

-DRAFT- Pending Committee Approval

Attachments to the minutes are available on this website under "Meeting Notes & Handouts - November 7, 2003 - Handouts"

SENATE BILL 304 STUDY COMMITTEE November 7, 2003

The third Senate Bill 304 Study Committee Meeting was held on November 7, 2003 at the Capitol Building, 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

Anita Bennett - Montana Logging Association
Carl Swanson - Swanson, Roybal & Leavitt
Dan Broyles - Swanson, Roybal & Leavitt
Mark Cole - Dick Irvin, Inc.
Jim Sill - Swanson, Roybal & Leavitt
Steve Beckham - Liberty Northwest
Ann Nelson - Employers' Insurance Group
Aidan Myhre - The Gallatin Group
B. Kolenberg - The Mitchell Group
Mark Merrick - Montana Building Industry Association
Sean Thatcher - Montana Building Industry Association
Stacey Bird - MPEA
Mike Taylor - NCCI
Cliff Merrit - NCCI
David Davidson - Liberty Northwest Insurance Corp.
Thomas Schneider - MPEA
Jerry Keck - Department of Labor and Industry
Cliff King - Division of Insurance - Nevada
Carl Kochman - Wendt Kochman
Webb Brown - Montana Chamber of Commerce
Bob Biskupiak - Payne Financial Group
Roger McGlenn - Independent Insurance Agents of Montana
Fred Miller - Liberty Northwest
Larry Jones - Liberty Northwest

Bill Stevens
Pat Murdo - Legislative Services
Spook Stang - Montana Motor Carriers
Derek Scoble - SGR, Inc.
Stan Kaleczyc - NCCI
Steve Pilcher - Montana Stockgrowers Association
Lorri Chugg - Payne Financial Group
Laurence Hubbard, Montana State Fund
Nancy Butler, Montana State Fund
Mark Barry, Montana State Fund
Matthew Cohn, Montana State Fund
Kathy Gowen, Montana State Fund

Senator Johnson called the meeting to order at 8:00 a.m., and announced a change in the agenda.

David Davidson, Executive Vice President and Actuary of Liberty Northwest gave a presentation entitled "Fair and Affordable Workers' Compensation Coverage". (Attachment A - Fair and Affordable Workers' Compensation Coverage)

Representative Lewis stated that in the last 30 years there has been an understanding in the legislature that there were some subsidies to the State Fund in the form of no premium tax and the monopoly of state employees. One of the benefits to the state is that rates would be held down for high-risk employers. He asked if Mr. Davidson was suggesting that the State Fund is subsidizing the business that is more subject to the competitive process.

Mr. Davidson stated that there has been an implied intent for the State Fund to provide a greater social fairness in their pricing by charging less than the actuarial price for certain types of businesses. Currently, there is no direction from the legislature to provide subsidizations to a specific segment of business. Mr. Davidson clarified that he thinks the State Fund is trying to do the right thing. He also stated that some of the advantages the State Fund has helps them become a more competitive force in the marketplace. The State Fund's solution is to build more actuarial fairness into their pricing.

Cliff Merrit, Director of Reinsurance Pool Administration with NCCI, first stated that NCCI does not take a position regarding how the committee should proceed. Mr. Merritt then gave a presentation on residual markets. (Attachment B - Residual Market Overview)

Cliff King, Chief Insurance Examiner, Nevada Division of Insurance, gave a presentation entitled "Workers' Compensation Insurance Marketplace in Nevada". (Attachment C - Workers' Compensation Insurance Market Place In Nevada)

There was some discussion about the manner in which guaranty funds and assigned risk pools operate, as well as discussion about who makes public policy decisions regarding workers' compensation insurance.

There was discussion about the Nevada experience, particularly what was done about the \$2 billion deficit and the role of the Insurance Commissioner in Nevada.

Senator Johnson asked for public comment.

Ann Nelson, of Employers' Insurance Company provided public comment. Ms. Nelson noted that no matter what the committee, and ultimately the legislature, decides about public policy in Montana, the Montana State Fund will not go away. The old Nevada State Fund has not gone away. Employers' Insurance Company has 31% of the marketplace in Nevada, and is still an integral part of the market, working very closely with the Insurance Commissioner. Employers' Insurance Company is also very active politically regarding workers' compensation benefits and system structures. Ms. Nelson stated that regardless of how the State Fund is modified, it will remain an integral part of Montana's workers' compensation system.

Laurence Hubbard, President/CEO of Montana State Fund, asked Mr. King to explain the most recent Nevada rate filing - the components of loss costs to premium for employers under a voluntary system compared with the same process in the assigned risk market. Mr. King offered to provide a copy of the most recent filing.

There was more discussion about assigned risk plans, and the perceived competitive advantages of MSF.

The minutes were approved as submitted.

Senator Johnson introduced new committee member David Hunter, who replaced Angela Huschka.

Jerry Keck, Administrator of the Employment Relations Division, Department of Labor and Industry, gave a presentation entitled, "Comparison of Montana to Assigned Risk Pools in Other States." (Attachment D - Comparison of Montana to Assigned Risk Pools in Other States)

There was some discussion about minimum premium and the policy surcharge.

Bruce Hockman, of Towers Perrin gave a presentation entitled "Assigned Risk Plans/State Funds - A National Perspective". (Attachment E - Assigned Risk Plans/State Funds - A National Perspective)

There was discussion about the workers' compensation crisis in California. There was also discussion about the size of the market in Montana and how many companies would be interested in writing insurance in Montana.

Senator Johnson asked the committee to take notice of a document entitled "Montana State Agency Loss History FY1999-2003" (Attachment F - Montana State Agency Loss History FY 1999-2003) and a letter from Ray Mehrer of the Montana Building Industry Association (Attachment G - Letter from Montana Building Industry Association). The committee was provided with both documents. The committee was also provided with a letter from Steve Pilcher, Executive Vice President of the Montana Stockgrowers Association. (Attachment H - Letter from Montana Stockgrowers Association)

Senator Johnson asked for public comment.

Roger McGlenn of the Independent Insurance Agents of Montana gave public comment. Mr. McGlenn stated that his organization supports Montana's three-way system. They believe the legislature made a wise choice in choosing the three-way system. Affordable workers' compensation insurance was not always available in the private market. The legislature created the State Fund because it did not trust the private sector to always be there. The Independent Insurance Agents have not always agreed with the Montana State Fund. One example is the issue of employers' liability. Mr. McGlenn stated that while the committee may have discussed competitive advantages that the State Fund has; the State Fund also has a disadvantage. The primary disadvantage of the State Fund is that it remains the insurer of last resort. The Independent Insurance Agents feel that assigned risk programs and residual markets have historically been problematic. As private carriers and the volunteer market are assessed based on the percentage of volume that they write, during the tightening of the market, the Independent Insurance Agents have seen private carriers dump business back into the residual market. This creates a downward spiral effect, which is disruptive to the marketplace. Mr. McGlenn states that the only one who benefits from the residual market are those who administer it. The Independent Insurance Agents do not understand why the state would consider selling the State Fund and doing away with the three-way system. They believe that reducing choice for Montana employers by eliminating the Montana State Fund would be the worst choice that could be made. They ask how selling the Montana State Fund and creating a residual market would help the small employers of Montana.

Larry Jones of Liberty Northwest gave public comment. He spoke about Mr. Keck's presentation and the following question, which was asked in Mr. Keck's presentation - "Would the sale of State Fund result in increase in premium for Montana employers?" Mr. Jones maintained that if the answer to that question is yes, a more important question to ask is "To which employers, and why?" He stated that there has been a lot of information - statistics and averages - but they do not have this type of specific information - which employers would have an increase and why. Mr. Jones stated that the committee has heard that the State Fund has to write premiums that are nothing more nor less than self-supporting. Mr. Jones referenced a quote from the minutes from the July 8, 2003 committee meeting - "Mr. Morgenstern commented that the larger customers are actually subsidizing the smaller customers." Mr. Jones stated that the real question is who is being subsidized by whom. Mr. Jones referenced Mr. Barry's

handout regarding Accident Year 2001. (Attachment I - MSF Accident Year 2001 Combined Ratio for Accounts Less than \$5,000) He stated that when looking at the system in the aggregate, the differences are swallowed up, and there is no way to pinpoint who is getting the benefit of the subsidy. To understand the "internal" subsidy of the State Fund, which he described as using large employers to subsidize small employers, the only way to understand who is being subsidized and why, is to have the State Fund reveal certain information. Mr. Jones explained that this would be things such as the industrial classes of the larger employers - how much of the large employers' premium is being used, and what are the industries? The second subsidy is an internal subsidy - the cost of doing business that the State Fund does not have to bear like a private carrier. Mr. Jones stated that this disenfranchises all of the people in Montana. Taxpayers and large employers do not have the information about who subsidizes whom, and why this is being done. These two subsidies cannot be captured in the aggregate. Mr. Jones asked the committee to have the State Fund identify the subsidy from large employers to small employers, by premium size and business type, of those providing the subsidy and those receiving the subsidy. Mr. Jones also asked the committee to ask the State Fund to identify those costs of business that the state pays entirely or subsidizes by not requiring the State Fund to pay fair market value. Mr. Jones asked the committee to ask industry stakeholders to appear before the committee at the next hearing and give their recommendations about what specifically should be done.

Senator Johnson asked Mr. Jones to put his request in writing and send it to Kathy Gowen at the Montana State Fund.

Mr. Wood asked Mr. Jones if he was aware that IRS regulations do not allow state agencies to be taxed. He asked Mr. Jones what the committee should do about that and stated that the committee cannot cure that particular complaint. Mr. Jones responded that if the State Fund were sold, it would then be taxed. He also stated that there is an alternative that some states have used. The amount of tax could be computed, and then the State Fund could pay that amount into the general fund.

Representative Bergren asked Mr. Jones how he should explain the resulting increased rates to his constituents. Mr. Jones replied that he should ask the constituent if he or she would like to know how their taxes are being spent, because that constituent doesn't know how the money is being spent to subsidize the State Fund. He would ask the constituent if he or she would like to know how their competitor's rates are being set and if they are getting a subsidy. He would ask the constituent if he or she would like transparency, and would like to know where their money is going. Representative Bergren replied that to the business owner, their workers' compensation premiums are a bill that shows up, and they do not know the internal workings of the system, and how premiums are made. The constituent might ask if the committee fixed something that wasn't broken. He stated that Montana's workers' compensation is not broken. Mr. Jones suggested that Representative Bergren should give the example of maintenance of an airplane. If you are on an airplane, do you want the maintenance to be done at 30,000 feet or when it is sitting on the apron? Mr. Jones stated that right now, the State

Fund is sitting on the apron. Secondly, Mr. Jones stated that the problem is that the constituent doesn't know why he or she is paying what they are paying or if they are subsidizing or being subsidized. Mr. Jones stated that now is the time to answer the questions about where the money is going and who is subsidizing whom.

Mr. Beck stated that his theory of subsidies is that there has to be affordability of premium written into the scenario. If premiums are raised much more, employers will avoid paying workers' compensation insurance. Mr. Jones stated that it is not his client's position that there should or should not be subsidies, but that the legislature make a policy decision based on the facts. Mr. Jones suggested that perhaps some people should go out of business because they are injuring or killing people, and maybe the industry shouldn't write premium they can afford. Mr. Beck responded with the example of the agriculture industry, which cannot control their market and has an exposure with its equipment. Mr. Beck stated that we certainly do not want them going out of business and that there has to be a balance. Mr. Jones replied that if there were a sector of business that needed to be nurtured, the legislature could make a conscious decision to subsidize that business, with or without an assigned risk pool.

Ms. Lenmark stated that a lot of very specific detail is provided to the Board of Directors and any observers at the State Fund's board meetings. She asked Mr. Jones exactly what information he is looking for, because it seems to her that it is available. She also asked what he would do with that information. Mr. Jones agreed that there is a lot of public information, but due to the nature of the system, there is information that is not readily available. For example, what is the cost to the State Fund for PERS? What about federal income tax, state income tax, accounting and payroll costs? Senator Johnson asked Mr. Jones to provide a detailed list of the information he wants.

Ms. Lenmark asked Mr. Jones if it is internal operating subsidies that he is looking for. Mr. Jones responded that he would like the State Fund to identify the large accounts, specifically the type of business by class codes and premium size, which are subsidizing the smaller accounts.

Senator McCarthy stated that it would be helpful to her to make comparisons if the five largest insurers in the state provided the same information to the committee. Mr. Jones responded that he could not commit his company to divulging that kind of information, and does not know what the relevance would be. Senator McCarthy replied that if the committee needs to know what it is subsidizing, it also needs to know what other companies are paying in order to compare. Mr. Jones replied that he does not see how that information would relate to the charge of studying the possible sale of the State Fund, which is a governmental entity subject to the constitutional public right to know.

Representative Lewis suggested that if the State Fund were to prepare this information, Mr. Jones would see that it costs the State Fund money to be a state agency. Mr. Jones replied that this is a risk Liberty Northwest is willing to take.

Mr. Morgenstern stated that he thinks there are two philosophical issues. 1. How much competitive advantage does the State Fund have? 2. How is that advantage being used? Mr. Morgenstern stated that he does not think it is necessary to define which class of large company is subsidizing small companies, because all of the companies in the voluntary market can buy their coverage from either Liberty or the State Fund. Mr. Jones responded that he believes the private sector is entitled to transparency under the right to know.

Mr. Hunter agreed with Representative Lewis that the cost advantage of the State Fund is primarily in two large areas and two smaller areas. The two large areas are that federal income tax and premium tax are not paid. The two smaller areas are state property tax and the difference in the cost of the regulatory burden of the Insurance Commissioner. Mr. Hunter suggested that in all of the other areas, such as building fees, accounting costs and retirement systems, the subsidy to the State Fund is either zero or negative.

Laurence Hubbard, President/CEO of Montana State Fund gave public comment. Mr. Hubbard stated that a number of key themes were raised in terms of the importance of the committee's work. One key theme is the following - What do we want to be in Montana and how do we want to structure our provision of mandatory workers' compensation insurance coverage for Montana employers, and what is reasonable in terms of costs? Montana State Fund's purpose is to provide a stable marketplace for Montana's employers, large and small. Montana State Fund fulfills that purpose, and has done it well over the last 14 years. There have been some structural changes, including Montana State Fund operating more like a private carrier. With the help of the legislature and Montana State Fund's Board of Directors, who understand the wisdom of making things transparent, Montana State Fund's ratemaking has become more transparent. The ratemaking process can be found in public documents in the form of the administrative rules. In the purposes section of the Workers' Compensation Act, the legislature has instructed all carriers in Montana to provide wage loss benefits and medical benefits as the legislature determines under the Workers' Compensation Act at a reasonable cost to employers. Montana State Fund serves one role, which is to provide a competitive, alternative market to employers, so they have a choice and can obtain workers' compensation insurance at a reasonable cost. A number of years ago, it was recognized that structural inadequacies existed in the way Montana State Fund operated. The legislature took the corrective action of creating a board of directors. Mr. Hubbard stated that it is ironic that MSF is so dominant that private companies cannot offer Montana employers choice. He asked if that is true, what happened in the mid 1990's, when private companies wrote business and discounted off of loss costs at an average of 40-45% in 1997 and 1998? The environment in Montana was very competitive, but things that happen elsewhere drive what happens in Montana. Montana State Fund is designed to protect against the volatility of events that happen elsewhere, and to provide high levels of service at affordable and competitive rates. The market decides how much Montana State Fund writes. Mr. Hubbard stated that he is perplexed by the discussion of subsidies, because in insurance there is a concept called the law of large numbers. When an aggregate of experience and exposures is

pooled, there is reliability and stability. When the data is sliced into smaller pieces, the results become very volatile. If a book of business is sliced and diced too small, it becomes meaningless. The purpose of an insurance company is, in large measure, to pool the experience. Montana State Fund does it by class code and industry. Mr. Hubbard stated that he can respect and appreciate the concern that the State Fund operate in a financially sound manner, and that rates are neither inadequate, excessive or unfairly discriminatory. That is why Montana State Fund has open ratemaking meetings in front of the board of directors. Any member of the public may attend and ask questions. Even more importantly, there is an independent actuary who certifies the reasonableness of the process and the fairness and adequacy of the rates as well as an independent legislative audit every year, which is independently reported to the legislature. Mr. Hubbard stated that Montana State Fund serves the social purpose of providing a stable market for Montana employers, and that is the real decision that needs to be made. The costs of doing business can be found in the financial statements. Mr. Hubbard explained that the best way to compare whether or not a private company and Montana State Fund have fair expense levels is to look at their expense ratios. Montana State Fund's expense ratios are very similar and comparable to competitors. Mr. Hubbard also noted that regardless of what system the legislature decides is appropriate, when a system is awry, someone, usually the taxpayer will pay for it. The question is, will Montana's public be participating more or less in the decisions that affect the cost of their workers' compensation insurance?

Senator Johnson commented that the money the legislature has appropriated from the State Fund is not New Fund money. Senator Johnson clarified that the Old Fund is the responsibility of the legislature, and that if there were no reserves, that money would have to come from the general fund.

Webb Brown of the Montana Chamber of Commerce gave public comment. He urged the committee to consider the competitive nature of the workers' compensation insurance system. He stated that a stable program with the three plans is a good set up. It concerns them to look at dominance by any one of the plans, but it is a complicated system. Mr. Brown reminded employers and those people administering the plan to keep in mind the competitive nature of the system. Mr. Brown made a correction to the minutes on page 9. The minutes stated, "In 1979 the Chamber was part of the Logging Association". They should be corrected to state, "In 1979 Mr. Brown was part of the Logging Association".

There was some discussion about the date and agenda of the next meeting, but no date was set. Senator Johnson will contact committee members to set a date sometime in January, 2004. The meeting was adjourned at 3:30 p.m.