

SENATE BILL 304 STUDY COMMITTEE
July 8, 2003

The first Senate Bill 304 Study Committee Meeting was held on July 8, 2003 at the Capitol Building, Helena, Montana.

Committee Members Attending

Senator Royal Johnson	Senator Bea McCarthy
Rep. Dave Lewis	Rep. Bob Bergren
Jacqueline Lenmark	George Wood
Jack Morgenstern	Tom Beck
Angela Huschka	

Others Attending

Anita Bennett, Montana Logging Association
Larry W. Jones, Liberty Northwest
Pat Murdo, Legislative Services Division
Carl Kochman, Wendt Kochman
Ed Henrich, MSF Board Member
Kent Rice, Legislative Audit Division
Sue Weingartner, Alliance of American Insurers
Shawn Bubb, Montana School Board Association
Aidan Myhre, The Gallatin Group
Don Judge, Teamsters Local 190
Bill Stevens
Jason Todhunter, Montana Logging Association
Steve Bender, Department of Administration
Mardi Madsen, MSF Board Member
Laurence Hubbard, Montana State Fund
Nancy Butler, Montana State Fund
Matthew Cohn, Montana State Fund
Mark Barry, Montana State Fund
Kathy Gowen, Montana State Fund

Tom Beck called the meeting to order and asked for nominations for a chairperson. Rep. Lewis nominated Senator Johnson, and the motion was seconded by Senator McCarthy. The committee unanimously voted for Senator Johnson as chairperson.

Senator Johnson stated that he believes that because the Senate and Montana taxpayers are financially responsible for the State Fund they ought to be more knowledgeable about it. Senator Johnson stated that he would like to have the committee meetings run similarly to the way they do in the legislature. Questions

should be asked through the chair, and some dialogue will be allowed. There will be no need to second motions.

Jacqueline Lenmark provided an overview of the responsibilities of the SB 304 study committee. The committee's specific roles are set forth in Section 2 of the bill as follows:

1. To determine if it is cost-effective and in the best interests of the state - Montana employees and Montana employers - to sell all or a portion of the State Fund, and then to create an assigned risk pool.
2. To make a separate determination regarding the sale of the assets of the Old Fund and the creation of an assigned risk pool.
3. The committee is to report to the legislature about its conclusions, and is to evaluate the role of the State Fund for the state of Montana's employees and employers.

Nancy Butler, General Counsel of the Montana State Fund, stated that Montana State Fund (MSF) will provide any support that the committee needs.

Senator Johnson asked for comments from the committee members.

Rep. Lewis spoke about three things he wants to get out of the committee's work.

1. A thorough discussion of state agency rates and how they are set. The State Fund has a monopoly with state agencies, and recently raised the rates substantially.
2. A discussion of small contractors who feel they are paying higher rates because of minimum premium. For the last 30 years, one of the major issues in having a State Fund is that it is important to keep rates affordable for small businesses, and some people are speculating that they are not getting as good a deal as they should.
3. If the State Fund were to be sold, how would it be valued?

Mr. Beck stated that the Governor's office agrees with Rep. Lewis. He would also like to make sure that the committee studies the high-risk pool. He also thinks the committee should get experience from other states. He agrees that the committee needs an idea of the value of the State Fund, and stated that the Governor would like more information on rate-setting.

George Wood said that he would like clarification on whether or not the State Fund is a state agency. He would also like to know about the relationship between private enterprise and the State Fund as based on actual costs; for example, the premium tax.

He would like to know why the State Fund is almost a monopoly. Is it because they are efficient and people want to go there or is because people do not know that there are other alternatives? He would also like to consider how much mini-management the legislature should have over the State Fund.

Senator McCarthy stated that she would like to know if the State Fund could be run more efficiently while still remaining a state agency, so that rates do not continue to be raised. Her biggest concern is the high-risk pool that must be kept for the employees in the state.

Ms. Lenmark stated that she agrees with all of the previous comments. She believes that the committee should exercise its initial focus on what the role of the State Fund is to be for Montana. Once that role is determined, that may direct the questions that follow.

Mr. Beck stated that the committee should identify what is driving rates up, and may be able to identify what other states are trying to do to control these factors.

Senator Johnson asked for public comment.

Larry Jones, Liberty Northwest, stated that the committee should feel free to ask Liberty for information or personnel. He believes that an assigned risk plan would bring transparency to the process, because there are servicing requirements in assigned risk pools that would ensure that everyone in that pool was treated consistently and uniformly. Liberty agrees that employers need affordable workers' compensation insurance, but it also wants the system to work fairly. Liberty is a private carrier, and believes the State Fund has an unfair competitive advantage. He stated that Liberty would be willing to provide speakers and experts to the committee.

Laurence Hubbard, President/CEO of MSF, thanked the committee for the opportunity to provide comment. He stated that MSF functions as a public entity under current law, and is required by law to have public meetings and open records, therefore MSF's board meetings are open to the public. Mr. Hubbard reiterated that once the committee and the legislature determine the role of MSF, a lot of the building blocks will fall into place. A critical threshold question is whether MSF is to service a guaranteed market. Is the private sector to fill the need for mandated insurance? It is the mandated aspect of workers' compensation insurance that drives the process. If it were optional, injured employees could file civil lawsuits in tort. Mr. Hubbard encouraged the committee to look at some of the models for system structure in various other states. He believes it is important to understand the kind of environment other state funds function in as well. The consequences of the sale of all or a portion of MSF are also very critical. Mr. Hubbard thinks that determining how to value MSF will be the most daunting challenge. Mr. Hubbard stated that Ms. Butler and the other staff will be available to assist the committee with whatever information it feels necessary. He would also like the opportunity to address such issues as ratemaking. MSF's rates are set by rule, and are required by the legislature to be neither inadequate, excessive, nor unfairly

discriminatory. MSF is subject to review by an independent actuary retained by MSF, and also to an actuary retained by the legislature. MSF's rates are reviewed annually by the Legislative Audit Division. Mr. Hubbard stated that there has been no issue with MSF's ratemaking process before, and he is very confident that the committee will find out that there are a lot of eyes watching the ratemaking process. He is disappointed that the committee feels the need for explanation, because of the transparency of the process should people choose to participate by providing comment and going to board meetings, but that it is very important to satisfy the committee.

Jerry Driscoll, AFL-CIO, said that the two most important issues for the committee to determine are the assigned risk pool and rates. The committee needs to look at rates for small employers, less than \$8,000 per year in annual premium. He stated that for the policy renewal period starting January 1, 2003, MSF has put in a tiered system. In his case, it meant a \$3,000 per year raise, so he went to the private sector. Most companies will not take any small employer in a risk that is more than just office, and that in an assigned risk pool, rates normally go up substantially. Once a business is in an assigned risk pool, it is usually hard for the business to get out of it.

Senator Johnson believes that the State Fund has done a good job of reporting in its annual 2002 report, and he would like to hear about how the five-year plan is going, and what the plan will be in the future. He would like to have some of the committee's meetings correlate with the MSF board meetings, and would like to have the committee included in any educational efforts on behalf of the board. He also suggested providing to the committee members the same materials and training that were provided to the board members.

Jack Morgenstern said that the committee would probably need to take the issues one at a time in some sort of priority. He recommended that the first few meetings have an educational focus. He spoke about the role of the Board of Directors of MSF. He outlined three methodologies to provide workers' compensation coverage:

1. A state monopoly system where private companies are not allowed to practice.
2. Private companies with an assigned risk pool - the state does not enter into workers' compensation insurance.
3. The state fund operates in competition with private insurers.

MSF has the obligation to provide insurance to the residual (high-risk) market. MSF does not have to make a profit, and does not pay taxes, but they are not able to pick and choose customers. Private insurers do have to make a profit and pay taxes, and are able to pick and choose customers. They have no obligation to take customers that they do not want. Mr. Morgenstern stated that MSF has approximately 27,000 customers, and there are about 5,000 employers whose premium is less than \$1,000 per year. There are 13,000 employers who pay less than \$5,000 per year. Somewhere in that range is the residual market, which is costly to manage. Mr. Morgenstern commented that the larger customers are actually subsidizing the smaller customers.

Mr. Wood commented that many people think the assigned risk pool is for those accounts that are bad risks. Because Montana is a rural state, the residual market will contain up to 13,000 employers. In order to keep perspective, he would like to know what the reserve and surplus are, and what their amounts are in dollars. He believes that with those numbers, the committee will get an idea of the size and trend of the State Fund. He thinks the committee should clearly understand that the State Fund is the assigned risk pool. That is the justification for having a state fund. Senator Johnson added this issue as an agenda item for the next meeting.

Senator Johnson asked what other information the committee would like regarding the role of the State Fund in the state.

Senator McCarthy said she is confused by the changes that have gone on in the fund in the last few years. She would like background information on how the State Fund works and how claims and policies are assigned.

Mr. Morgenstern stated that operation of MSF should be another agenda item. He also said that MSF is a leader in the business management industry. MSF recently re-organized and was flattened out and broken down from a hierarchy system into a series of business units, each of which is responsible for a different classification. There are six business units - specialty insurance companies in their own right. He would like to see MSF staff provide more detail to the committee. Mr. Hubbard agreed to provide the committee with educational materials regarding the operation of MSF.

Rep. Lewis feels that it would be helpful to have comparisons with other states and how those states operate their state fund.

Senator Johnson made a list of issues the committee is interested in:

1. State agency rates - Dynamic
2. Small contractor rates - Dynamic
3. How do we value the State Fund? - Static
4. Other state experience - Static
5. Educational opportunities - Static
6. High risk pool - Static & Dynamic
7. How much mini-management should the legislature have? - Static
8. Role of the State Fund - Static
9. What drives rates up? - Dynamic
10. Competitive advantages & disadvantages - Dynamic
11. Senate Bill 19 Study Committee - Static

Ms. Lenmark reminded the committee that the State Fund is a creature of statute, and that its role is set out in statute. Any changes in that role would require a change in statute, and perhaps a review of case law interpreting the statute.

Senator McCarthy asked if there was a ruling by Greg Petesch regarding Ms. Lenmark's question. Pat Murdo, Legislative Services Division, responded to her question, and stated that according to Mr. Petesch, the constitution might need to be amended if there were a decision to sell all assets.

Senator Johnson asked if the State Fund has a list of cumbersome legislation. Ms. Butler replied that this was discussed in the Senate Bill 19 study committee, and that information is available.

Senator Johnson asked if the committee would like to discuss the role of the State Fund based on the constitution and statutes. Senator McCarthy suggested that if the State Fund is going to be asked to do a presentation on their role, the private sector should also be able to make a presentation. Mr. Morgenstern suggested that the committee should look at the items on the list as either dynamic or static. For example, operating statement, and profit and loss statements are dynamic, while balance sheets are static.

Mr. Wood spoke regarding the high-risk pool, and stated that Senate Bill 304 asks the committee to make a comparison between MSF and an assigned risk pool, which makes it dynamic. Ms. Butler stated that it is both dynamic and static. The committee will want to look at how assigned risk pools work in other states, but will also want to look at what is unique about Montana and how a high-risk pool would work here. Mr. Wood stated that many of the dynamic issues will become static when the committee decides to do something in Montana. Mr. Morgenstern agreed, and stated that dynamics refers to the current operations of the State Fund.

Mr. Beck spoke regarding mini-management of the State Fund by the legislature. He stated that in the early 1990's, micro-management by government got the State Fund in trouble. Currently, the right people have been hired to manage the system. Senator Johnson said that he believes it is imperative that the administration is always aware of what is going on. Rep. Lewis asked about the Senate Bill 19 study committee, and whether or not it was designed to study the relationship of the State Fund and the legislature. Ms. Butler stated that MSF was looking at restructuring to be more like a private insurance company, including regulation by the insurance commissioner. For example, today MSF functions like a state agency, with some exemptions. Some of these things do not work well when functioning as an insurance agency. Senator Johnson asked what other things the State Fund was trying to change with its legislation. Ms. Butler used the example of the Board of Directors approving MSF's budget and any technology projects. As a state entity, MSF is also required to have ITSD approval for computer projects and contracts, which can cause delays. Mr. Beck commented that the consensus of the committee seemed to be that the state should keep MSF at arms length. Mr. Wood stated that one of the issues that was not really addressed was the authority of the insurance commissioner over the State Fund. Mr. Beck said that as long as there is a state workers' compensation fund, there will be some scrutiny by the executive branch. He is more concerned about rates getting too high. Senator McCarthy asked if the committee could have a copy of the report from Senate Bill 19, which Ms. Butler agreed to provide. Rep. Bergren commented that

there is another committee looking into the workers' compensation system, and asked if anything could be done to avoid duplication. Mr. Hubbard replied that there are two other committees, the Interim Economic Affairs Committee, which is primarily looking at procedural changes within the workers' compensation act. Also, the Department of Labor is studying the independent contractor law. Senator Johnson asked about the makeup of the Senate Joint 17 committee. Ms. Butler replied that it was formed to study making the workers' compensation act more user friendly, and does not mention MSF. The Department of Labor is handling Senate Bill 270, which is to study independent contractor issues, and there are a variety of interested parties serving on that committee.

Mr. Morgenstern commented that he would like to add the results of the Senate Bill 19 study committee to the topics of discussion. Ms. Huschka replied that a lot of work was done that she feels would be beneficial for the committee to go through. Senator McCarthy agreed that it would be helpful to have those materials. Ms. Butler agreed to send the Senate Bill 19 study committee final report and minutes.

The next topic of discussion was the competitive advantages or disadvantages of the State Fund. Senator Johnson said that the committee needs to ensure that it does not put the State Fund into a disadvantage, but also needs to allow private insurers to come into the state.

There was some discussion about looking at the assets and liabilities of the State Fund, as well as surplus and reserves. Mr. Wood said that the committee must understand what reserves are. Mr. Hubbard agreed that this was important, and that it could be supplied at the next meeting.

Senator Johnson asked how often an actuary looks at the State Fund's financials. Ms. Butler replied that it happens once in the spring, when the actuary looks at rates and determines if a dividend can be declared, and once in the fall for the reserve report which is presented to the Board of Directors.

There was some discussion about how often the Board of Directors meets, and whether or not agendas for the board meetings could be provided to the committee members. Senator Johnson feels that it would be beneficial for the committee members to attend a Board Meeting. Mr. Hubbard volunteered to coordinate the committee meetings and board meetings. He explained that he travels to the board members in advance of the meeting and discusses the agenda items with them, so that he can answer any questions in advance.

Based on the committee's input and comments, Ms. Butler proposed an agenda for the next meeting as follows:

- I. Role of MSF
 - A. Overview of MSF
 - B. Ratemaking

1. NCCI Rates
 2. Overview of Process
 - a. State Agencies
 - b. Tiered Pricing
 3. What Factors Drive Rates
 4. Segment Information
- C. How Do You Value MSF?
1. Financial Condition
 2. Role of Surplus
 3. Reserves
- D. Competitive Disadvantages or Advantages
1. Plan II Position
 2. MSF Position
 3. SB 19 - Proposed Legislation/Legislative Oversight
- E. Public Comment

Other Issues

Other states experience

Assigned risk pool

There was some discussion among the committee members about allowing other interested parties such as insurance companies, employers, and employees, etc. to provide public comment on their view of the role of the State Fund. Senator Johnson suggested that one hour be added for public comment. Ms. Lenmark commented that other insurers concerns would be addressed under item D, "Competitive Disadvantages or Advantages." Mr. Wood would also like to hear from the union. Senator McCarthy feels that it would be beneficial for someone from NCCI to speak to the committee about ratemaking and other states' experience. Ms. Butler referenced a letter from Mike Taylor, explaining that NCCI would not take a position, but would be willing to provide information within their expertise. There was some discussion about having Mr. Taylor, and possibly their actuary, speak to the committee at the next meeting. The committee consensus was that this would be beneficial.

The committee discussed the length of the meeting, and the consensus of the committee was to have a two-day meeting.

Mr. Wood asked a question about the topic of segment information. Mark Barry, Montana State Fund, explained that segment information would explain the experience of MSF based on size of premium and industry types. He explained that small books of business are volatile, which makes pricing more difficult. Mr. Barry also spoke about reserves, and explained that reserves are made up of losses and how much is set aside to manage those losses.

There was some discussion about what information should be presented by NCCI. Ms. Butler explained that NCCI is fairly accessible, and a representative could be present at most of the meetings.

Ms. Huschka suggested having a review of the Legislative Auditor's role in preparing their report of the State Fund's financials. It was also mentioned that a Legislative Auditor's Report on the review of State Fund rates would be beneficial. Ms. Lenmark suggested having a presentation on how the Insurance Commissioner regulates rates for private companies, the function of the classification committee and how NCCI files the advisory rates.

Rep. Lewis would like information on the Old Fund and New Fund, and feels that this would fit under the topic of valuing the State Fund.

Mr. Morgenstern suggested looking at what can be done to make the State Fund more efficient; for example, statistical comparisons to other state funds.

There was some discussion about the use of a facilitator. The consensus of the committee was that a facilitator is not needed. Mr. Beck stated that if at some point the committee actually decides to sell the State Fund, a facilitator might be needed.

Mr. Wood recommended that the committee members consider attending the Governor's Conference on Workers' Compensation, which is to be held October 1st, 2nd and 3rd.

The next committee meeting was scheduled for September 23rd and 24th, 2003 and will be held at the Capitol in Helena. The committee discussed how often the meetings would be held. Senator Johnson suggested that the committee should see how the next meeting goes.

It was decided that Kathy Gowen, Montana State Fund, will take minutes of the committee meetings.

The next topic of discussion was a website to be used for posting information about the study committee. There were some questions about tying the website to the legislature's page. Matthew Cohn, Montana State Fund, stated that because this committee is not an official legislative committee, it would not be appropriate to put the materials on the legislative website. It would be simpler to have another domain, such as www.sb304.com, which the committee members and the public could access. It was decided to have a separate domain with a link to the website from the economic affairs page. Mr. Beck stated that there should also be a link from the Governor's website to the SB 304 website.

Mr. Morgenstern mentioned that he would like to have paper copies of the materials mailed to the committee members. He also corrected a statistic that he had quoted

earlier, regarding MSF's residual market: 5,500 of MSF's customers pay a premium of \$300 or less. An additional 14,000 accounts pay \$1,000 or less in premium.

Senator Johnson raised the issue of preparation of the final report. It was agreed that MSF would be responsible for preparing the final report, with the committee's review and approval.

Senator Johnson asked for additional public comment.

Don Judge, Teamsters Local 190, suggested that when studying the value of the Montana State Fund, the committee should look at the market share, the stability of customers, the type of customers, and the contract terms with those customers. The committee will also want to look at outstanding liabilities and current financial condition.

Mr. Hubbard suggested that other experts are available to speak to the committee. MSF uses Tillinghast Towers-Perrin as an independent actuary, and for reinsurance. Mr. Hubbard offered to contact these people if the committee is interested.

Mr. Beck stated that he believes the first meeting will be educational, then the committee can decide what experts they want to hear. He said that the purpose of the committee is to decide whether or not to privatize the State Fund, and that the State Fund itself had wanted to privatize. Mr. Cohn clarified that the purpose of the Senate Bill 19 study committee was not to actually privatize the State Fund, but to change the structure and function, while still operating as a public entity. Mr. Beck stated that he wants to make sure that all of the things the Senate Bill 19 study committee looked at are on the table for this committee.

The meeting was adjourned.