



## MEMORANDUM

**To: SB 304 Study Committee Members**  
**From: Laurence Hubbard, President/CEO**  
**Re: Montana State Fund Position on Legislative Options**  
**Date: May 7, 2004**

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Following is a summary of Montana State Fund's (MSF) position on the matters that will be considered by the study committee on May 11, 2004. The information supports and clarifies my prior testimony from the March 26, 2004 meeting. The headings are numbered consistently with the corresponding item on the May 11<sup>th</sup> meeting agenda.

### **II. Old Fund**

**Montana State Fund Position:** Montana State Fund (MSF) does not take a position on the sale of the Old Fund or on the issuance of a RFP for a Loss Portfolio Transfer (LPT) or Adverse Development Cover (ADC). We do believe the committee could consider other legislative options for the Old Fund.

### **IV. Any Additional Legislative Oversight**

**Montana State Fund Position:** We are not opposed to legislative oversight as MSF is a public entity created by the legislature. Any additional oversight should not create any conflict with execution of the workers' compensation insurance functions of MSF or duplicate current oversight functions. Following are the statutory oversight and informational functions of MSF today.

#### **Current oversight by Legislative Audit Division (LAD):**

- Annual legislative financial compliance audit and review of reserves
- Annual review of rates by LAD contracted actuary

#### **Constitutional Requirements:**

- All Board meetings are open to the public and public participation
- MSF is subject to public documents requirements
- MSF protects individual rights of privacy
- Board of Investments invests all MSF assets

**State Agency Status-**Subject to laws applying to state agencies except as otherwise provided by law.

Exceptions for MSF from state agency requirements:

- Budgeting authority in the Board of Directors
- State pay and classification plan
- State printing requirements for educational and marketing materials
- State requirements for procurement of services if insurance related
- Option for personal leave plan

**Budget** – The Board is to approve annually an estimated budget of the entire expense of administering MSF.

- Funded from premium dollars, not tax dollars
- Submission of annual approved budget by the MSF board of directors to the Legislative Finance Committee for review

**Strategic business plan**- Board is to approve a strategic business plan each year.

- Must include specific goals for financial and operating performance
- Each year the Board is to review the performance of MSF

**Annual Report** -The Board is to submit the annual financial report of MSF to the governor and the legislature. It is to contain a statement of the estimated liabilities of MSF as determined by an independent actuary.

## **V. Role and Purpose of Montana State Fund**

### **B. Guaranteed Market Function/Federal Tax Exempt Status**

**Montana State Fund Position:** MSF believes it should continue as a competitive workers' compensation insurer functioning as the guaranteed market in Montana. As such, the federal regulations recognize that a state fund serving that purpose is exempt from federal taxes.

### **C. Payment of Premium Tax**

**Montana State Fund Position:** Whether MSF should pay premium tax is a policy decision of the legislature. It would become a cost of providing workers' compensation insurance and be passed through to employers in their premiums.

### **D. Status as Sole Carrier of State Agencies**

**Montana State Fund Position:** This is also a policy decision by the legislature. The committee has considered whether state agencies should be allowed the same choice as the University system. MSF is prepared to support legislation to allow this choice, but requests a delayed effective date to give adequate time for internal and administrative adjustments. The 2002 SB 19 study committee supported a period of transition. (i.e. 2009 if adopted by the 2005 legislature)

**i. Authority for MSF as Third Party Administrator (TPA)**

**Montana State Fund Position:** Allowing MSF to compete as a TPA for public entities aids in minimizing impacts to MSF. It also provides another option for state agencies should they self-insure at some future point in time.

**E. State Agency Status of Montana State Fund**

**Montana State Fund Position:** Due to the number of statutory modifications necessary to comply with Title 33, and the potential impacts on our 28,000 policyholders, we believe maintaining our current state agency status at this juncture is in the best interest of MSF and the employers we insure. As a statutorily created workers' compensation insurer, MSF functions in many ways as a state agency while also functioning as a workers' compensation company. The current statutory structure recognizes both functions by providing for the public nature of a state agency, but the oversight functions also include oversight of the insurance functions. For example, the rate review by LAD requires a determination of whether rates are excessive, inadequate or unfairly discriminatory, the same standard that is applied to private insurance companies. The annual audit by LAD also includes a review of reserves.

**i. Punitive Damages**

**Montana State Fund Position:** State Agencies are exempt from punitive damages under Title 2, Chapter 9.

**ii. Exemption from Certain State Agency Requirements**

**Montana State Fund Position:** In performing its functions as a workers' compensation insurer, MSF finds that functioning under all state agency requirements does not always support the legislature's expectation that we operate as a competitive workers' compensation insurer. MSF requests an exemption from state procurement requirements for goods and services, as well as exemptions from the Information Technology requirements currently required by law (SB 131) for state agencies and the requirement to use state IT resources.

**F. Montana State Fund Office Building –Sale/Rent/Build**

**Montana State Fund Position:** MSF is open to options in regards to the office building we currently occupy. MSF would support legislation allowing the opportunity to purchase the building. We would also explore rent options. In addition, while not an option we are actively pursuing, we believe it would be advisable to have the authority to build or purchase another building to house our operations.

## Background Information

After completion of the building, it was initially occupied by the Division of Workers' Compensation. At that time, the State Fund was a bureau within the Division. In 1990, when the State Fund was separated from the Division of Workers' Compensation, MSF remained in the building. Since completing full payment of the bonds in the mid 90's, MSF has maintained the building and paid all associated costs under a 10-year lease for \$1.00 from the Department of Administration.

Total Bond Repayment Amount: \$5,781,518.05  
Amount Paid by Montana State Fund (MSF): \$4,133,166.81

MSF customers paid 71.5% of the building payments from premiums paid to the State Fund. The remaining costs not paid by MSF customers were made from two sources. \$1.5 million or 26.2% was paid by investment income generated from the building bond proceeds. The Department of Administration, Architecture and Engineering Division initiated these transactions. Other tenants in the building prior to fiscal year 1991 paid the remaining 2.3%. Other occupants included the Department of Labor and Industry and the Workers' Compensation Court.

- Current costs- \$689,459 (costs for maintenance-janitorial services-utilities-etc.- paid directly by MSF)
- Costs compared to other State Agencies- \$720,463 (if renting at state rate of \$5.99 per square foot - with most costs included in the rental fee)
- Operating as Private Business in downtown Helena- \$890,223 (if renting at \$10.00 per square foot - with most costs included in the rental fee)

### **G. Insurance Commissioner Regulation**

- i. Dissolution and Liquidation Status of Montana State Fund**
- ii. Investment Authority by Board of Directors**
- iii. Insurance Fraud Investigation and Prosecution Status**
- iv. Guaranty Fund Membership**
- v. Domestic Mutual Status of Montana State Fund**
  - a. Election of Directors**
- vi. Ratemaking Authority**
- vii. Compliance with NCCI Classification Codes**
- viii. Financial Reporting and Examinations by Insurance Commissioner**

**Montana State Fund Position:** Montana State Fund does not believe it prudent at this juncture to pursue Insurance Commissioner Regulation. The exception requirements are too important to MSF's unique needs and responsibilities as the guaranteed market to ignore, and it would be unrealistic to foist a responsibility upon the State Auditor that the office cannot fully implement. In addition, even the more limited regulation proposed in SB 153 would take time to implement. Moving to full Insurance Commissioner regulation would, by necessity, require an implementation period of greater duration. This is not to suggest that in the future such an endeavor

would not be worthwhile, rather, now is not the time. In addition, the Committee understands through the various presentations on the operations of MSF, we are in a period of rapidly escalating claim severity and cost. Our organization must be able to commit all of its limited resources on claim cost containment and improve injured worker outcomes. In other words, we cannot afford to take our “eye off the ball” during this critical period in the workers’ compensation business.

**i. & ii. Dissolution and Liquidation Status of Montana State Fund & Investment Authority by Board of Directors:** These are two fundamental areas where conflict exists. First is the area of liquidation and dissolution - as a statutorily created workers’ compensation insurer serving as the guaranteed market, the power for liquidation or dissolution (repeal) of MSF is with the legislature. Repeal would only realistically occur if an alternative guaranteed market was in place. Secondly, MSF’s Board of Directors does not have authority to handle investments. However, Title 33 addresses the board of director’s authority for investments. A conflict exists, as under the Montana Constitution, the Montana Board of Investments has investment responsibility for MSF.

**iii. Insurance Fraud Investigation and Prosecution Status:** How and where fraud cases are investigated and prosecuted is an additional area that would need to be addressed as it causes multi-agency impacts. Currently, MSF is required by law to work with the Department of Justice and pays for the costs of staffing and expenses at the Department of Justice.

**iv. Guaranty Fund Membership:** Membership of MSF in the Guaranty Fund is a policy decision that would need to be made. The 2002 SB 19 study committee recommended against MSF membership in the Guaranty Fund, one of the primary reasons being that MSF is a one-line, one-state insurance company.

**v. Domestic Mutual Status of Montana State Fund:** The mutual statutes requiring elected board members conflicts with MSF’s exempt federal tax status. Federal regulation requires that the Governor or similar entity appoint a majority of the Board.

**vi. Ratemaking Authority:** Establishment of rates would be impacted if MSF was under full compliance of Title 33, as the Board of Directors would no longer have ratemaking flexibility. For FY05, MSF will utilize NCCI loss costs for over 95% of MSF classification codes. However, MSF is the guaranteed market in Montana and needs the ability to set rates to best meet that role. Private carriers have the option of no longer writing certain risks or even withdrawing from a state, but not a guaranteed market state fund.

**vii. Compliance with NCCI Classification Codes:** Out of 406 classification codes used by MSF, 391 primarily follow NCCI classification code descriptions. However, exceptions have evolved to meet the business needs of Montana employers. To fully implement all NCCI classification codes and descriptions, 297 codes would be changed in varying degrees. Full adoption of NCCI classification codes and descriptions would impact a large number of our insured employers.

**viii. Financial Reporting and Examinations by Insurance Commissioner:** Under Title 33, MSF would need to report on a statutory and calendar basis. State agencies report on a fiscal year and governmental accounting basis. In addition, it is likely dual financial oversight would be necessary. (By the Insurance Commissioner if under Title 33 and under LAD due to our status as a statutory entity.)

#### **H. Other Insurance Business- Non-Workers' Compensation Related**

***Montana State Fund Position:*** MSF is not interested in pursuing the ability to write other lines of coverage or to become licensed in other states.