

SENATE BILL 304 STUDY COMMITTEE
August 20, 2004

The sixth Senate Bill 304 Study Committee Meeting was held on August 20, 2004 at the Holiday Inn Downtown, Helena, Montana.

Committee Members Attending

Senator Royal Johnson
Representative Dave Lewis
Jacqueline Lenmark
Jack Morgenstern
David Hunter

Senator Bea McCarthy
Representative Bob Bergren
George Wood
Tom Beck

Others Attending

Larry Jones, Liberty Northwest
Mark Cole, Dick Irvin, Inc.
Tom Schneider, MPEA
Roger McGlenn, IIAM
Steve Bender, Department of Administration
Stacey Bird, MPEA
Jason Todhunter, MLA
Aidan Myhre, The Gallatin Group
Herbert Leuptrecht, MSF
Bill Stevens, Self
Laurence Hubbard, MSF
Nancy Butler - MSF
Peter Strauss, MSF
Mark Barry, MSF
Kathy Gowen, MSF

Senator Johnson called the meeting to order at 8:30 a.m. The minutes of the May 11, 2004 meeting were approved as submitted.

Senator Johnson reviewed the report entitled "Old Fund Report Requested by SB 304 Study Committee" (Attachment A). Representative Lewis asked Mark Barry, VP Corporate Support of Montana State Fund (MSF) if the cash flow option for the Old Fund dictates that the Old Fund should go through its current assets and investment income before any transfer is made from the General Fund, eliminating the actuarially sound concept. Mr. Barry responded that the draft legislation would put the Old Fund on a cash flow basis, so that money would be paid out from current assets before going to the General Fund for an appropriation.

Nancy Butler, General Counsel, MSF, distributed a document entitled "Draft Term Sheet, Loss Portfolio Transfer, Old Fund Liabilities". (Attachment B) Bruce Hockman, of

Tillinghast-Towers Perrin obtained an anonymous hypothetical offer, based on the FY03 financial statistics of the Old Fund. This document shows that for \$81 million in premium, the company could provide \$103 million in liability coverage. The Old Fund currently has about \$71 million in assets; therefore another funding source would need to be found for the additional \$10 million to fund this option. Ms. Butler explained it is likely that additional funds would need to be added to the funds currently available in the Old Fund for any risk-financing alternative. It is also clear that should the limits of liability in the Old Fund exceed the coverage provided, the liability would go back to the state.

Mark Barry, VP Corporate Support, MSF, explained that the proposal received was based on the June 30, 2003 loss reserve estimate. The company reviewing the proposal based their estimate on this information. Mr. Barry provided some preliminary indications on the Old Fund. The consulting actuary indicates that the Old Fund has seen adverse development on the medical side of \$10 million, while the indemnity side was down \$3 million for a net increase in loss reserves of about \$7 million over that June 30, 2003 number. The situation has since changed. The re-insurer's proposal is used as a possible scenario, but should the legislature choose to go this route, there would need to be a great deal of review and due diligence. This means that on a discounted basis, the Old Fund would be unfunded at this point by approximately \$4+ million. Mr. Barry explained that these are unaudited, preliminary numbers, and that MSF does not yet have the actuary's report.

Mr. Barry provided four exhibits entitled "Old Fund Financial Modeling" (Attachment C).

There was discussion about the exhibits, the merits of different risk financing alternatives, and re-insurance.

Senator Johnson asked for public comment. No comment was received

Tom Beck moved that the committee take the option of selling the Old Fund off the table.

Senator Johnson asked for discussion on the motion. Jack Morgenstern stated that he would like to reinforce the idea of managing the Old Fund. He believes it is always more economical to self-insure, and the state of Montana is in a better position to assume the risk than anyone else. The New Fund is in the business of managing the liability and does it very economically. He said that he believes the Old Fund should be kept on a cash flow basis.

The committee voted on Mr. Beck's motion and the motion was passed unanimously.

In light of the previous motion, the committee agreed to not look at the bill regarding the sale of the Old Fund. Nancy Butler, General Counsel, Montana State Fund, asked if the committee would want to make a recommendation regarding the cash flow option attached to the Old Fund report. She explained that there is some difference of opinion as to whether the statute requires the Old Fund to be adequately funded or whether it says "cash flow". Ms. Butler explained that MSF's concern is that the statute requires adequate funding today, meaning that the General Fund would need to transfer \$4 million dollars to the Old Fund to keep it actuarially sound. Senator Johnson explained to the committee

that they were provided with a bill, (attached to the Old Fund Report - Attachment A) which would put the Old Fund on a cash flow basis, and would clarify the situation. There was discussion about whether or not the Governor's office was prepared to transfer \$4 million to the Old Fund this fiscal year, as well as discussion on the merits of legislation to clarify the situation. Steve Bender agreed to have the Department of Administration's legal counsel look at the issue. Representative Lewis raised the issue of whether or not the state would be borrowing to cover a deficit. Senator Johnson asked Ms. Butler if it was correct that money would not need to be transferred to the Old Fund until after the next legislative session. Ms. Butler responded that there are different opinions, but her interpretation of the law is that this fall, if there were a shortage in the Old Fund for ultimate liabilities, MSF would notify the budget office that a transfer needed to be made to the Old Fund in order to keep it adequately funded. There was more discussion on the issue of borrowing money to pay a deficit.

Mr. Morgenstern made the suggestion of having a sinking fund approach. Every year the legislature would contribute a payment that would be amortized over the period of time to bring us to point zero, and would be recalculated every year. This would be a modest commitment for the legislature on an annual basis. George Wood stated that Mr. Morgenstern's proposal is actually maintaining actuarial soundness. Mr. Wood said that he strongly supports the cash flow option. David Hunter also expressed concerns about a time-pay proposal. Mr. Beck said he believes that at this time, the budget director will probably not put money into the Old Fund.

Mr. Hunter asked Mr. Bender if he agreed that if the committee were to determine Old Fund should be on a cash flow basis, no legislation would be necessary, because the Legislative Auditor believes the existing statute requires payment only on a cash flow basis. Mr. Bender stated that he interprets Scott Seacat's response to this question, and his chief accountant's similar response, to say that a liability exists when the Old Fund runs out of cash. Mr. Bender said that he believes that will be the Budget Director's interpretation as well. Mr. Hunter asked Ms. Butler if she agrees that MSF believes the Old Fund is on an actuarial basis; therefore MSF thinks legislation will be necessary to clarify that the Old Fund is on a cash flow basis. Ms. Butler responded that it would be very helpful to have clarifying legislation, as the law says that if at the end of the year the Old Fund is not adequately funded, any amount necessary to pay claims must be transferred from the General Fund. The definition of "adequate funding" says it is a total cost of future benefits remaining to be paid, plus the cost of administering the claims. Therefore, if there is any confusion, MSF recommends clarification so that no one is put in the position of being challenged on the decision.

Senator Johnson stated that the committee's option is to have a draft bill that clears up the cash flow option. Mr. Wood so moved.

Senator Johnson asked for discussion on the motion.

The committee voted on Mr. Wood's motion. The motion was passed unanimously.

Mr. Beck said that he believes a legal opinion should be rendered, rather than legislation. Mr. Beck recommended rescinding the previous motion, and recommended that the State Fund ask for a legal opinion.

Ms. Butler explained that there are some limitations on who can ask for an Attorney General Opinion, and said that the Board of Directors or a legislator may be able to approach the Attorney General. A legislator could also ask for an opinion from Legislative Council. Senator Johnson asked if a legal opinion could be obtained prior to the committee's report to the Economic Affairs Committee on September 7th. Ms. Butler responded that the committee could probably obtain an opinion from Legislative Council by that time, but not from the Attorney General. There was discussion about who could ask for an Attorney General opinion. Representative Lewis recommended that the committee ask Greg Petesch for his opinion, which could probably be obtained prior to September 7th. Laurence Hubbard, President/CEO of MSF, explained that an Attorney General opinion would be appropriate, but would not preclude challenge in the district court. An Attorney General opinion only regulates the parties to the transaction, and does not impact a private citizen or constituent's ability to bring a lawsuit.

Senator Johnson proposed getting Greg Petesch's opinion prior to the September 7th Economic Affairs Committee Meeting. Mr. Petesch's opinion could be presented on September 7th.

Mr. Wood stated that the committee is not required to report to the Economic Affairs Committee, but is required to report to the Legislature. Mr. Wood suggested that the committee let the motion stand. After the chairman has received the opinion, the chairman could provide written notice of the opinion, and could have the committee rescind the motion by conference. Ms. Butler agreed that the committee does not need to function through the Economic Affairs Committee, but that the committee is very interested in the SB 304 committee, and was hoping to hear the results at the September 7th meeting. Ms. Butler also advised the committee that if they would like to go forward with legislation, a sponsor would need to be found. There was discussion about the sponsorship of the bill.

There was discussion about the merits of a legal opinion as opposed to legislation.

Mr. Beck moved to reconsider the committee's action on the previous motion.

Senator Johnson asked for discussion on Mr. Beck's motion.

The committee voted on Mr. Beck's motion. There were 6 votes in favor of the motion, and 3 votes opposed. The motion passed.

Mr. Beck moved that the committee not consider the draft bill.

Senator Johnson asked for discussion. There was further discussion on the merits of a legal opinion as opposed to legislation.

The committee voted on Mr. Beck's motion. There were 4 votes in favor of the motion, and 5 votes opposed. The motion failed.

Senator Johnson spoke about the committee's final report, and provided a cover page for the report. There was discussion about the stationery the report would be on. Ms. Lenmark recommended designing a letterhead especially for the committee. Ms. Lenmark also suggested changing the phrase "seemingly endless discussion" to "thorough discussion". Senator Johnson explained that the motions from the August 20, 2004 meeting will be added to the report. He also suggested adding language such as "further details of these reports may be found at www.sb304.com or hard copies may be obtained through contact with the State Fund." Senator Johnson explained that the actual report will consist of the cover page and the draft report.

There was discussion about whether or not to attach the bill drafts as part of the bill.

Senator Johnson asked if there were any suggestions for changes to the draft legislation. (Attachment D) Mr. Wood referenced page 3 of the bill draft and stated that the wording "2 ¾%", does not provide for changes in that rate. Ms. Butler suggested that the language could be amended to read "at the rate provided in Title 33, Chapter 2, Section 705 for fiscal year 2008, and for each subsequent year." He also referenced page 3 of the bill draft and the language "and state agencies". He asked if the definition of state agencies is the state and its political subdivisions, or if it includes anything beyond that. Ms. Butler responded that this section provides for state agencies to have the option to insure with other companies than the State Fund. Mr. Wood referenced page 7 of the bill draft, subsection (5) (a), and asked the reasoning behind the delay to July 1, 2009. Ms. Butler explained that MSF asked for that delay in order to prepare for a transition. Mr. Wood said that staff changes could not be made immediately upon losing business. Ms. Butler explained that this language was based on the committee's prior motion. Mr. Wood referenced page 10 of the bill draft, subsection (n) about the State Fund acting as a third party administrator. He said that he believes this section could become a political issue and could jeopardize the rest of the bill.

Ms. Lenmark referenced page 10 of the draft bill, and expressed a concern over the use of the term "public entities", and suggested changing it to "public corporation". The definition of public corporation is: "the state or a county, municipal corporation, school district, city, city and/or commission form of government, or special charter town or village." Ms. Butler stated that MSF would have no objection to using that term.

Ms. Lenmark referenced page 7 of the draft bill, subsection (6) which says that the term "public corporation" will include the Montana university system in subsection (2) - (4), while in those subsections, the state is always excluded from the permission. She suggested that the phrase "other than a state agency" should be stricken in subsections (2), (3) and (4).

Ms. Lenmark moved that the term "public entity" on page 10 of the draft bill be amended to read "public corporation", which is the defined term in §39-71-116, MCA.

Senator Johnson asked for discussion.

The committee voted on Ms. Lenmark's motion. The motion passed unanimously.

Mr. Beck explained that the Governor's office does not support payment of the premium tax by the State Fund.

Mr. Beck moved that the committee remove the premium tax from the State Fund.

Representative Bergren expressed his support of Mr. Beck's motion, and stated that he would not vote for an increase in premiums.

Senator Johnson asked for discussion.

The committee voted on Mr. Beck's motion. There were 4 votes in favor of the motion, and 5 votes opposed. The motion failed.

Senator Johnson referenced page 11 of the bill draft and asked why there was an effective date of July 1, 2005. Ms. Butler explained that benefit changes are typically effective on July 1st, and although there are not any benefit changes in this bill, it was done for ease of remembering, however this could be changed if the committee wished.

Ms. Lenmark called attention to the fact that there is no effective date for Sections 5 and 6. Ms. Butler explained that it should read "Sections 1 - 6 are effective on July 1, 2005".

Senator Johnson asked for public comment. No comment was received.

Senator McCarthy stated that she would rather not have the bill draft attached to the committee's report, but would be more comfortable if the bill were brought in separately. Ms. Butler agreed that the committee is not required to attach any recommended legislation.

Senator Johnson moved to attach the draft bill to the report.

The committee voted on Senator Johnson's motion. There were 4 votes in favor of the motion, and 5 votes opposed. The motion failed.

Ms. Butler suggested that the final committee report should consist of the draft committee report, the motions from the August 20, 2004 meeting and the preamble with signatures, as well as information on where to find the additional materials. Ms. Butler suggested that the report should be mailed to each individual legislator after the election.

Senator McCarthy moved that the final committee report consist of the items discussed by Ms. Butler.

It was agreed that the final report would be distributed to the committee members for their signature.

Senator Johnson asked for discussion.

The committee voted on Senator McCarthy's motion. The motion passed unanimously.

Senator McCarthy moved that the committee thank Senator Johnson and the support staff.

The committee voted on Senator McCarthy's motion. The motion passed unanimously.

The meeting was adjourned at 11:10 a.m.