SENATE BILL 304 STUDY COMMITTEE
May 11, 2004

The sixth Senate Bill 304 Study Committee Meeting was held on May 11, 2004 at the Holiday Inn Downtown, Helena, Montana.

Committee Members Attending

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

Others Attending

Larry Jones, Liberty Northwest
Herb Leuprecht, MSF
Steve Bender, Department of Administration
Tom Schneider, MPEA
Bob Biskupiak, Payne Financial Group
Steve Pilcher, Montana Stockgrowers Association
Stacey Bird, MPEA
Aidan Myhre, Gallatin Group
Ann Nelson, Employers Insurance Group
Larry Kibbee, PCIAA
Jerry Keck, Department of Labor
Eddye McClure, Legislative Services Division
Laurence Hubbard, MSF
Nancy Butler - MSF
Peter Strauss, MSF
Layne Kertamus, MSF
Curt Larsen, MSF
Mark Barry, MSF
Matthew Cohn, MSF
Kathy Gowen, MSF

I. Opening Comments

Senator Johnson called the meeting to order at 8:00 a.m. The minutes of the March 26, 2004 meeting were approved as submitted.

II. Old Fund

There was discussion about the determination on the sale of the Old Fund. *George Wood made a motion that the committee make a recommendation to the legislature not to sell the Old Fund*. There was discussion about the possibility of doing a RFP for the sale of the Old Fund. *Representative Lewis offered a substitute motion that the committee ask staff to prepare a RFP to determine what the market believes the value of the Old Fund might be*. Senator McCarthy raised questions about the proper procedure to carry out these motions, and the committee's authority. Ms. Butler explained that SB 304 states "the committee shall prepare any necessary legislation to implement a recommended sale". If the committee were going to recommend a sale, the committee would have the authority to prepare draft legislation to go with its report.

There was discussion about the motion and substitute motion, as well as discussion about the state's liability for the Old Fund.

Jacqueline Lenmark encouraged the committee to amend Representative Lewis' motion so the state has the ability to decline a bid. *Representative Lewis so amended his motion.*

Scott Seacat, Legislative Auditor, spoke about the issue of paying claims in the Old Fund. He said that it is his understanding that the term "pay claims" means cash, therefore the General Fund does not have an obligation to the Old Fund until the Old Fund is out of cash. However, an actuary should still continue to make a projection of Old Fund liabilities. Nancy Butler, General Counsel of Montana State Fund (MSF), said that § 39-71-2352, MCA, states that in any fiscal year, after the tax is terminated, if claims are not adequately funded, then any amount necessary to pay claims must be transferred from the General Fund. The term "adequately funded" requires that all the money necessary to pay claims and administer claims be set aside. Ms. Butler explained that there is potential for different interpretations.

There was discussion about the potential costs and administrative burdens of doing a RFP.

Mr. Wood withdrew his motion and Representative Lewis withdrew his substitute motion.

David Hunter suggested that the MSF Board of Directors would have the authority to issue a RFP for the Old Fund. Laurence Hubbard, President/CEO of MSF, explained that the General Fund owns the Old Fund, while MSF administrates the claims. MSF does not oppose or suggest that the committee should consider a RFP approach. Mr. Hubbard stated that he believes a RFP would more logically be run through the Department of Administration, on behalf of the legislature. The RFP process could impact the operations of MSF, depending on the level of due diligence required. He does not believe it is the place of the Board of Directors or MSF management to assess the RFP.

Senator McCarthy asked if the committee has the authority to direct MSF to prepare a RFP. Ms. Butler replied that she believes the committee could recommend and propose legislation that would require that. She also said that she does not think the Board of Directors has that authority. There was discussion about who has the authority to issue a RFP or request an appraisal.

Ms. Lenmark stated that there is a two-step process in SB 304, and that the language in sub-section one of the bill does empower the committee to determine whether it would be cost-effective to sell either the New Fund or the Old Fund. She explained that she thinks sub-section three gives the committee the authority to utilize the services of other executive branch agencies. Sub-section four gives the committee the authority only to recommend to the legislature whether to go forward on a recommended sale if determined to be cost-effective. She does not think the committee has the authority to accept a bid.

There was discussion about whether or not anyone would bid on a RFP issued by a party that could not make decisions about the RFP.

Ms. Butler explained that there is enough funding for the committee to hire experts to get additional information, and it might help to get an independent opinion on the value of selling the Old Fund.

There was discussion about the current situation in the Old Fund, and what would trigger a General Fund obligation. Mr. Hubbard clarified that as of the end of the third quarter, the Old Fund is projected to be $888,000 in the green, while by the end of June, given current payout patterns, it will be approximately $500,000 under-funded.

Mr. Beck asked what the trigger was to transfer money from the Old Fund Reserve to the General Fund. Mark Barry, Vice President of Corporate Support of MSF, explained that the law currently says that there is supposed to be zero surplus in the Old Fund. *Mr. Beck made a motion that the committee try to determine what the figure should be before it triggers either the State Fund to pay into the General Fund, or the General Fund to pay into the State Fund and see if the committee can determine that and present some legislation to the legislature on that aspect.*

Jack Morgenstern suggested having $7.5 million as a swing limit, and stated that he felt this would be actuarially prudent. The legislature could review this annually, and make periodic adjustments as necessary.

Senator Johnson asked why it would be a problem to use the reserve money to pay claims as they occur. Mr. Beck suggested that there should be some variables so the General Fund does not have to be triggered every year.

Mr. Beck withdrew his motion.

Senator Johnson made a motion that the committee recommend to the legislature that they have staff prepare a RFP for sale of the Old F und.

There was discussion about Senator Johnson's motion, including the fact that because of due diligence, the first time the legislature would be able to act would be in 2007. The motion also does not address the issue of a trigger mechanism.

Ms. Lenmark made a substitute motion that the committee request the SB 304 staff to prepare for the committee an inventory of all adverse development protection mechanisms, which includes specific costs and result projections. Those mechanisms could include, but not be limited to; an RFP for sale, loss portfolio transfers, reinsurance and other mechanisms to enable the committee to make a specific recommendation regarding the status of the Old Fund to the 2005 legislature.

Senator Johnson asked Ms. Butler how long it would take for MSF to prepare this information. Ms. Butler replied that there may be some difficulty in getting definitive numbers, and would probably take 2-3 months. Mr. Hubbard clarified that MSF would need to use a reinsurance broker, and would like to use Tillinghast-Towers Perrin, unless the committee prefers to use someone else. Mr. Hubbard estimated that such a study could cost around $10,000. This assumes that the committee will accept MSF's actuary's results.

There was discussion about which agenda items Ms. Lenmark's motion was intended to address. Ms. Lenmark stated that it was not her intention to make her motion cover all three agenda items. Ms. Lenmark also commented that it should be implicit in the committee's recommendation that any other actuarial analysis undertaken to bring proposals to the committee should be funded by the interested entity.

The committee voted on Ms. Lenmark's motion. There were eight (8) votes in favor, one (1) vote opposed. Senator Johnson opposed the motion. The motion passed.

III. University System Update

Jerry Keck, Administrator of the Employment Relations Division, Department of Labor and Industry (DOLI), gave an update on the University System's self-insured status. DOLI has the responsibility to review, approve, and oversee the self-insured employers in Montana.

Mr. Keck gave an overview of the manner in which self-insureds operate. DOLI allows employers and groups of employers who can demonstrate financial ability to self-insure. Currently, there are 48 employers or groups of employers who are self-insured. 43 of those are private employers, while 5 are public groups. For private groups, the Montana Self-Insurers Association and the Montana Self-Insurers Guaranty Fund has joint responsibility with DOLI to approve, renew and set the security deposit amounts for all private insurers and private insurer groups. DOLI has sole responsibility for oversight of the public groups. All public and private groups are obligated to submit an annual review, a re-application process, and a re-approval process on an annual basis. Part of that annual process is to submit audited financial statements and a certified actuarial report showing their claim history and liabilities. A DOLI staff member reviews the financial statements and actuarial reports in order to do an analysis of where each self-insured sits in terms of liabilities, assets and surplus. Overall, the average of the 48 private self-insurers' surplus is 38%. The surplus position of the five public groups is 25%.

The Montana University System (MUS) was approved to self-insure on July 1 of 2003. The MUS chose to issue revenue bonds in the amount of $2 million in order to have sufficient assets to operate their program. The MUS has not yet had a full year of experience, but had a renewal review on April 1, 2004. The MUS was renewed to continue to self-insure from April 1, 2004 to March 31, 2005. DOLI determined that the MUS is off to a strong start. In the first six months, they accumulated 14% surplus, which represents $366,000 as of December 31, 2003, with assets of approximately $2.8 million and liabilities of approximately $2.3 million. DOLI will be reviewing the MUS again after a full year of operation, and will look at the audited financial statements and actuarial report, with the goal of having a 25% surplus position.

There was discussion about the high percentage of reserves. Mr. Keck explained that the actual obligations of the MUS are 100% reserved, while the targeted 25% is a surplus that would guarantee against fluctuations and adverse development. Industry recommendations are 30-35% surplus, but DOLI has set a minimum of 25% for public groups. One reason for this is that DOLI has waived the requirement for public groups to provide a security deposit.

Senator Johnson asked if the MUS has a top limit of loss per accident. Mr. Keck replied that DOLI requires all self-insurance groups to hold excess insurance to cover claims over a certain dollar limit. For the MUS, the limit is $500,000 per injury. Senator Johnson asked how DOLI monitors the MUS. Mr. Keck responded that DOLI does an annual review of the group's financial strength, and renews the group based on that analysis. DOLI has the authority to deny a group the ability to self-insure, and can tell that group to raise its rates so that it can be fully reserved and have a certain level of surplus. Mr. Wood explained that there is joint and several liability with the other members of the group in the public groups, but with the private groups, there is also joint and several liability with all the other self-insureds.

IV. Committee Proposals for Any Additional Legislative Oversight of Montana State Fund

There was discussion about having a group of legislative members who regularly meet with the MSF Board of Directors.

Senator McCarthy made a motion that the committee recommend to the legislature that that two House members - the Chair of the Business Committee and the lead minority person, and the same in the Senate - the Chair of the Business Committee and the lead minority person - be named as liaison members to the Board of the State Fund.

There was discussion about the fact that the Chair of the Business Committee and the lead minority person would be likely to be termed out, and discussion about the purpose the liaisons would serve - communication vs. oversight.

Senator McCarthy amended her motion to state that the Committee recommend to the legislature that two members of the House and two members of the Senate, appointed by the leadership, would be attached as liaisons to the Board of the State Fund, and it is understood that they would receive the briefings and pre-information that currently is supplied to the regular board members, and they would be appointed as early in the legislative session as the leadership could do it so that we have the continuity of the fund.

The Committee voted on Senator McCarthy's motion. The motion was passed unanimously.

V. Role and Purpose of the Montana State Fund

A. Public Comment

Senator Johnson asked for public comment. Seeing none, the meeting continued.

B. Guaranteed Market Function/Federal Tax Exempt Status

There was discussion about the makeup of MSF's Board of Directors and the possibility of some of the board members being elected by MSF's policyholders. *Ms. Lenmark made a motion that three of the seven Board of Directors be elected by the policyholders.* There was discussion about the logistical difficulties that would be raised by such a change, such as finding qualified and motivated candidates and the election process.

The Committee voted on Ms. Lenmark's motion. There were two (2) votes in favor of the motion, seven (7) votes opposed to the motion. The motion failed.

C. Payment of Premium Tax

Ms. Lenmark made a motion that the State Fund be required to collect and remit to the state of Montana pursuant to 33-2-705, MCA, a premium tax as private insurance companies are required to do. The State Fund would commence payment of the tax in calendar year 2006.

There was discussion about the difficulties of switching between calendar and fiscal years. Mr. Barry explained that once legislation is passed, MSF would need 18 months after the passage of the law, which would be January 1, 2007, if passed in the 2005 session. Ms. Lenmark asked why it would take 18 months. Mr. Barry replied that MSF would need to make changes to its system, and explained that MSF currently reports its financials on a fiscal year basis.

Mr. Hunter explained the manner in which private insurers pay the premium tax.

There was discussion about whether the premium tax should be paid to the State Auditor or to the Department of Revenue.

Ms. Lenmark amended her motion to state that the tax be paid to the Department of Insurance as private carriers do, if the Committee makes other decisions that bring the State Fund under the regulation of the Insurance Commissioner, or to the Department of Revenue if the Committee decides not to bring the State Fund under the regulation of the Insurance Commissioner, but in any event, that the amount required of private carriers under 33-2-705, MCA, be required as a payment of tax from State Fund.

There was discussion about the impact of the premium tax on the General Fund and on rates.

Mr. Wood made a substitute motion that the committee recommend to the legislature the removal of the premium tax on all employers in the state.

There was discussion about the merits of Mr. Wood's motion.

The committee voted on Mr. Wood's motion to eliminate the premium tax on workers' compensation premiums. There were three (3) votes in favor of the motion, six (6) votes opposed to the motion. The motion failed.

Senator Johnson made a substitute motion that the committee recommend that the legislature assess a premium tax on the State Fund, allowing the assessment to start at 1% in fiscal year 2006, at 2% in fiscal year 2007 and 2.75% in fiscal year 2008. From then on the State Fund would pay the same tax as other providers in the state pay. The tax would be paid to the Department of Revenue.

The committee voted on Senator Johnson's motion. There were six (6) votes in favor of the motion, three (3) votes opposed to the motion. The motion passed.

D. Status as Sole Carrier of State Agencies

There was discussion about the possibility of allowing Montana State Fund to act as a third-party administrator for public entities.

Mr. Beck made a motion that the State Fund be allowed to bid on third party administrator services to public entities, such as MACO, MUS, etc.

Mr. Wood made a substitute motion limiting the State Fund's third party administrator services to state agencies who are presently captives of the State Fund, if and when they are released to choose other types of insurance.

Mr. Hubbard clarified that MSF believes it is appropriate to provide third party administrator services for both state agencies and public entities.

The committee voted on Mr. Wood's motion. There were four (4) votes in favor of the motion, five (5) votes opposed to the motion. The motion failed.

The committee voted on Mr. Beck's motion. There were seven (7) votes in favor of the motion, two (2) votes opposed to the motion. The motion passed.

E. State Agency Status of Montana State Fund

Mr. Hubbard explained that MSF would like the ability to choose platforms for delivering insurance products to its customers. MSF is highly focused on an architecture that enables web-based applications. Currently, those proposals must be run through ITSD, which can impact MSF's ability to get those delivered to customers in a timely manner. As an insurance company, MSF does business differently than traditional state agencies. Mr. Hubbard explained that the same is true with procuring other goods and services. MSF currently has an exemption for procuring insurance related services. Exemptions from state agency requirements would give MSF greater flexibility.

Steve Bender, Acting Director of the Department of Administration (DOA) explained that it is the public policy of the state of Montana to go through the central procurement process, in order to level the playing field and have a fair and competitive process. He stated that it does take a lot of time to prepare a RFP. Mr. Bender said that it is up to the committee to decide if the benefits of the procurement policy outweigh the cost in this instance. Mr. Bender explained that DOA is preparing a budget with assessments to all the state agencies, based on current law and current lines of business. If the State Fund were to pull out, it would mean about $1 million in lost business to DOA. DOA would need to plan for this loss of business.

Mr. Morgenstern made a motion that the committee recommend to the legislature that the State Fund be granted the exemptions as requested, including the exemption from the requirement to run IT things through ITSD, and also to be exempted from the current state procurement requirements for other goods and services, with a provision to communicate and work and plan with the Department of Administration.

The committee voted on Mr. Morgenstern's motion. There were four (4) votes in favor of the motion, five (5) votes opposed to the motion. The motion failed.

F. Montana State Fund Office Building - Sale/Rent/Build

Senator Johnson referenced page 4 of the MSF Memorandum Re: Montana State Fund Position on Legislative Options (Attachment A) regarding the amounts paid by MSF for its office building.

Senator Johnson made a motion that the committee recommend to the legislature that they request the Department of Administration review the current lease with the State Fund to determine the fairness of the lease arrangement for both the State Fund and the building owners.

There was discussion about who actually owns the building, and also about what constitutes a fair market rate for the lease of the building.

The committee voted on Senator Johnson's motion. There were nine (9) votes in favor of the motion, and no votes opposed. The motion passed.

G. Insurance Commissioner Regulation

Mr. Hunter stated that Commissioner Morrison has indicated that the State Auditor's Office would take whatever direction the legislature gave them about the regulation of the State Fund, but Commissioner Morrison's position is that if he is to have regulatory authority over the State Fund, he would like regulatory authority that is as close to private carriers as possible, with some exceptions, such as no liquidation.

There was discussion about the proposed exemptions. Ms. Lenmark stated some of the exemptions, such as: the State Fund would not be required to participate in the Guaranty Fund, and could not be liquidated by the Insurance Commissioner. Ms. Lenmark also explained that there are separate privacy regulations within the Workers' Compensation

Act that would probably be given priority over the privacy laws typically applied to insurance companies, because the State Fund writes a single line of insurance. Another issue that would need to be considered would be fraud investigations.

Mr. Hubbard explained that MSF is different from other insurance companies by definition, and listed the most important exceptions:

1. Fraud Investigation and Prosecution is currently done through the Department of Justice. As MSF has a good history and track record with the Department of Justice, it would make sense to maintain this.

2. MSF's investments are required by law to be managed by the Board of Investments.

3. Ratemaking authority and responsibility is currently held by the Board of Directors. MSF uses the same ratemaking process and procedure that private companies use, taking the NCCI loss costs to create multipliers. Because MSF is the guaranteed market, MSF feels it is important that the Board of Directors maintain the responsibility for ratemaking.

4., MSF has developed special classifications and has some differences in class code usage that would take considerable effort and time to change. The exceptions are mainly state agencies and the agricultural code.

Mr. Hunter explained that the Insurance Commissioner reviews private insurance companies' rates to see whether they are excessive, inadequate or unfairly discriminatory, but it is actually the Board of Directors of the insurance company who sets the rates. The Insurance Commissioner only takes action on an insurance company's rates if the standards are violated. The Insurance Commissioner must make a case that it violates one of those standards. Mr. Hunter stated that he does not believe the investment issue is a legitimate issue, as the Insurance Commissioner does not regulate how private insurance companies invest their money, and neither is the fraud issue a make or break issue. Mr. Hunter does feel that the classification code issue is legitimate. Mr. Hunter stated that one issue is adjustment of claims and who consumers have the right to complain against, while another issue is investigation of insurance agents and sellers. The Insurance Department currently has authority in both areas.

Ms. Lenmark made a motion that the committee make a decision on the policy that the State Fund (to the extent that is consistent with its mission) be regulated under the authority of the State Auditor and Commissioner of Insurance. She also moved that a sub-group of the committee come back with recommendations about the other issues.

Ms. Lenmark clarified that there is a dual system of regulation in the workers' compensation system. The regulation that is delivered through the Insurance Commissioner's office has to do with ratemaking, policy forms, solvency of the company, etc. There is a separate regulatory system that is administered through the Department of Labor over the delivery of the benefits system. All three plans are currently regulated under that uniform system of benefit delivery.

Representative Bergren asked for clarification of the motion. Ms. Lenmark explained that her motion is that as a policy statement of the committee, the committee recommend that the State Fund be regulated under the authority of the State Auditor, Commissioner of Insurance, for the things that are regulated by the Insurance Code, and that there be further direction to come back to specific issues.

The committee voted on Ms. Lenmark's motion. There were three (3) votes in favor of the motion, six (6) votes opposed to the motion. The motion failed.

VI. Role of Montana State Fund

Mr. Hubbard explained that there are two essential principals which MSF supports. The first is to maintain MSF's role as the guaranteed market for Montana employers, and the second is to be a competitive marketplace for Montana employers to purchase their worker' compensation insurance under the three-way system.

Senator Johnson made a motion that Mr. Hubbard's statement be the role of the State Fund.

The committee voted on Senator Johnson's motion. There were eight (8) votes in favor of the motion, one (1) vote opposed to the motion. The motion passed.

Ms. Lenmark made a motion that MSF not be entitled to have state agencies as an exclusive book of business, and that that business be available for self-insurance or to private carriers.

Representative Lewis asked if the state agencies would be treated as a block or as individual agencies. Ms. Lenmark replied that she believed that the various executive branch agencies could make those determinations separately, or some of the agencies could be marketed as a group. If they were not able to find coverage in the private market, they could still go to the State Fund.

Mr. Hubbard stated that if the committee were to make that decision, MSF would ask for a period of time to adjust to the change in business. MSF would need to right size through appropriate staffing reductions to anticipate losing the book of business.

Ms. Lenmark reminded the committee that the State Fund has been on record for several sessions running, that at some point in the future they would support this with an appropriate transition period.

Mr. Hubbard recommended a four-year transition period.

Senator Johnson asked if the fact that most state agencies' premiums are paid by taxpayers would make any difference. Ms. Lenmark explained that all premiums are paid by taxpayers. Perhaps the state will not find more cost-effective insurance anywhere, but she believes it would benefit state agencies to look for more cost-effective insurance, and would also put the three plans on a more equitable footing.

Mr. Morgenstern amended the motion to delay the freeing of the state agencies for 4 years.

Mr. Beck stated his concerns about allowing individual agencies to choose their own insurance. Ms. Lenmark clarified that her motion allows the state to choose whether it goes as a pool, or agency-by-agency.

The committee voted on Mr. Morgenstern's amendment. The motion passed unanimously.

The committee voted on Ms. Lenmark's motion. There were eight (8) votes in favor of the motion, one (1) vote opposed to the motion. The motion passed.

It was decided to have the next meeting at the end of August. This will allow time for the Old Fund report to be prepared.

The meeting was adjourned.