would detail each item, why they want it and the impact.

Ms. Caruso mentioned the need to determine the fiscal impact of the proposed legislation on the rest of the state agencies.

Senator Cocchiarella stated the need for some legal opinions on constitutionality issues that may arise, for example, can the State Fund legally become a non-state agency? Senator Cocchiarella suggested that a legal opinion should be obtained from Greg Petesch and possibly one other person. Senator Mahlum asked Ms. Butler to provide her opinion on this issue. Ms. Butler explained that MSF has done a lot of research and believes it is feasible. MSF has looked at how other state funds were structured, and the common theme was the domestic mutual insurer with a corporate status of some kind. After researching the constitution, it was clear that in Montana, the legislature is not to create a private corporation, but it may create a public corporation. In Missouri, a state fund was created as a public corporation in the 1990's. Missouri has the same constitutional language as Montana does in regards to creation of a corporation by the legislature. There was a lawsuit brought against the state fund in Missouri as to whether or not they could exist as a public corporation, and the courts in Missouri

affirmed that they could. MSF feels comfortable that a public corporation status is appropriate in Montana. Being an insurance company doesn't always fit well with being a state agency; at the same time, MSF as the guaranteed market gives it a public structure. The committee agreed that it would still like an independent legal opinion.

Senator McNutt stated that the legal issue should be the priority.

There was some discussion about determining what surplus is and who owns it. Also, how is it different than reserves. Mr. Driscoll stated that the State Fund needs to protect all of the premium dollars that have been paid in. It is really the Board of Directors' job to define how much surplus the State Fund needs.

Mr. Steinman explained that the surplus should actually be thought of as a contingent liability fund.

Mr. Swanson volunteered to obtain another outside legal opinion in preparation for the next meeting. Regarding surplus, it is a contingent liability fund, set aside to deal with the inherent uncertainties in the workers' compensation insurance business. Senator McNutt asked if that is a common practice, and if reserves are set by a formula. Mr. Swanson replied that MSF has an outside, independent actuary who appears before the Board of Directors and determines for each year that MSF has been in business, a best estimate of what MSF's liability is. Typically, insurance regulatory bodies have requirements for all carriers to maintain certain risk based capital standards, which are minimum surplus requirements, which are different from reserves. It is prudent in the insurance industry for carriers to have substantial amounts of surplus. Organizations like AM Best and other rating organizations rate carriers based on their financial strength on various ratios. MSF looks at premium to surplus, reserve to surplus ratio. Tillinghast benchmarks MSF against its peers annually, so the targeted reserve to surplus ratio is 1.5 to 1.9 reserve to surplus ratio. Senator McNutt asked Mr. Jones how private companies do this. Mr. Jones replied that reserves are typically set by adjusters, depending on the severity of that case. Each case is reserved individually, rather than in the aggregate. Surplus is set separately.

Representative Matthews asked Mr. Swanson to explain why in the year 2000, MSF had 26,200 policyholders with \$70 million in premiums. Underwriting losses were \$18 million that year. In 2001, MSF decreased by about 50 policyholders, but had \$74 million in premiums, with a loss of \$21 million. The projection is for approximately 500 more policyholders, but the premium is going to be \$92 million. The flexibility of the Board of Directors to determine premium is one of MSF's key issues. With that \$500 million dollars, MSF is able to subsidize their losses and are able to undercut private insurance carriers. Mr. Swanson replied that the policyholders which MSF has been writing are much larger than in the past, and that is primarily where the premium growth occurred. MSF is the market for small business, and retains a fairly stable 20,000 customers through hard and soft markets. Fluctuation occurs on the size of accounts during hard and soft markets. Representative Matthews asked if the Board of Directors has increased the rates on different categories also. Mr. Swanson replied that there

have been slight increases, but the key answer is that MSF is writing larger customers. Representative Matthews asked if in 1998, when MSF had 28,000 policyholders, it had 50% of the market. Mr. Swanson replied that currently MSF has about 51% of the market. There was a time when MSF had 85% of the market, when the market was under-priced. Mr. Swanson stated that the State Fund really does not determine the market share. He believes that private carriers determine the market share. MSF decreased to \$70 million in annual premium. Montana was one of the most profitable states in the nation from 1991-1995. The average return on net worth for private carriers was about 31%. Four years later, Montana was the most unprofitable state in the nation for private carriers, with a combined loss ratio of 167. For every \$100 taken in, there was \$167 of loss. In general, in Montana, private carriers ended up with 167 combined loss ratio in 1999 and investment returns were not offsetting that. MSF had a positive net operating income every year, which meant that MSF had to maintain pricing integrity. That is the role MSF plays. During hard times, private carriers leave the state. Part of the reason is national in scope, but some of the reason is unprofitability. MSF did not follow the market and maintained prudent pricing, which is why MSF's business went down in the cycle.

Representative Laible asked Mr. Swanson if there was a chart available, showing how the market changed from MSF having 85% of the market. Mr. Swanson agreed to try to find that information before the next meeting. However, he stated that he was speaking about the Old Fund era when there was political rate suppression, and companies left the state because of that. Representative Laible asked about the MSF financials, which listed surplus at \$150 million under contingencies and subsequent events. He asked at what point the surplus would be considered over-surplus, and either be returned to the ratepayers or have a reduction in rates. Mr. Swanson replied that Tillinghast Towers Perrin has recommended, and the Board has adopted a target range of a reserve to surplus ratio of between 1.5 and 1.9. Once that target has been reached, there will be no reason to grow surplus beyond that. The current ratio is about 2.16 to 1, so surplus needs to be grown slightly more. Once the target has been reached, the Board will have the opportunity to release those dollars back to policyholders in the form of dividends. Mr. Swanson volunteered to provide the committee with a copy of Tillinghast Towers Perrins presentation to the Board, which explains how they arrived at the target ratio. Mr. Steinman distributed a copy of "Analysis of Surplus Adequacy and Support for Policyholder Dividend Program". Mr. Swanson explained that MSF is targeting a range based upon where other insurance companies in the peer group are. Every year, the independent actuary looks at the peer group of AM Best rated companies, then decides where MSF needs to be in that range.

Mr. Woods asked Mr. Swanson how accurate MSF's actuaries have been. Mr. Swanson replied that in one year, the actuary lowered the ultimate liability for all accident years since 1990 by \$100 million. So, in effect, they were wrong. This was occurring nationally, not just with MSF's actuary. Because of this, MSF was able to send that \$100 million to the Old Fund and end the Old Fund Liability Tax. Actuaries' best estimates are just that - an estimate. They are only right about half of the time. Mr. Wood asked what the actuaries have done in the past 5 years. Mr. Swanson

replied that they have seen adverse developments of about \$9 million since July 1, 1990. The entire industry is seeing adverse developments. In the last three years, the actuary has been off about \$13 million.

Representative Matthews asked if Mr. Swanson is confident that the Old Fund is taken care of. He asked how many claims are out there, and who would be responsible if there were mistakes. Mr. Swanson responded that there are approximately 1,535 claims remaining in the Old Fund. Those claims will play out for perhaps another 30 years or so. MSF believes that it has a pretty strong handle on the claims. The 10% contingency, which is in law is there for a very good reason. The things that will impact the liability in the Old Fund are things like medical inflation and retroactive adverse Supreme Court decisions. Representative Matthews asked if the \$1.2 million to service these claims is figured in. Mr. Swanson replied that this is a lost adjustment expense (LAE). MSF discounts Old Fund claims at 5.5%, recognizing present day value. MSF has approximately \$91 million between losses and loss adjustment expense, which is the cost of managing the claims through the life of the claim. If the claims were not discounted, it would be approximately \$129 million in liability. Representative Matthews asked how many people service the Old Fund claims. Mr. Swanson replied that approximately 8-10 individuals service those claims. Those claims have already been investigated. The \$1.2 million is for salaries, rent, overhead, information technology and systems. Mr. Driscoll asked if the \$91 million is with the 10%. Mr. Swanson replied that it is without the 10%.

Representative Laible asked if there is anything in the proposed legislation that deals with the Old Fund. He also asked if there is an alternative, i.e. can the Old Fund liability be sold? Mr. Swanson replied that MSF could come prepared for the next meeting to discuss whether an annuity could be purchased. The legislature would need to authorize something like this. This has already been researched, and the initial impression is that it would cost the state money, because the Old Fund has already been discounted, so in order to get an annuity, the state would have to come up with some money. MSF believes that the Old Fund is adequately funded with 10% above what the actuary believes the ultimate liability will be, so the state may not want to give that up to another company, which will potentially make a profit. If the state no longer wants the liability, it might be worth the cost, but the state would have to find additional money. Mr. Laible clarified his original question - Does the proposed legislation deal with the Old Fund at all? Mr. Swanson replied that it does not. The Old Fund liability will continue to be a state responsibility, and the bill proposes turning over any excess to the general fund. MSF will continue to administer the plan if the legislature desires. Mr. Swanson stated that it is pretty traumatic for an injured employee to have their adjuster changed. The Legislative audit office audits the Old Fund financials. Representative Laible asked if there were any co-mingling of funds between the New Fund and the Old Fund other than to service those particular accounts. Mr. Swanson stated that there are separate financials. Senate Bill 67 provided that anything over the 10% goes back to the New Fund. The proposed legislation proposes that that money would go to the general revenue.

Mr. Driscoll asked about the \$14 million that went the other way. If the \$91 million plus 10% is not enough to pay off the ultimate, isn't the New Fund stuck for \$14 million? Mr. Swanson responded that the state would be responsible for any unfunded liability.

Senator Cocchiarella mentioned to the committee that she has asked Scott Seacatt to develop a timeline listing when all of the financial transactions occurred.

Mr. Wood asked who benefited from the political rate suppression. Mr. Swanson replied that he estimates that 85% of the businesses in Montana benefited from the political rate suppression, but they had to pay a price with the Old Fund Liability Tax.

Senator McNutt spoke to the committee about setting the next meeting date. The dates for the next meetings are October 25th and November 7th at 10:00 a.m. The November 7th meeting is a tentative date, if the committee is not able to get everything done at the October 25th meeting. If the Holiday Inn is available, the meeting should be held there.

Senator McNutt and several other committee members requested a copy of the draft of MSF's proposed legislation.

Mr. Steinman worked with the committee to create a list of priorities.

1. Legal Opinion
2. Definition and discussion of the surplus.
3. Clarification of the goals of MSF's proposed legislation. Senator McNutt requested that MSF prioritize its goals for the committee.
4. Impact of the legislation on MSF employees.
5. Competitive issues - Mr. Jones requested that competition of the marketplace be distinguished from the competitiveness of the State Fund in the market place. This would also include the issue of the State Fund monopoly on state business.

Senator McNutt suggested that the rest of the items could be in random order. Mr. Driscoll suggested adding employees. Mr. Wood suggested allowing the chairman to put items on the agenda in whatever order he wants.

Senator Cocchiarella requested that someone from the guaranty fund make a presentation to the committee. Mr. Jones stated that the Montana Insurance Guaranty Association is contracted with the Western Guaranty Fund in Denver, so perhaps the Denver branch would be the appropriate contact. Ms. Caruso volunteered to get that information to Senator McNutt.

Mr. Swanson clarified that usually the word "privatization" means selling the State Fund, which is not what MSF is proposing. MSF is actually proposing to restructure the State Fund. Senator McNutt suggested that this be handled under the number 3 priority - Clarification of the goals of the bill.

Mr. Jones asked if the committee would be interested in a presentation from someone from Michigan or Nevada on how they privatized. Mr. Swanson stated that it would be fine with MSF to do this, but both Nevada and Michigan have an assigned risk pool. If the committee were interested in pursuing the Nevada or Michigan approach, perhaps an assigned risk pool vehicle should be on the table. Mr. Driscoll mentioned that he had asked Jerry Keck about a study done in 1989 or 1990 on assigned risk pools. Mr. Keck is going to look for the study. Mr. Wood suggested that MSF get any handouts to the committee 10 days prior to the meeting. The committee concurred.

Bruce Hockman, of Towers Perrin in Philadelphia, Pennsylvania, provided a presentation entitled "The Role of State Funds". (See attached) Mr. Hockman started in 1970 with Liberty Mutual Insurance in Philadelphia, then moved to the Pennsylvania Manufacturer's Association. Mr. Hockman worked with Governor Dick Thornberg in Pennsylvania as the Director of the Bureau of Workers' Compensation, and then began working for Towers Perrin.

Senator Mahlum asked what role the legal settlements played in the early 1980's, in regards to increased premiums. Mr. Hockman replied that there were jurisdictions whose benefits were categorized as a wage loss system, which meant that if an employee was hurt, that employee would have a percentage of his or her wages paid for the duration of the disability. When the employee was able to return to work with no restrictions, those benefits would stop. Medical would be paid all the way through. The far majority of states were what was called permanent partial disability states. The employee would get as well as possible, and then they would receive a permanent impairment rating of the disability and an amount would be paid to that employee, as a percentage of the impairment of the body. This system primarily used lump sum settlements, whereas in wage loss states, lump sum settlements were virtually never used. During that period of time, a number of wage loss states began to allow compromise and release settlements. This did a couple of things to the system. The system built rates and made investments based on holding reserves during the payment period of 10-20 years. All of a sudden, that payment span was shortened to 3 or 5 years.

Representative Laible asked Mr. Hockman to explain the significance of the NCCI assigned risk plan. If the assigned risk went down, and volume stayed the same, where did the volume go? Mr. Hockman explained that first, the chart represents billions of dollars. However the chart only represents those assigned risk plans that NCCI administers. It does not include the Montana State Fund. Two things were driving the premium down during that time. First was major system reform. Billions of dollars were taken out of the system. Second was putting competition back into the system. This

allowed the market to compete again. Investment returns were very high. Every state fund in the country saw the bottom of their premium writings in 1998 and 1999.

Representative Laible commented that during this same period of time, Montana State Fund policyholders hit bottom, with the least amount of policyholders, which means that private insurers made up the difference.

Mr. Swanson suggested that one other reason for the decrease in policyholders was that some of them may have gone out of business.

Senator Cocchiarella asked Mr. Hockman if he could design a workers' comp system, what would he do? Mr. Hockman replied that such a system should be financially strong. Workers' compensation is a very volatile market. Things were already getting bad, but on September 11th, the workers' compensation industry lost \$1.5 to \$2.5 billion in one day. The volatile nature of the business is such that financial soundness and strength is absolutely number one. The State Fund should be held responsible to be financially sound. Secondly, the State Fund needs to be able to make and execute good business decisions. Third, is that a State Fund in a jurisdiction like this has to be responsible for all employers. A state fund does not create its environment, but reacts to it. The environment is created by the private sector. An employer in Montana ought not to have any question that he or she can turn to the Montana State Fund for a policy. No employer should be treated like a second-class citizen as relates to service. There should be an avenue for complaints to be lodged. In most jurisdictions, the insurance department is responsible for that.

Mr. Driscoll asked about what other states did with percentage of benefits, and what cuts they made. For example, Montana cut benefits 65%, but only cut premium 38%. Mr. Hockman replied that Montana's premium was not driving the chart. There were huge battles during that period of time, and some of that had to do with looking at where the dollars were going. The biggest battles had to do with medical. Several jurisdictions went to a medicare fee schedule for medical reimbursement. If one were to look at the injury rate per hundred employees in 1988, and look at it in 1997, that there was probably an appreciable drop. Mr. Driscoll stated that Montana has a medical fee schedule, and always has had. In 1987, the legislature put in a cap so the fee schedule could not go up any more than the state's average weekly wage.

Representative Laible stated that Pennsylvania has been the "poster child" for economic development. He asked Mr. Hockman to go through some of the major legislation statutes that were passed to assist the state of Pennsylvania and how they compare to what has been done in Montana. Mr. Hockman replied that there were two major reforms in 1993 and 1995. The 1993 reforms were, in the most part, related to medical and legal issues. However, every jurisdiction benefited from a strong economy. Mr. Laible asked if Mr. Hockman would do a comparison between Pennsylvania and Montana by statute. He would like to see how Montana's system works now in comparison to what Pennsylvania is currently doing.

Mr. Steinman asked if what Representative Laible was really seeking was a combination of benchmarking and best practices, as a guide for future references. Representative Laible responded that the committee knows how Montana's workers' compensation system is structured now. Obviously, the legislature has done an excellent job of moving the system forward and reducing rates. Representative Laible would like to know how the structure of Pennsylvania's state fund is alike and different from Montana's. For example, does it come under the same regulatory system that Montana's does?

Senator Cocchiarella commented that she served on the committee in 1993 and there were several presentations made that compared Montana to other states. First of all, the wage in Montana is not nearly what Pennsylvania's is. Eddy McClure has a study, which she has prepared, and there are several other comparisons. Even though the study can present the information, she does not feel that Montana can be compared to Pennsylvania.

Representative Laible asked if Pennsylvania's workers compensation system comes under the same regulatory control that Montana's does. Does Pennsylvania have the same flexibility that Montana State Fund wants? Mr. Hockman replied that Labor and Industry is responsible for SWIF. Organizationally there is the Governor, the Secretary of Labor & Industry, the Deputy Secretary of Workers' Compensation and Collections. The person who reports to the Deputy Secretary is the Director of the Pennsylvania State Workers Insurance Fund. SWIF's budget is part of Labor and Industry's budget. SWIF is regulated by the Insurance Department. Mr. Driscoll asked who appoints the person who runs the state fund, and Mr. Hockman replied that the governor appoints that person.

Representative Laible asked if Pennsylvania's state fund is included within the guaranty fund. Mr. Hockman replied that they are not part of the guaranty fund.

Senator Cocchiarella asked Mr. Hockman what the committee should do in the face of the upcoming crisis. Mr. Hockman replied that the first thing is to understand it, and secondly is to understand what can be controlled and what can't be controlled. Mr. Hockman's biggest suggestion is to have sound financial companies doing the right thing, with quality service.

The committee discussed whether or not they wanted to receive more information from other state funds. Representative Laible suggested having one of the states come to Montana to speak to the committee. Mr. Jones stated that Michigan sold its state fund, so that would be an extreme example of privatization. Mr. Jones offered to pay for this. Mr. Swanson stated that Michigan had an assigned risk pool already in the state, so they sold their state fund. Nevada was a monopolistic state, which went to a three-way system in 1999, then completely privatized with the same leadership. Nevada also has an assigned risk pool. Mr. Wood replied that he does not think either Michigan or Nevada fit into a process that the committee can use, and he has reservations about going to other states with other conditions, and trying to compare them with Montana.

The committee consensus was that the committee would continue their meetings without that information. Mr. Jones requested the committee's permission to prepare some information regarding this issue and circulate it among the committee members.

The meeting was adjourned at 5:15 p.m.