Attachments to the minutes are available on this website under "Meeting Notes and Handouts" September 22-23, 2003

SENATE BILL 304 STUDY COMMITTEE
September 22nd and 23rd, 2003

The second Senate Bill 304 Study Committee Meeting was held on September 22nd and 23rd, 2003 at the Capitol Building, Helena, Montana.

Committee Members Attending

Senator Royal Johnson
Rep. Dave Lewis
Jacqueline Lenmark - 9/23/03 only
Jack Morgenstern
Angela Huschka
Senator Bea McCarthy
Rep. Bob Bergren
George Wood
Tom Beck

Others Attending

September 22, 2003
Stacey Bird, MPEA
Riley Johnson, NFIB
Anita Bennett, Montana Logging Association
Larry W. Jones, Liberty Northwest
Pat Murdo, Legislative Services
David Warner, PNWRC of Carpenters
Cathy Burwell, Helena Chamber
Aidan Myhre, The Gallatin Group
Ann Nelson, Employers' Insurance Company of Nevada
Don Judge, Teamsters Local 190
Jason Todhunter, Montana Logging Association
Amy Sassano, Governor's Budget Office
Shawn Bubb, Montana School Board Association
Tom Schneider, MPEA
Connie G. Clarke, Payne Financial Group
Tom W. Clark, Independent Insurance Agents of Montana
Webb Brown, Montana Chamber of Commerce
Sharon Pfeiffer, Payne Financial Group
Shaun Peterson, Payne Financial Group
Laurence Hubbard, Montana State Fund
Nancy Butler, Montana State Fund
Joanne Shydian, Montana State Fund
Mark Barry, Montana State Fund
Matthew Cohn, Montana State Fund

Layne Kertamus, Montana State Fund
Peter Strauss, Montana State Fund
Richard Root, Montana State Fund
Dan Gengler, Montana State Fund
Kathy Gowen, Montana State Fund

September 23, 2003
Anita Bennett, Montana Logging Association
Stacey Bird, MPEA
Aidan Myhre, The Gallatin Group
Ann Nelson, Employers' Insurance Company of Nevada
Larry Jones, Liberty Northwest
Tom Schneider, MPEA
Shawn Bubb, Montana School Board Association
Riley Johnson, NFIB
Geri Hoffman, Legislative Audit Division
Jason Todhunter, Montana Loggin Association
Mike Taylor, NCCI
Webb Brown, Montana Chamber of Commerce
Rosi Keller, University of Montana
Jon Metropoulos - National Association of Independent Insurers-GSJW
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

September 22, 2003

Senator Johnson called the meeting to order at 10:00 a.m. The minutes of the July 8, 2003 meeting were approved as submitted. Senator Johnson asked for nominations for a vice-chairman of the committee. Dave Lewis made a motion that Senator Bea McCarthy be selected. All committee members approved, and Senator McCarthy accepted. Senator Johnson announced that Jacqueline Lenmark would not be at the meeting on September 22nd.

Laurence Hubbard, President/CEO of Montana State Fund gave an overview of the role of the Montana State Fund (MSF). Mr. Hubbard spoke generally about the role of state funds in the United States - how they were created and why they exist. There are 26 state funds in the United States, five of which are monopolistic. The monopolistic states include Washington, North Dakota, Wyoming, Ohio and West Virginia. Twenty-five states (including the District of Columbia) have no state fund, but have some type of assigned risk plan and self-insurance options. Montana has a three-way system, which includes self-insurers, private insurers and MSF. Conning Asset Management

Company released a report that indicates the market share of state funds today ranges from 10% to 65%. MSF's market share is approximately 56% of the market.

Mr. Hubbard explained that the first workers' compensation act was passed in 1914. Montana's state fund was created in 1915, although not in its current form. State funds and assigned risk pools were created because workers' compensation insurance is mandatory. A term often heard in the industry is "quid pro quo". Workers receive statutorily guaranteed benefits in exchange for employers' immunity from civil lawsuits. The feature of all these systems is that they are mandatory. When state funds were first created, there were no private markets available. Currently, however, there are a number of approaches that can be taken in providing mandatory coverage. Some states (Arizona, Idaho, Minnesota, Missouri, New Mexico, Oregon and South Carolina) actually operate with a state fund and an assigned risk plan. However, in the last 12 years, a number of states have created state funds in place of assigned risk plans to provide a more stable and competitive market. (Hawaii, Kentucky, Louisiana, Maine, Rhode Island and Texas)

Mr. Hubbard also spoke about the customers of state funds and assigned risk pool plans. Nationwide, 80-85% of employers in assigned risk plans and state funds pay less than $5,000 a year in premium. State funds and assigned risk plans are the markets for small employers.

Mr. Hubbard spoke about the cycle of the workers' compensation insurance market. From 1988 to 1992, the workers' compensation insurance industry was in a "hard market". Private carriers were not writing workers' compensation insurance in many states because of the lack of profitability in the line, and negative impact on the profitability of private markets. Assigned risk plans and state funds grew their premium at an exponential rate. State funds and assigned risk plans fulfilled the obligations in their various jurisdictions by absorbing the business that the voluntary market was not pursuing. Benefit reforms in the early 1990s, and improving investment returns created a competitive environment all over the country. From 1993 to 1999, the workers' compensation insurance business was profitable. Private carriers returned to markets that they had not been in during the previous 10 years, and competition grew. As early as 1998, with aggressive competition in Montana and other states, pricing for workers' compensation insurance decreased substantially. In 1997 to 1998, private carriers in Montana were discounting off of NCCI loss costs by an average of 40-45%. This was the result of successful competition. NCCI began reporting that the workers' compensation insurance industry was substantially under-reserved. Most recent reports indicate that there are $18-20 billion in under-reserves nationwide in the workers' compensation line. Carriers in Montana and nation-wide began to dissolve, become insolvent, or consolidate. In Montana, of the top 20 carriers who were writing business in 1996, seven of them either became insolvent or withdrew from the Montana market. Mr. Hubbard gave the example of Valor Insurance in Billings and its parent company, Daniels Holding Company of California. The parent company decided to withdraw from Montana because California was not profitable for the parent company. Decisions made in California impacted employers' market availability in Montana.

Montana State Fund saw premium increases from about $70 million in 2000 to a projection of $126 million this year. Much of that is driven by appropriate and necessary rate increases, but another factor is the business that the voluntary market no longer writes in Montana. Mr. Hubbard gave the example of the California market, which is in crisis. The private market in California failed to successfully write business. The California State Fund is absorbing as much business as it possibly can, but it is in crisis because the amount of business it has written is not supported by sufficient surplus and reserves. Montana is not in the same situation, but the California crisis is an example of the volatility of the workers' compensation insurance market. Workers' compensation insurance is unique, because of what is called "long tail liability". For example, the MSF New Fund has claims that date back to 1990. Actuaries and underwriters have to estimate how much money will be needed to sustain and pay for those claims. Such things as medical inflation, court decisions and other unknowns have to be considered. Employers and employees need stable markets and predictability. State funds are designed to provide that stability and consistency, and are there to weather the storms of soft and hard markets. Employers and employees need financially sound, stable companies.

Mr. Hubbard gave a presentation on the Role of the Montana State Fund (Attachment A, "Montana State Fund Role and Functions", p. 1-3).

Senator Johnson asked Mr. Hubbard how many people are in the assigned risk pool and what kind of premium is generated. Mr. Hubbard replied that there is often an attempt to define the residual market, but that the industry has struggled with that definition. It can be based on premium size or type of business. The distinguishing factor between private companies and state funds is that private carriers are able to choose which companies they will write based on business needs. State funds generally do not drive the markets. Therefore it is impossible to clearly define what residual is. Senator Johnson asked for clarification on the figures of policyholders who pay less than $5,000 premium per year. Mr. Hubbard replied that MSF has approximately 21,000 customers in Montana who pay less than $5,000 in premium per year.

George Wood clarified that of the states with monopolistic state funds, 2 do not allow self-insurers, while 3 others do not allow private insurers but do allow self-insurers. Mr. Wood also asked for clarification of who might find themselves in the assigned risk pool, and asked if the average premium payer ($1100) would end up in the assigned risk pool. Mr. Hubbard replied that in MSF's book of business of $5,000 in premium and below, the average premium is $1100. This does not have anything to do with whether or not those employers could find voluntary coverage in the private market.

Jack Morgenstern asked Mr. Hubbard to address the issue of whether or not MSF is competitive. He also asked Mr. Hubbard to explain how the public can know that MSF's premiums are fairly charged.

Mr. Hubbard stated that most of Mr. Morgenstern's questions would be answered later in the presentation. Regarding the question of efficiency, MSF benchmarks itself off the same standards and industry ratios as private insurance companies. Mr. Hubbard stated that it would be fair to say that in the early 1990s when MSF was created, it was not a model of efficiency or customer service. That changed beginning in 1994 with the appointment of a new CEO who brought a service oriented background to the leadership of MSF. Today, MSF offers effective and efficient service and maintains the discipline of good underwriting practices and appropriate rate-setting. As a result, some business was lost. The legislature has ensured that MSF must operate as an insurance company and is held to the same level of standard, both in terms of financial performance and otherwise. MSF does not have market share goals, but is trying to maintain a quality, balanced book of business that makes a contribution to the appropriate financial solvency of MSF. Mark Barry, VP of Corporate Support will address the question of financial ratios and benchmarks that ensure financial and service level responsibilities.

Senator McCarthy asked for clarification of the assigned risk pool/insurer of last resort. Are these 21,000 customers the customers that private companies chose not to take, or would it be correct to say that if the private companies chose to take them, the premium would be so high that they could not afford it?

Mr. Hubbard responded that generally speaking, Senator McCarthy is right. An assigned risk pool is the alternative mechanism to a state fund, for companies that cannot obtain coverage from the voluntary market. It does not have so much to do with premium size, but there is a lot of volatility in a smaller premium level. In a state with an assigned risk plan, high-risk businesses could end up in an assigned risk pool, regardless of premium size. Montana has a lot of high-risk industries.

Senator McCarthy asked if the "high-risk" term is because of the type of industry rather than the size of the company. Mr. Hubbard agreed that it could be one factor. Mr. Wood stated that it is a big factor in Montana.

Nancy Butler, General Counsel of Montana State Fund, provided a presentation and spoke about the statutory structure of MSF and the membership and responsibilities of the Board of Directors. (See Attachment A, "Montana State Fund Role and Functions", p. 4-6)

Layne Kertamus, VP of Insurance Operations, Montana State Fund, gave a presentation and spoke about the Insurance Operations department. (See Attachment A, "Montana State Fund Role and Functions", p. 6-7).

Jack Morgenstern asked if the current staffing at MSF is efficient. Mr. Kertamus responded that according to the staffing models he has reviewed, MSF's staffing is consistent with industry practices in terms of caseloads, customer service representatives, etc. He has a consciousness of expense management, which is one of the keys to success in this business. MSF's goal is to be a low cost provider, because high cost providers don't succeed in the long run.

Mr. Wood asked for a clarification of the raise in premium this year. Was it $150 million or $126 million? Mr. Hubbard clarified that the number is $126 million.

Senator Johnson asked what dollar amount was raises in premiums as opposed to new business. Mr. Hubbard replied that Mr. Barry could provide that information in detail on 9/23/03, because it has to do with recent NCCI loss cost filings and is a function of ratemaking. Mr. Hubbard stated that when one regional carrier withdrew from Montana, there was an estimate that they controlled $11 million in premium in Montana. He thinks MSF may have written about $7 million of that $11 million.

Peter Strauss, VP of Operations Support, Montana State Fund, gave a presentation and spoke about the Operations Support department. (See Attachment A, "Montana State Fund Role and Functions", p. 8- 9)

Senator McCarthy asked about the average turnaround time on medical bills. Mr. Strauss replied that the target is to pay 87-93% of all medical bills within 30 days. He also announced that MSF is going to be implementing electronic bill processing.

Senator McCarthy asked about the re-opened claims, and asked if the request for new payment came from the injured party or from MSF asking for a review. Mr. Strauss explained that the claims were re-opened at the claimant's request.

Tom Beck asked if MSF is increasing the liability on the Old Fund. He also asked if it is still actuarially sound. Mr. Strauss replied that it is actuarially sound. MSF is required to provide lifetime medical care for Old Fund claims. Mr. Hubbard added that MSF hires an actuary to make recommendations to the Board regarding appropriate reserve levels for the New Fund and the Old Fund. The short answer is that there is always risk that development, open claims, court decisions or medical technologies will put pressure on the reserves. As long as the Old Fund has open claims or the potential for re-opened claims, there is a potential for risk. Mr. Beck stated that the reason he had asked the question is because the legislature had taken some of the Old Fund's money.

Mr. Wood asked if there were any decisions made on the retroactivity of the recent Supreme Court decisions. Ms. Butler replied that there are four decisions with the retroactivity issue yet to be decided. The Workers' Compensation Court ruled that one case was retroactive, and that it could be treated as a common fund. The extent of the retroactivity has not been ruled on yet, but it may go back as far as 1974.

Senator Johnson asked about a claim from 1959, and why it was still being paid. Mr. Strauss responded that most of the payments are for ongoing medical treatment.

Mark Barry, VP of Corporate Support, Montana State Fund, gave a presentation on the Corporate Support Department. (See Attachment A, "Montana State Fund Role and Functions", p. 9-10)

Joanne Shydian, Human Resource Leader, Montana State Fund, gave a presentation on the Human Resources Department. (See Attachment A, "Montana State Fund Role and Functions", p. 10-11)

Mr. Hubbard gave a presentation on the Information Technology Department (See Attachment A, "Montana State Fund Role and Functions", p. 11-13)

The Committee adjourned for lunch from 12:25 p.m. to 2:00 p.m.

Mr. Barry gave a presentation on three areas. He spoke first about the national workers' compensation market and how Montana fits into that market. Next he spoke about the workers' compensation market in Montana and the leading writers. Lastly, he spoke about Montana State Fund's segment information. (See Attachment B, "Market Segment Information")

Representative Lewis asked Larry Jones, of Liberty Northwest, if he could explain why MSF's market share is expanding. Mr. Jones replied that he would be happy to have someone from Portland analyze MSF's numbers and provide the committee with Liberty Northwest's perspective.

Representative Lewis then asked Mr. Barry to explain the same question. Mr. Barry replied that the primary reason is that there are a number of insurers who no longer write business in Montana. He gave the example of Valor Insurance who wrote over $11 million in premium, but is no longer in business in Montana. MSF is seeing an increase in business because of the hardening of the market. Insurers have withdrawn from the workers' compensation market in Montana because they don't think they can make money.

Representative Lewis then asked Ann Nelson, of Employers' Insurance Company of Nevada the same question. Ms. Nelson stated that her company is new in the Montana market, and their license is pending with the Insurance Commissioner. She stated that from her perspective, MSF's market share is expanding because there is a very dominant state fund, and it is very difficult for other companies to compete. She stated that as a potential competitor, her board needs to carefully look at the situation and talk about where Montana is going with its workers' compensation system. Her perspective is from an outsider looking in, and she believes that MSF is dominant and very competitive.

Senator McCarthy asked Mr. Barry to explain MSF's system of independent agents. Mr. Barry replied that MSF uses independent agents to produce and service business. Senator McCarthy asked how long MSF has had this system. Mr. Barry replied that it has been using agents since 1998. Senator McCarthy asked what difference he thinks this system has made. Mr. Barry replied that as licensed producers have less markets to write insurance with, they turn to MSF. Liberty Northwest is a direct writer and does not utilize an agent system. Senator McCarthy asked for clarification of “direct writer”. Mr. Barry explained that a direct writer markets and writes business on its own, rather than using independent agents. MSF does not own the agents’ business. The agent owns the business and can decide where it will be placed.

Mr. Wood asked if it would be possible to get the loss ratio for 2001 for the group of policyholders who pay less than $5,000 in premium. Mr. Barry replied that he would try to provide that information on 9/23/03, or at the next meeting.

Mr. Wood asked Mr. Barry to verify that a large part of MSF’s growth came when other companies left Montana. He also asked if MSF attributes part of its growth to the use of independent agents, and if MSF believes the business would have gone elsewhere if it had not had an agency system. Mr. Barry replied that it is possible that if there had been no mechanism for agents to send their business to MSF, that it might have gone elsewhere. Mr. Hubbard stated that before 1998, MSF had no marketing mechanism, but that MSF still receives phone calls from employers who choose not to use independent agents. Mr. Hubbard explained that agency-placed business currently represents approximately 62% of MSF’s book of business.

Senator McCarthy asked if agents are paid a commission based on premium. Mr. Hubbard replied that commissions are paid based on premiums.

Senator Johnson asked Mr. Barry a question regarding business obtained from other companies, and at what time MSF takes over responsibility for claims. Mr. Barry replied that MSF only goes forward from the time the business was written. Any previous claims stay with the previous insurers.

Senator Johnson asked for public comment.

Anita Bennett, Member Services Director for the Montana Logging Association (MLA) provided public comment. She stated that the MLA has a 28-year relationship with MSF through safety services. It also has a for-profit corporation, MLA Services Incorporated which is an insurance agency for group health insurance and workers’ compensation. At the time MSF began using insurance agents, MLA Services, Inc. also received an appointment. MLA Services Inc. only provides insurance to logging codes, and sells that program through their membership. They also have an appointment with Associated Loggers Exchange in Idaho, and give members quotes from both entities, and the member can choose which program they want to insure them for workers’ compensation.

Webb Brown, Montana Chamber of Commerce, provided public comment. In 1979 Mr. Brown was part of the Logging Association. Since that time, the Montana Chamber of Commerce has been very involved in workers’ compensation issues. For some of its members, workers’ compensation insurance is a major expense. At the same time, exclusive remedy is very important for the employer. The Chamber has followed the issue closely, and was sometimes shoulder-to-shoulder with MSF and sometimes not. Last fall the Board of Directors had some specific concerns with the proposed bill, particularly the lack of Insurance Commissioner oversight and the oversight that was provided by the legislative process. Other issues were the guaranty fund and unfair trade practices issues. The Montana Chamber is well aware of MSF's role as insurer of last resort. The Chamber's ultimate goal is to provide for a competitive system that is not dominated by the private sector or MSF. The Chamber hopes that as the committee goes forward, there can be a strong, competitive market with MSF and the private insurers. The Chamber realizes that this is not an easy issue and encourages the committee to look at all the details and keep in mind the balance of the competitive nature of the system.

Ann Nelson, of Employers' Insurance Group, provided public comment. Ms. Nelson stated that she is appearing as a potential competitor in the Montana marketplace, and as the representative of another state fund. The Employers' Insurance Company was formerly the Nevada State Fund. Ms. Nelson got her start in the business as the General Counsel to then Governor Bob Miller, then took a position with Employers' Insurance Company of Nevada, which was then the monopolistic state fund. The new Governor, Kenny Guinn, introduced legislation to privatize the state fund. The state fund became private in January of 2000. Montana has the opportunity to take a look at what workers' compensation should be in Montana. The committee should decide what is the best public policy decision for Montana policyholders and employers, as well as Montana's government. A number of companies are watching to see what the committee will do. The question to the committee is, what role should state government play in the workers' compensation market in Montana? State workers' compensation statutes were enacted from 1913 to 1920. In most states, workers' compensation insurance was mandatory, and because there were no insurance companies in the west, state funds were established. Ms. Nelson asked the committee to contrast that mandatory coverage with the auto insurance market. Auto insurance is mandatory, but the state does not sell auto insurance. By the time auto insurance statutes became mandatory, there were enough insurance companies selling insurance. When Governor Guinn took office in January 1999, he examined state agencies and state government. The Nevada State Fund had a similar history to the Montana State Fund. Through a series of financial examinations in 1992 it was discovered that the Fund was about $2.4 billion in the red. A series of reforms were enacted, with a new and old fund. Ms. Nelson stated that the similarity between the two states is not coincidental. In looking at the economies (leaving out the casino industry), the two states are very similar. Nevada's largest drivers are construction, agriculture, ranching and mining, which is very similar to Montana's market. Nevada reformed its benefit structure and significantly increased the authority of the insurance commissioner's office to set and review rates, and opened the market to competition in July of 1999. The legislation to open the market was passed in 1994, and it took 4 years to implement the reforms. At the end of 1998, the Nevada State Fund was actuarially back to even. In his first legislative appearance, Governor Guinn drew the following analogy: He had looked at state government and what role state government should play, and he didn't feel that the state should be in the insurance business any longer. Now that the state fund was back to even, it was like having been at the poker tables all night. After losing all night, when you get back to even you pick up your cards and leave the table. He believed that is what the state of Nevada needed to do. Ultimately, the legislature agreed, and completely privatized the state fund. The insurance commissioner's strength was increased and a rate structure was put into place whereby the insurance commissioner determined rates. Nevada is a NCCI rated state. The market opened to competition in July and Employers' Insurance Group rolled out as a private, for-profit mutual insurance company on January 1, 2000. Nevada has a fully competitive market with about 175 companies actively writing. Employers' Insurance Group writes between 32% and 33% of the insured premium in the state of Nevada. Employers' Insurance Group's core business group is employers with $7,000 or less in annual premium. Employers' Insurance Group ended up non-renewing 18,000 small business holders, defined as $750 or less in annual premium. 800 of those small business holders ended up in the residual market, which means that 12,200 found a place in the competitive private market. Nevada worked very hard to ensure that the market is stable, rates are adequate and that there is a fully competitive environment. Ms. Nelson stated that the insurance commissioner has done an excellent job. She urged the committee to look at the legislature's role in establishing the statutory and regulatory framework on which the workers' compensation market hangs. She believes there are two roles for government in the workers' compensation market. One of those roles is that of a state fund. The other role is in establishing a statutory and regulatory framework - benefit levels, benefit delivery systems, litigation costs, rate adequacy, qualifications to become an insurance company, etc. She urged the committee to remember the second role, because it is crucial to maintaining a healthy market.

Mr. Wood asked about what happened to the assets and liabilities of the State Fund, and what happened to the status of the state employees. Ms. Nelson responded to the first question of the assets and liabilities. In Nevada, the assets and liabilities of the State Fund were constitutionally held in trust. The trust was transferred from the state of Nevada to the new mutual insurance company. Regarding the status of the state employees, there were different groups of employees, depending on how close each employee was to retirement. There were a number of employees who were interested in working for the private company, and a lot of time was spent putting together compensation and retirement packages that closely mirrored those of the state. There were also a number of employees that were close enough to retirement with the state that they had no interest in working for Employers' Insurance Group. The state of Nevada was also in a budget crisis at the time and in a hiring freeze. A special re-hiring list was established, and the hiring freeze was lifted for those employees. In that way, almost 100% of the employees who wanted to stay with the state were able to. The hiring list was extended for two years, so that employees who did not like working for the private company could put their names on the re-hiring list.

Mr. Wood asked what happened to medical benefits. Ms. Nelson replied that the private company was able to match the state's benefits. The people in the re-hiring list continued to work for the private company, and did not experience a gap in employment.

Senator Johnson asked what the state of Nevada got out of the deal. Ms. Nelson responded that Nevada was unique but the Nevada State Fund did not have assets, and in fact had an actuarial deficit of $650,000. The liability was removed from the state's books. Senator Johnson asked if the reason the state got out of the insurance business was because of the removal of the liability. Ms. Nelson agreed that some people have put it that way. She also stated that there was a debate about who owned the assets. Did the state of Nevada own the assets or did the policyholders own the assets? Nevada decided that the policyholders owned the assets. The Nevada State Fund was started with $1000 paid by the State Treasurer to the state fund in 1913. The money was paid back 6 months after the inception of the agency, and the state never had to put any more money in. Senator Johnson stated that Montana was in the same position at one time, and when the state tried to sell the State Fund, no one wanted to buy it. However, the situation is different now because MSF has some value beyond its liabilities. Ms. Nelson responded that her personal advice is for the committee to look at the role of government in workers' compensation in Montana, and what the workers' compensation market should look like in Montana.

Mr. Morgenstern asked Ms. Nelson and Mr. Barry to compare the sizes of the Montana and Nevada state funds. Ms. Nelson replied that the insured market in Nevada as of 2002 was about $270 million.

Representative Bergren asked Ms. Nelson what is in place in Montana that would keep her company from doing business. Ms. Nelson responded that there is nothing to keep them from doing business once they are licensed, and they can compete with MSF in terms of price, service, agent commissions, etc. Representative Bergren asked if she believes that MSF has an unfair advantage over the private market. Ms. Nelson responded that MSF does not have an unfair advantage. An outside company coming into Montana needs to do business by Montana's rules. If Montana decides that there should be a dominant state fund, Employers' Insurance Group still wants to be licensed in Montana, but its market will be limited to its regional customers that it covers in other states. If, however, the committee decides as a matter of public policy that it wants a number of competitive insurance companies in Montana, Employers' Insurance Group will aggressively compete. When insurers are looking at a market to stay in, they look at predictability and stability. One of the difficult things about the Montana market right now is predicting what costs will be in the future. Carriers look at things like what kind of structure the legislature has put in place to ensure that there is predictability and certainty in the market. A good example of an incredibly unpredictable market is California. California has a state fund with anywhere from 51-58% of the marketplace, and costs in that market have increased 200-400% annually. Private carriers have been watching the California market, but not jumping in.

Shaun Peterson of Montana International Insurance (MII)/Payne Financial Group provided public comment. He stated that a viable, competitive and dynamic state fund facilitates a competitive market for workers' compensation insurance. This is a benefit to any employer doing business in Montana and ultimately to the economics of the state.

Payne Financial Group believes that there is a need for the state to provide a mechanism that businesses can use to purchase their workers' compensation coverage that provides a consistent market during soft and hard insurance cycles. The current system provides the most options and flexibility for employers. It also protects the interests of the majority of Montana businesses by fostering a competitive marketplace, resulting in pricing that can be as low as prudently possible.

Montana State Fund is not always the lowest price for coverage. But a strong Montana State Fund protects the businesses in Montana, both small and large, by providing stability and options in this mandatory line of insurance. Montanans have also experienced the pain of an unbalanced workers' compensation market, and know first hand what happens when the system doesn't function properly, and the dollars and time that must be invested to fix it. This is a mandatory form of insurance. We have no option but to make sure that we do it right.

Mr. Peterson, asked the committee to consider the following question before it makes any recommendation. Will main street Montana businesses be better off in a system that gives them fewer choices, and no recourse for competitive pricing during difficult market cycles when private carriers can just pack up and leave the market? How much more will thousands of Montana businesses be paying under an assigned risk pool scenario?

Mr. Peterson stated that a decade ago the system was in a mess. Many people joined together to create a workers' compensation system that works for the people of Montana. Now is not the time to be fiddling with a system that isn't broken, and doesn't need a major overhaul.

Senator McCarthy asked Mr. Peterson what percentage of his agency's total business comes from MSF. Mr. Peterson responded that his agency writes approximately $25 million in premium through MSF. Senator McCarthy asked if all of MII's employees are able to write workers' compensation insurance. Mr. Peterson replied that out of 200 employees, 40 or 50 work in the workers' compensation market.

Riley Johnson, of the National Federation of Independent Businesses (NFIB), provided public comment. NFIB has over 8,000 members in Montana. The average business has 3 employees and about $250,000 in gross sales. NFIB does not take sides on this issue, but does take it very seriously. Mr. Johnson stated that he was here in the 1980's when the state fund was in debt. In the last 10 years, there has been a dramatic turnaround for small businesses. Small businesses wanted a solution, and they got it. The system works very well today for small businesses. Now that the system is working and MSF is on its feet, perhaps it is time to look at some different options. It is time to look at competition and the question of the insurance commissioner having more authority. It is also time to look at the issue of the premium tax. NFIB wants to participate in the process and is happy that the committee is looking at the issues. He asked the committee to go slow and be sure it knows what it is doing.

Mike Taylor, of the National Council on Compensation Insurance (NCCI) gave a presentation on NCCI rates. (See Attachment C, "NCCI Presentation on Ratemaking")

Mr. Wood asked if Montana insurers are required to accept NCCI lost costs. Mr. Taylor replied that they are required to accept NCCI loss costs. The insurer starts with NCCI's loss cost as a basis, and adds their individual experience on top of that. Mr. Wood asked if MSF is required to use NCCI's loss costs. Mr. Taylor replied that MSF does submit data to NCCI, but he is not sure if they are required to use NCCI's loss costs.

Senator Johnson asked if it is a subjective call for the insurer to have an increase in premium for something like a lower safety record. Mr. Taylor responded that the carrier may decide whether or not to insure an employer and what price they are going to charge.

Mari Gray, an actuary with the Montana Department of Insurance, State Auditor's Office, discussed three items pertaining to ratemaking options of private carriers in Montana. She spoke about the classification and review committee, NCCI loss costs, and rates filed by private carriers. The insurance law provides the requirements for all three items, and also the insurance commissioner's role in regulating those activities. The classification and review committee determines how data is compiled and ultimately determines how loss costs are determined. The insurance law establishes the review committee for workers' compensation. The committee consists of 5 voting members who serve for 3 years, and who are charged with establishing and revising workers' compensation classifications. Two of the members are from private insurance carriers who write workers' compensation insurance in the state and are appointed by the Insurance Commissioner. Dave Wilson of Liberty Northwest fills one of the two positions, while the other position is vacant. Tom Clark, an insurance producer, fills another position, while another representative is Dick Root of MSF. There is also one employer, Cliff Hanson of Billings Truck Exchange. The committee also looks into problems with a certain classification. The committee does not establish rates. NCCI staffs the committee and is available to answer questions. The next meeting of the commitee is November 13, 2003 at the Colonial Hotel in Helena.

Ms. Gray also spoke about NCCI loss costs. The Insurance Commissioner designates one workers' compensation advisory organization (currently NCCI) to gather and compile data and assist the Insurance Commissioner. Every private carrier, as well as MSF, is required to report its experience to NCCI, using a uniform plan. Every spring, Mike Taylor and NCCI's actuaries file their loss costs. By law, these loss costs are filed about 30 days prior to being effective, and are subject to prior approval by the Insurance Commissioner. The Commissioner is required to review the loss costs as filed by NCCI. The loss costs are reviewed for compliance with the ratemaking standards, which are that rates may not be excessive, inadequate or unfairly discriminatory. The Insurance

Commissioner reviews the supporting information, methodologies and the assumptions utilized to drive the loss costs to ensure that they are following accepted actuarial standards. Ms. Gray stated that she is a fellow of the Casualty Actuarial Society, and a member of the American Academy of Actuaries. She looks at trend factors, development factors, tail factors, and actuarial assumptions. There is a lot of interaction between the insurance commissioner's office and the companies.

She then spoke about private carriers' rates. Most carriers start with NCCI loss costs. Carriers usually file rates after NCCI has filed their loss costs. A private carrier must be a member of NCCI, and must use the uniform classification plan and experience rating plan that NCCI files. All private carriers use the same set of plans, but can deviate with their rates. Carriers file a loss cost multiplier, which loads the loss costs for the company's expenses. Certain carriers will deviate from the loss costs if their experience dictates. For example, if their experience shows they are better than average loss costs as filed by NCCI, they will deviate downwards. In most cases, those rates are subject to file and use rating law, which means that once the insurance company files the rates, they can be used as soon as they are filed. If the company's rates are above NCCI loss cost, they are file and use. If the company wants to charge rates lower than the NCCI loss cost, they are subject to the prior approved rating law. Montana law is set up as a modified file and use state, which is to encourage competition among carriers. The Insurance Commissioner's role is to review the rates that are filed. The law defines specifically what excessive, inadequate and unfairly discriminatory means. The law states what the Insurance Commissioner should look at in reviewing rates, such as past and prospective loss experience, catastrophes, expenses, reasonable profit margins and other relevant profit factors.

Dan Gengler, Internal Actuary, Montana State Fund, provided an overview of MSF's ratesetting process and the MSF Tiered Rating Program. (See Attachment D, "Overview of Montana State Fund Ratesetting Process")

Mr. Morgenstern asked if there is anything under rule or statute that would allow a multiplier to be adjusted upward. Mr. Gengler replied that the multiplier is established by MSF's Board of Directors and has to be adjusted at that time. The loss cost multiplier cannot be adjusted until the next year.

Richard Root, Underwriting Specialist, Montana State Fund gave a presentation on Individual Risk Pricing. (See Attachment E, "State Agency Pricing")

Senator McCarthy asked a question regarding the data from 2000-2001 and the $2 million difference. She asked if MSF looked at each agency to see what happened. Mr. Root replied that MSF did look at each agency, and was able to see a pattern in the large agencies. However, the pattern was not seen until the following year. Senator McCarthy asked if MSF was able to help the agencies bring losses down. Mr. Root replied that MSF is working with the agencies now. He also mentioned that one of the problems is the severity of claims, and one of the key components is early return to work. Senator McCarthy clarified that it is the severity of claims that is significant, rather than the frequency. She also asked what MSF is doing differently in its education programs to the agencies. Mr. Root responded that MSF is using the same techniques, such as early return to work and early reporting of claims, but the difference now is that the numbers mean something, and there is a lot more attention paid to the matter on both sides. Mr. Hubbard told the committee that MSF recently brought a nationally renowned speaker, Richard Pimentel, to speak to agency directors, risk managers and human resources professionals about safety in the workplace, the aging workforce, and solutions to those problems. Senator McCarthy stated that 2 things were missing from the chart. First, the number of state employees in 1999 vs. 2002, and secondly, the number of claims. She stated that if there are the same number of claims in 1999 as in 2002, maybe the state is coming back to where it should be. Mr. Hubbard responded that severity of claims is the key, and that medical costs and inflation costs increase the severity of claims. Senator McCarthy said that we must have done something right in 2000. Mr. Root responded that in 2002 there were 953 claims, while in 2000 there were 940 claims.

Mr. Wood asked how comfortable MSF is with the 4.8% figure for state agencies. Mr. Gengler responded that the 4.8% figure represents the impact of legislation passed in the last legislature that increased benefit costs and the Stavenjord court case. There are increases in benefit costs and pricing that exceed that 4.8%, but that is the portion relating to what the courts and the legislature have recently done. Mr. Wood asked if MSF will have to recover some losses because of the effect of the court decisions and their retroactivity. Mr. Gengler replied that the 4.8% figure includes the impact of Stavenjord only on a going-forward basis. Even if the impact of Stavenjord were applied retroactively, MSF would not charge current customers for past customers' losses. Any retroactive impact of Stavenjord would be a hit on the surplus. Mr. Wood asked if MSF has computed administrative costs of finding the retroactive cases. If rates are not recovered, what happens when the surplus goes down from $150 million to $120 million? Mr. Gengler replied that when court cases are applied retroactively, it is a hit to the equity position of the carrier, and the surplus needs to be rebuilt. Mr. Wood stated that in the same situation, self-insurers have to charge current customers for past losses. He asked how it is different for MSF. Mr. Hubbard replied that the money comes from the contingency reserves, which are also known as surplus. The industry uses risk-based capital measures to target the right level of surplus, based on liabilities, exposure, and premium volume. The actuaries recommend a target level range of surplus. Each accident year must stand on its own. MSF must set aside enough money in its ratemaking to ensure that it can pay the claims that occur in each year. Actuaries must look at the past to make reasonable predictions about the future. This is the purpose for having contingency funds available for any events that may occur. Mr. Wood asked how MSF would replace its contingency funds. Mr. Hubbard responded that it would have to be replaced within the current rate structure.

Senator Johnson asked Mr. Root to break state agency dollar losses down by agency. Mr. Root responded that he would bring that information to the September 23rd meeting. He also stated that the losses ranged from -12% to 150%.

The meeting was adjourned at 5:30 p.m.

September 23, 2003

Senator Johnson called the meeting to order at 8:00 a.m.

Mark Barry, VP of Corporate Support, gave a presentation on the financial condition of the Montana State Fund. (See Attachment F, "Financial Condition of Old and New Fund", p. 1 - 5)

Senator Johnson asked if the figures presented in the FY 2002 New Fund Balance Sheet and FY2002 Income Statement are actual figures. Mr. Barry replied that they are actual figures as of the end of FY 2002.

Senator McCarthy asked Mr. Barry to explain the underwriting expenses. Mr. Barry replied that there are three main expenses for an insurance company. The loss adjustment expense (LAE) is the expense of adjusting claims. The underwriting expense is the cost of acquiring and servicing business. The third category is investment expense, which is not listed because the Board of Investments nets their expenses to MSF investment income. Underwriting expenses include the cost of agents' commission and costs of servicing and renewing the account - all the costs that are allocated to producing a piece of business. Senator McCarthy asked if MSF increased the number of agents it was using or if the costs increased with the same number of agents. Mr. Barry responded that considering the amount of increased premium, commission expense will increase, regardless of the number of agents.

Mr. Wood asked how much of the underwriting expense is internal and how much is external. Mr. Barry responded that MSF paid approximately $7 or $8 million in commission expense, which is external.

Mr. Barry continued his presentation with Fiscal Year 2003 financials as of the third quarter. (See F, p. 6 - 7) Senator Johnson asked Mr. Barry if the large change in the loss adjustment expense is explained by the adjustment of previous claims. Mr. Barry agreed that this is true. Mr. Barry also explained that the actuary looks at a number of methods in evaluating the ultimate cost of claims in any given accident year. Based on payment patterns on those claims, the payment pattern is higher than was previously expected. Therefore, MSF is expecting that ultimate costs on prior accident years will increase - in some years up to $3-5 million. This is also being seen on older years such as 1991 to 1993, which is primarily related to what is called "tail activity". MSF is projecting that ultimate bsses on prior accident years will increase as a result. MSF believes that the current accident year, FY 2003, is profitable. However, adverse development is being seen in 1999, 2000, 2001 and 2002.

Representative Bergren asked how low the surplus can get before it is a problem. Mr. Barry replied that MSF believes the surplus level should be high enough to support a dividend to deserving policyholders. MSF's consulting actuary has advised that the lowest level of surplus that would support a dividend program is $111 million.

Jacqueline Lenmark asked Mr. Barry to talk more about MSF's policy of paying dividends when it is showing a net loss. Mr. Barry stated that the philosophy behind a dividend is that MSF needs to provide incentives to employers who are safety conscious. If their workers' compensation experience is profitable, MSF should be returning a portion of their premium to them. MSF does not just look at the current year's losses, but measures results from two accident years ago. MSF looks at the level of surplus and whether or not there is sufficient surplus to safely provide a dividend and still continue on with a strong surplus even in a loss situation. Ms. Lenmark asked Mr. Barry if it is a correct conclusion that the surplus is more important in making that determination than an operating loss. Mr. Barry agreed, but stated that MSF does look at both.

Ms. Lenmark asked what the basis is for payment of agent commissions. Mr. Barry responded that commission rates are established with agents, and depend on the amount of premium in the book of business. MSF can issue a commission of up to 10%. Commissions start at 2% or 4%. The average commission rate is about 7.5% of written premium.

Representative Lewis asked if MSF's Board of Directors has been satisfied with the Board of Investments. Mr. Barry replied that MSF consults with Conning Asset Management Company to work with MSF and the Board of Investments to create a strategy on investments and an investment policy and guidelines. For instance, MSF has limited its investments in equities to 12% of invested assets. MSF is over that limit now, and is in the process of selling some of the equities to get back to that level. MSF also targets a certain grade of investment, and is working with the Board of Investments to get to a certain level. Senator Johnson asked if MSF could compare its gain or loss portfolio with like investments. Mr. Barry replied that Conning helps MSF do a market evaluation. Rather than looking at what the return is, it looks at the quality of investments. MSF is a member of the American Association of State Compensation Insurance Funds (AASCIF), which does an investment questionnaire each year evaluating the investment returns of all AASCIF members (including Canadian boards). As of 2001, MSF's total return was the highest of all the members at 11.4%. Senator Johnson stated that MSF's return was very good compared to everyone else. Mr. Barry agreed, but stated that a company can chase return by taking additional risk. MSF believes it needs to balance quality with return.

Senator Johnson asked about the dividend and how it is reflected on the balance sheets. Mr. Barry explained that if a dividend is declared, it is declared in April and is recorded as a liability on the financials. The dividend is paid out by June.

Mr. Wood asked if any adjustment is made in an agent's commission for a series of business that is not profitable. Mr. Barry responded that this would not affect base commission. However, MSF does have an agent incentive program for agents if their business is profitable.

Mr. Morgenstern asked if the 11% return on investments revolves around the fact that MSF is invested in fixed income. He also stated that going forward, this could hurt MSF, especially under the GASB accounting method. He asked what the average maturity of the fixed income is. Mr. Barry responded that the average maturity is about 6 years. The 11% total return includes unrealized gains. At the time of measure, MSF was invested in fixed assets that were paying 7-8% interest. As those mature, and as MSF invests more, MSF is invested in 4.5 - 5.5 % yielding investments, and that 11.4% is coming down.

Senator McCarthy asked what responsibilities the independent agents have once the agent has recruited the business. Mr. Barry responded that MSF expects agents to help manage losses and be the main contact for the customer. MSF's expectation is that the customer will call the agent first if they have questions.

Mr. Barry gave a presentation on the Old Fund financials. (See Attachment F, "Financial Condition of Old and New Fund", p. 7-10)

Senator Johnson asked about the expenses for the management of the Old Fund. Mr. Barry explained that as of the end of last year, MSF had reserved approximately $15 million for loss adjustment expense in the Old Fund. As those claims are paid, the loss adjustment reserves are reduced as well. The administrative cost of the Old Fund is currently $1.25 million. Senator Johnson asked if it has gone down over the last 3 years. Mr. Barry replied that it has not. Senator Johnson asked if MSF has planned on reducing the amount. Mr. Barry replied that MSF actually incurs costs greater than $1.25 million, but is limited by law to that amount. Senator Johnson asked what items are included in that amount. Mr. Barry explained that the amount includes adjusters, financial staff, and the consulting actuary, as well as allocation of depreciation and amortization of computer equipment and software. Senator Johnson asked if MSF feels that $1.25 million is enough to take care of the liabilities in the Old Fund. Mr. Barry replied that MSF feels there is an excess amount of about $1 million due to MSF for administration of the Old Fund, but it is not reported on the financial statements.

Representative Lewis asked about the average age of claimants in the Old Fund. Mr. Barry responded that the oldest claim was a 1959 claim. There are 1,413 claims in the Old Fund. Those claims include lifetime medical. There is about $100 million of liability remaining on the Old Fund. Representative Lewis stated that it seems like liability would be reduced over time as the claimants age, and that $100 million seems like a lot of money to be holding back for the Old Fund. Mr. Barry explained that one of the reasons for the liability is that the benefit structure of the Old Fund is more liberal.

Bob Conger, consulting actuary from Tillinghast-Towers Perrin, gave a presentation on the role of loss reserves. (See Attachment G, "How Loss Reserves Are Established")

Senator McCarthy asked if an actuary is able to estimate how much a claim will cost at time of injury. Mr. Conger explained that the claim adjuster usually does this at the time of injury, and reviews it on a regular basis thereafter. There are special consultants (usually not actuaries) who are able to develop detailed plans for more severe injuries. Senator McCarthy asked if each of the claimants in the Old Fund have a dollar amount associated with their claim. Mr. Conger replied that this is correct. Actuaries perform a "forest level" review to determine if that dollar amount is enough or if there will need to be some additional reserves. Senator McCarthy asked if Mr. Conger's company places injuries into categories. Mr. Conger replied that this is true, but also included are the types of benefits that the individual receives based on the severity of the injury.

Ms. Lenmark asked if actuaries front-load their reserving for anticipated variables, such as judicial interpretation. Mr. Conger explained that what is typically built in are events that are reasonably knowable and predictable. Regarding a specific judicial determination, a company might set aside a contingency provision specifically relating to that determination. In a broader area, such as medical technology, the actuary does not try to anticipate what types of new machines will be available, but does try to recognize a broad pattern of movement and trends.

Angela Huschka asked if the actuaries took a new look at the reserves, and if that was the reason there was such an adjustment to the bottom line this year. Mr. Conger replied that actuaries look closely at the reserves every 6 months. Each time they look at the whole history of claims and re-evaluate each of those old years. Each time that is done, there is some movement in the numbers. What has been seen recently is a broad pattern of movement, where medical costs and duration of medical care are stretching out. What would be expected more typically is that individual years might go up and down. Ms. Huschka asked if there will be an ongoing adjustment of this magnitude, or if it is a one time hit to the reserve. Mr. Conger stated that this phenomenon is not unique to Montana. MSF staff and Tillinghast Towers Perrin have examined the question and have tried to understand the issue. Mr. Conger believes they have quantified the effect of the deterioration and have reasonably interpreted how it is going to affect the cost going forward.

Senator Johnson asked if two actuaries were comparing the same company, at the same moment in time, if there would be a variance. Mr. Conger replied that there would definitely be a variance. A fairly typical range of variation between two actuaries is about 5%.

Mr. Conger responded to Representative Lewis' earlier question regarding the magnitude of the Old Fund's reserves. The mix of Old Fund claimants is an aging mix. Over the last 7 or 8 years, the amount actually being paid on the Old Fund has gradually declined. One troubling thing is that for 6 or 7 years there was a very steady and predictable decline in the dollars paid out of the Old Fund each year. However, in the most recent year, the progression of gradual decline spiked back up. The projection is that it will be approximately 40 years before the Old Fund is closed.

Tom Beck asked if surplus is as important in the Old Fund as in the New Fund. Mr. Conger responded that it is, because there is the potential for the Old Fund to use up the reserves and then some, because there is no real cushion. Until recently, there was a 10% margin of surplus kept in the Old Fund, but this was eliminated. Mr. Beck asked if the Old Fund is actuarially sound. Mr. Conger replied that it is actuarially sound, with assets and liabilities in balance. Mr. Beck stated that by law, the Old Fund is still an obligation of the general fund.

Mr. Conger also provided a presentation on the role of surplus. (See Attachment H, "Role of Surplus")

Mr. Morgenstern clarified that the surplus protects MSF in a volatile market, and cushions it from the ups and downs of the market. He also stated that it is the nature of the business to make, and also to lose, money. Mr. Conger replied that variations of $10 million or $20 million a year are very normal for a company the size of MSF.

Mr. Beck asked if there is a standard percentage of surplus. Mr. Conger replied that there are two sets of standards that are most used. One is based on evaluating when an insurance company is weak. These standards are calculated by applying a series of factors to premium, reserves, etc. There are also standards based on a company's strength. For example, AM Best evaluates a company's strength based on benchmarks such as reserve to surplus ratio.

Ms. Huschka asked about the charts showing reserve variability. She asked if the 35% was under or over reserved. Mr. Conger replied that it was a bad result. In hindsight, the reserves should have been 34% higher than they were. Ms. Huschka asked about the Accident Year Chart showing that benefits to premiums were high in 1982 and 1983. Mr. Conger explained that one of the factors impacting high benefit to premium ratios was legislative action regarding the benefit structure and the adequacy of the premiums being charged. There was also some legislative action taken regarding the management process.

Ms. Huschka asked Mr. Conger to describe his role as the consulting actuary versus the internal actuary. Mr. Conger deferred to Mr. Barry, who explained that MSF is required by statute to utilize the services of an independent consulting actuary to help MSF to set its reserves and rates. The internal actuary's function is to assist the consulting actuary.

Mr. Barry provided a presentation on the role of the Legislative Audit Division (LAD) in reviewing MSF. (See Attachment F, "Financial Condition of Old and New Fund", p. 10-13)

Mr. Beck asked if there were any recommendations from the Auditor. Mr. Barry responded that there have been no material recommendations. Mr. Beck asked how far LAD can go with their recommendations. Mr. Barry explained that LAD has the authority to submit reports to the legislature regarding rates and can make recommendations regarding loss reserves.

Mr. Barry also provided a presentation on different ways to determine the value of MSF. (See Attachment F, "Financial Condition of Old and New Fund", p. 14 - 15)

Mr. Barry provided some statistics on efficiencies of MSF. (See Attachment I, "Statistics on Efficiencies of Montana State Fund")

Larry Jones, of Liberty Northwest, gave a presentation on the Plan II position on the competitive disadvantages and advantages of MSF. He stated that MSF is currently deregulated because it is not under the Insurance Code, nor is it under the regulatory authority of the Insurance Commissioner. If the state were to sell MSF to a private carrier, that carrier would be regulated. Privatization equals regulation. Mr. Jones stated that the failure of the Old Fund was not a market failure, but a regulatory failure. Mr. Jones made three points about Montana's current role in the workers' compensation insurance market. First, he stated that the State of Montana is operating a deregulated workers' compensation insurer that competes directly with the private market. Secondly, the State operates the largest workers' compensation insurer. Thirdly, the State operates this deregulated workers' compensation insurer by keeping it from the regulatory authority of the Insurance Commissioner and the statutes that govern all other workers' compensation insurers. He explained that he believes these policies have created an unfair competitive advantage. Mr. Jones stated that there is a consumer protection issue, because an injured worker whose employer is insured by MSF cannot go to the Insurance Commissioner if he is not satisfied with his treatment by MSF. Similarly, an employer insured by MSF cannot go to the Insurance Commissioner for relief if that employer feels the rates are unfair. In addition, MSF is not subject to state income tax or the premium tax that private insurers pay, and does not have the cost of complying with the regulation of the Insurance Commissioner. Mr. Jones stated that these are costs of doing business that MSF does not have. He also said that private carriers do not have a guaranteed book of business. Mr. Jones believes that some of MSF's operating costs are absorbed by the state, such as payroll, the building, and PERS. Mr. Jones stated that the term "insurer of last resort" could have two meanings. First, it means that the insurer of last resort cannot decline to write workers' compensation insurance for an employer. Another meaning of the term pertains to who will have to pay the bill if the business fails - the taxpayer.

Senator Johnson asked Mr. Jones to provide the committee with a condensed version of his company's view of the competitive advantages and disadvantages of MSF. Mr. Jones agreed to provide this.

Mr. Morgenstern asked Mr. Jones if MSF becoming more like a private insurance company would create a more level playing field. Mr. Jones replied that anything that will level the playing field is an advantage to the private sector. He did state however, that Senate Bill 19 and Senate Bill 153 are not enough. For example, making MSF a domestic mutual insurance company would place MSF in the Montana Guaranty Association. Private carriers were concerned about MSF being part of the Guaranty Association. Mr. Jones stated that Senate Bill 19 and Senate Bill 153 may have appeared to level the playing field, but were in fact half steps that did not address the fundamental problem of MSF not being regulated by the Insurance Commissioner and the Insurance Code.

Ms. Lenmark asked Mr. Jones what changes he would recommend to the structure to limit or mitigate the effects of competitive disadvantages if MSF were to remain a statutorily created mechanism. Mr. Jones stated that MSF could function only as the market of last resort. However, this still does not address the issue of whether or not state government should be in the insurance business. Mr. Jones said that the solution is for the State to look at its role in workers' compensation insurance, and perhaps decide that it should not be selling insurance.

Ms. Lenmark asked what recommendations Mr. Jones would make to modify MSF as it is now to achieve a more competitive footing. Mr. Jones replied that MSF needs to operate more like a private carrier. Ms. Lenmark asked if Mr. Jones would recommend that MSF pay premium tax. Mr. Jones replied that MSF should pay premium tax, just as private carriers are required to do. Ms. Lenmark asked if there is any deviation from what private carriers are required to do that Mr. Jones would support. Mr. Jones stated that as long as MSF is an assigned risk pool, the Insurance Commissioner cannot declare it insolvent, because it is the insurer of last resort, and MSF will find itself less able to approach the market model.

Representative Lewis stated that regulation by the Insurance Commissioner, the payment of premium tax and the loss of the monopoly of state employees would all raise costs to MSF, and would thereby raise premiums. Mr. Jones replied that this might be a possibility. Currently, MSF is statutorily required to write rates that are neither more nor less than self-supporting. Representative Lewis stated that the committee needs to make sure there is a system that keeps premiums lower. Mr. Jones replied that if there were a private market, competition might bring down prices.

Mr. Morgenstern asked if there is enough of a market to support vigorous competition. Mr. Jones stated that because of the dominant position of MSF, the two main players in Montana are MSF and Liberty Northwest. He stated his opinion that other insurers would come to Montana and compete if the climate were conducive to their entering the market.

Mr. Beck asked if the private sector was beginning to increase its market share. Mr. Jones stated that there are about 240 workers' compensation insurers licensed to do business in Montana, but that a large number of these insurers are writing national accounts or "policies of convenience". Mr. Beck stated that he looks at MSF as the insurance company of last resort. He asked Mr. Jones to address that issue, as well as the practice of "cherry picking" by private insurance companies. Mr. Jones recommended that the committee invite people from other states who have sold their state fund. Also, NCCI administers assigned risk pools in approximately 21 states and could speak to the committee. Mr. Jones also responded to the "cherry picking" question and stated that another way of looking at that is giving employers a chance to make a decision as to who they want to be insured by and what types of services they want. Mr. Jones explained that assigned risk pools work well in other states, and offer the transparency of who is in the pool and why. A state can fashion its assigned risk pool any way it wants. An assigned risk pool is not imposed upon a state, but is created to meet the needs of the state. Mr. Jones also spoke about MSF's statistics on assigned risk pools. Tier 4 & 5 are expressed as a percentage of premium. There are 23,000 Montana employers with premium of under $5,000. Mr. Jones asked if these statistics could be re-expressed to identify by number how many policyholders under $5,000 are in Tiers 4 and 5. Mr. Jones believes that would be a way to identify what is now in fact an assigned risk pool. Mr. Jones stated that it might be that the people in Tier 4 and 5 are already paying the highest premium. Mr. Jones stated that Ann Nelson of Nevada, Mark Ogle of Michigan, and the NCCI representative from Boca Raton would be willing to come to the next meeting to discuss their experiences.

Senator Johnson asked Mr. Jones what guarantee there is that Liberty Northwest or any other private company would stay in Montana. Mr. Jones responded that in a competitive market there are no guarantees. He stated that many people say that in the 1980's and 1990's private carriers left the state. He also stated that workers' compensation carriers did not leave the state, but were driven out by the predatory pricing of MSF - the Old Fund. If there is a healthy competitive market with a level playing field, carriers will not leave.

Mr. Hubbard spoke about MSF's position on competitive advantages and disadvantages. He stated that he feels the intent of SB 304 is to clearly define whether or not Montana employers and workers need a protective mechanism that ensures a ready supply of workers' compensation coverage. Mr. Hubbard stated that MSF supports a competitive system. He also addressed Mr. Jones' issue of oversight of MSF. He explained that MSF has public meetings, where every decision of the Board of Directors is made in a public and open forum. Mr. Hubbard acknowledged that the system was in crisis in the early 1990s, but the legislature acted to fix those issues. The structure of MSF today is materially the same as it was in 1991. Private carriers did not leave the state because of predatory pricing. As was happening all over the country, the line of business was not profitable.

Mr. Hubbard addressed the issue of what is competitive or not competitive about MSF. He said that the committee needs to ask the employers of Montana if they have had choice over the last ten years. For a certain group of employers there is no choice, because nobody in the private market wants to write insurance for them. MSF provides a guaranteed market for those employers. Mr. Hubbard explained that MSF does not pay premium tax, but the guaranteed market responsibility is anti-competitive for MSF.

Mr. Hubbard also addressed the issue of oversight. MSF's Board of Directors is appointed by the Governor, which ensures oversight by the Governor. The Board's content, makeup, size, authority and power are statutorily mandated. MSF is statutorily required to employ an independent actuary to assist in ratemaking and make recommendations to the Board. MSF is subject to a legislative audit each year to determine that rates are neither inadequate, excessive or unfairly discriminatory. The committee needs to ask if there are sufficient checks on the process to ensure that the company is sound and operates on behalf of Montana employers as the legislature intended.

Mr. Hubbard also discussed what MSF's presence does to the marketplace. He acknowledged that by the numbers, MSF is the dominant presence in the marketplace. MSF has 22,000 customers under $5,000 in premium, which the private market chose not to pursue. Most of the business in Montana is small business, and does not have a readily available market.

Mr. Hubbard stated that MSF offers safety services to everyone, including its competitors' customers. MSF's safety management expert has traveled all over Montana and held over 60 community meetings on workplace safety and early return to work. The meetings are open to anyone who wants to attend, regardless of whether or not they are insured with MSF. MSF does this because it is commited to improving the safety records of employers in Montana. This is education and knowledge that is offered to the communities by MSF as a state fund, and improves the environment for private carriers, because it improves the experience of its potential customers. The more emphasis is placed on early return to work, the better the competitive environment in Montana. The existence of MSF has been an enhancement to the marketplace and the opportunities for private companies, but it also enhances the value to Montana employers. If there were no competitive state fund, there would be no check or balance to ensure that when private companies come into Montana, all Montana customers are given a fair deal.

Mr. Hubbard stated that there is a lot more to be discovered on the topic of assigned risk plans. MSF does not maintain that assigned risk plans are wrong or bad. They have worked in a number of states, but the question is whether it will work in Montana, providing Montana employers with the competitive environment they deserve to have. The other question is what will it do to the cost to Montana employers. There are costs associated with any change to the system. The committee can design a plan that is tailored uniquely to making sure that the small employers of Montana are treated fairly, but if that plan is not attractive, there may be no one willing to administrate the plan.

Mr. Hubbard addressed the issue of payment of premium tax. He stated that MSF could pay premium tax, and the cost of that tax would be passed on to the customer, as is done by private carriers. By federal law, MSF is exempt from paying federal taxes because it meets the standard of being a non-profit entity because it serves as the guaranteed market. Mr. Hubbard stated that MSF does not pay state income tax, but he does not believe that private carriers pay state income tax either. Mr. Hubbard stated that he believes that the evidence shows that MSF has not created a displacement in the marketplace for competitive workers' compensation insurance.

Mr. Hubbard addressed Mr. Jones' point of the costs of compliance with regulatory authorities. MSF also has many costs associated with compliance, such as paying for an independent auditor and even paying for this committee's work to study MSF.

Mr. Hubbard acknowledged that if MSF were to become insolvent, it would be a burden on the taxpayers of Montana. The standards by which MSF must operate are the same standards that are required of private insurance companies, but are contained in different parts of the law. Injured employees who are denied benefits go to the Department of Labor and Industry to resolve their disputes, whether they are insured by MSF or a private insurer. If someone does not like a policy or decision, they can contact the Board of Directors or the legislature.

Regarding the residual market, defined as whomever the voluntary market decides not to write, an employer could have to obtain up to 3 declination letters from private insurers in order to become part of the residual market. This would be an inconvenience for many small employers.

Mr. Hubbard stated that competition in Montana over the last 12 years has been dynamic. In 1997 and 1998, private carriers were discounting off of NCCI loss costs by 40-45% because of a healthy, competitive environment. Over the last 12 years, 9 new state funds have been created to replace assigned risk pools. The committee should address the issue of why that has happened.

Mr. Wood asked if MSF would cease to exist as a competitive factor in the market if it accepted some of Mr. Morgenstern's and Mr. Jones' suggestions. Mr. Hubbard replied that if MSF were to remain a competitive factor, it would need to have a healthy cross-section of business.

Matthew Cohn, Communications Leader, Montana State Fund, provided a presentation on the Senate Bill 19 Study Committee. (See Attachment J, "Discussion of Goals and Objectives of SB 19 Study Committee")

Senator Johnson asked if the Senate Bill 19 Study Committee sent Senate Bill 153 to the legislature. Mr. Cohn replied that the bill was drafted from the recommendations of the committee. Senator Johnson asked if the bill was reviewed by the committee before it was sent to the legislature. Mr. Cohn responded that it was not. The committee finished its work in November and the bill was drafted in December. Senator Johnson asked why it was never taken back to the committee. Mr. Cohn stated that the committee chose not to convene again. Mr. Wood stated that there was agreement by the committee on a number of the items, but there were complaints from committee members that they did not get to see the finished product and did not vote on it. Mr. Cohn agreed that the committee never did vote on the bill. Senator Johnson asked if the committee voted on committee actions. Mr. Cohn replied that they did vote on action items.

Senator Johnson stated that in the Senate Bill 19 meetings, Carl Swanson, former President/CEO of MSF, made some interesting comments. These comments had to do with the priorities of the proposed legislation. Mr. Swanson's first comment was, "The key items are protecting MSF's surplus, a structure that allows MSF to function more effectively and efficiently, and as a non-state entity." His second comment was, "Ensuring MSF retains the role as the guaranteed market, providing options for Montana businesses." Senator Johnson stated that the bill went way past the original request, and asked Mr. Cohn if he agreed. Mr. Cohn responded that there were many different opinions, and that Senator McNutt felt that the bill reflected enough of the committee's ideas that he introduced the bill.

Senator Johnson stated that he feels that the Senate Bill 19 committee had the same questions as this committee. He asked Mr. Cohn if there were items that could be taken out of or added into the bill. Mr. Cohn replied that he believes the two committees were created for different purposes. The Senate Bill 19 committee was created to look at MSF's legislative proposal, while the Senate Bill 304 committee was created to look at the role of MSF and whether or not it should be sold. Mr. Cohn did agree that many of the issues are similar.

Senator Johnson provided time for public comment.

Jason Todhunter of the Montana Logging Association provided public comment. Mr.Todhunter stated that he is a field safety representative and an insurance producer. The logging industry is a high hazard industry, and the industry feels acutely the bumps in the market. When rates go up 10%, an employer paying a secretarial class code will see about a 5-cent increase on $100 of payroll. That same rate for a logger, who is paying $34 per $100 of payroll, will cost the logger $3.40. Therefore it is very important for high-risk industries to have a stable marketplace. Currently, a logger has choices available. The three-way system is very beneficial to employers in high-risk industries, and Mr. Todhunter stated that he believes it is important to all employers in the state.

Larry Jones of Liberty Northwest provided public comment and stated that the Senate Bill 19 study committee's report and recommendations were fundamentally flawed. The committee did not have information about other states' experience and had no chance to investigate assigned risk pools. Mr. Jones stated that he believes that Senate Bill 153 does not reflect informed decision-making, with the ability to rely on information about how other states operate their assigned risk pool or about the possibility of selling the state fund. Mr. Jones also questioned whether or not MSF is paying fair market value for IT services and rental of its building.

Jon Metropoulos of the National Association of Independent Insurers (NAII) provided public comment. Mr. Metropoulos stated that the NAII is very interested in what the state of Montana decides to do with MSF. It is an important issue as far as private enterprise and whether a quasi-state agency should have competitive advantages over private insurers. Mr. Metropoulos pointed out that some people and entities think it is very appropriate to think about the proper role of state agencies in the economic life of the people of Montana, and whether they should engage deeply in that economic life, and whether they should have competitive advantages when they do so. Mr. Metropoulos stated that MSF might be working fine now, but without oversight, who can be sure that it will continue. Without the sharpening of skills, and the sharpening of services that come with true competition, can you be sure that MSF, which does have competitive advantages, will continue to do its job in 5, 10 or 20 years? Mr. Metropoulos stated that he thinks it is a laudable thing to look at the issue now, and not wait until it is broken.

Ann Nelson of Employers' Insurance Group provided public comment. She seconded Mr. Metropoulos' comments. She stated that the committee has an advantage because it is not in a crisis situation, and has the opportunity to look at the entire structure. Ms. Nelson stated that Employers' Insurance Group is on the outside of Montana's workers' compensation market, looking in. Employers' Insurance Group has an application for license pending with the Insurance Commissioner. If the license is granted, Employers' Insurance Group will begin writing coverage for its regional clients. Ms. Nelson stated that there are two continuums that the committee needs to deal with. The first continuum deals with the role of government vis a vis the State Fund. The second continuum deals with the regulatory and statutory structure. She urged the committee to look at the two continuums. Ms. Nelson also urged the committee to consider what has happened in other markets, such as Nevada. When the market opened in Nevada in 2000, rates began declining. There has not been an increase in Nevada since 1992. Nevada is a NCCI rated state, meaning that insurance carriers in Nevada must accept NCCI's loss costs, and must base their rates on them. Carriers do their own multiplier, and are permitted to deviate by a certain percentage. This is one way that Nevada has ensured that its rates are accurate. Ms. Nelson urged the committee to look at Nevada's model, as well as Michigan's regulatory and statutory structure. Ms. Nelson recommended four items for the committee to consider. The first item is other states' experience. The second item is assigned risk pools. The third item is regulatory models, and the fourth item is the impact of any change on taxpayers, injured workers and policyholders.

Senator Johnson asked Ms. Nelson if she participated in the study to change the Nevada State Fund. Ms. Nelson replied that there was no formal study, but that she was legal counsel to Governor Bob Miller. The Nevada State Fund went through a series of changes, until 1992 when the Governor commissioned an outside study to value the State Fund. The person doing the study discovered that there was a $2.4 billion liability. As a result of that discovery, in 1993, the Governor put together a small committee. Legislation was passed in 1993, which placed the State Fund under the total control of the Governor. Legislation passed in 1995 split the fund into Old Fund and New Fund. When the market opened to competition, the fund did not retain the state agencies or the market of last resort. When Governor Guinn came to office in 1998, he put together a committee that introduced legislation in January of 1999 to make the State Fund private. Senator Johnson asked how the $2.4 billion liability was taken care of. Ms. Nelson explained that through legislative and agency reforms the liability was reduced to $1.6 billion. A loss portfolio transfer was then executed. For

$775 million, a $2 billion reinsurance policy was purchased. Senator Johnson asked how the $775 million was raised. Ms. Nelson replied that they were able to transfer reserves to the reinsurance company.

Mr. Morgenstern asked if rates had declined since the turnaround of the early 1990s or since going private. Ms. Nelson replied that rates began to decline when reforms were made to the system in 1993. When the market was opened to competition and the state fund went private, Nevada was the fifth highest in the nation for premium levels. Two years later they were the tenth highest in the nation. The Nevada Insurance Department attributes that directly to a truly competitive market and the privatization of the state fund. Mr. Morgenstern asked if the $755 million was the discounted present value to fund the future $1.6 billion in anticipated actuarial claims. Ms. Nelson replied that the loss portfolio transfer recognized the present value of money. This took the risk off of the Nevada taxpayer and placed it onto the reinsurance entities. The reinsurers and Employers' Insurance Group share in any positive development.

Ms. Huschka asked if the competitive nature of Nevada is related to the fact that carriers primarily charge the same rates and the only difference in choosing a carrier is the service provided. Ms. Nelson stated that this is correct. Nevada's competition is based on service levels.

The next committee meeting was tentatively scheduled for November 6, 2003.

It was decided that the next committee meeting will focus on assigned risk pools.

The meeting was adjourned.