5 South Last Chance Gulch
P.O. Box 4759
Helena, MT 59601-4759
Curtis Larsen, Legal Counsel
Office of the General Counsel
(406) 444-7772 Fax (406) 444-1493

Memo

To: **SB 304 Study Committee**

From: **Nancy Butler & Curt Larsen, Montana State Fund**

Re: **Old Fund Risk Financing Alternatives**

CC: **Laurence Hubbard**
Matthew Cohn
Mark Barry

Date: **May 7, 2004**

This is a summary of legal and financial points concerning risk financing alternatives for the Old Fund, specifically a loss portfolio transfer (LPT) or adverse development cover (ADC). Bruce Hockman made a presentation about these alternatives at the committee's March 26, 2004 meeting. These points are summarized as follows:

- In the LPT type of transfer, a re-insurer accepts liability up to a finite amount for a defined period of time. Contracts typically include loss adjustment expense within the contract's limit of liability. If actual liabilities exceed the contract limit, the "excess" liabilities will revert back to the state. There are no unlimited transfers available in the market. The state would be liable for any expenses beyond loss adjustment expenses - such as an annual actuarial analysis, financial statements, legislative audits and Department of Labor assessments.

- In the ADC, a re-insurer would provide protection against unforeseen adverse development of existing case reserves. Premium cost is directly related to the limits of liability purchased, the re-insurer's comfort with existing reserves, and the actuarial projections related to payment patterns and interest rates.

- Old Fund liabilities are obligations of the state of Montana. We do not believe the state of Montana may completely discharge its obligations to Old Fund claimants. Subject to contractual arrangements with a re-insurer or other private party, the state retains ultimate liability on these claims until they are completely paid up.

- Authorizing legislation would be needed to implement either of these options.

    - The best approach in order to get responses to a RFP, would be to select just one of the options for a RFP, or as a possible alternative, allow a responder to make the selection of either a LPT or ADC, at their preference. The entities that may respond usually offer both products.
    - The RFP may need to provide for the option of a responder to charge a fee to cover actuarial expenses incurred in responding to a RFP. Our understanding is that the selected responder would credit their fee.
    - For this type of product, a responder may choose to work only through an intermediary, rather than respond directly to a RFP. Any advertisement of the RFP will need to be targeted in order to increase opportunities for responses. A possible option would be for the state to hire their own consultant or representative to handle the RFP and selection process.
    - The handling of the claims would need to be addressed as well, such as whether the state would supply that function or whether the responder would assume that function.
    - The authorizing legislation would need to provide funds for financial analysis and implementation costs of the RFP.
    - The legislation should be detailed enough to be self-executing without the need for rulemaking. We anticipate that it would take six to twelve months for analysis, program development and placement.
    - An agency, such as the Department of Administration, would need to issue a request for proposal (RFP) to solicit proposals from interested parties to implement either an LPT or ADC.
    - The RFP should include a provision to secure the contractor's obligations under any contractual transfer arrangement, such as a letter of credit or other security.

In summary, while the LPT and ADC are options the committee and the legislature may pursue, there are financial and legal limitations on what may be accomplished with either of these alternatives. Current market conditions and the state's residual liability for Old Fund claims mean that the state cannot simply contract with a private entity to completely assume Old Fund liabilities. Under better market conditions, liabilities might be able to be transferred with a higher guarantee, but no contract has unlimited liability.